



Omni Rosen owner Harris Rosen and artist William Robertson admire the artist's handiwork.

ART ECO

Orlando Omni Embraces Nature

Diners at Orlando's new Omni Rosen Hotel's Everglades restaurant can swim with a manatee, dodge a panther and freeze at the sight of an alligator—all from a safe distance. The restaurant commissioned art depicting a world of Everglades flora and fauna, then added a soundtrack to make the experience even more realistic.

Art features scenes of the Everglades and Florida flowers. One wall consists of a 12-foot floor-to-ceiling aquarium.

Portions of profits from the restaurant will benefit the Everglades Foundation.

STEPHEN RUSHMORE

Cap Rate 101

Whenever people say they're planning to purchase a hotel, one of the first questions asked of them is: "What capitalization rate are you using?" Cap rate, as it is called in the industry, has many meanings. Generally, it represents the investor's desired rate of return and is used to establish an estimate of value based on an assumed net income.

Say you want to acquire a hotel and need an 11-percent return on your investment, and the property's anticipated net income is \$750,000. You can spend up to \$6,818,181 for this hotel. To derive the purchase price, you simply divide the anticipated net income by the capitalization rate as follows: $\$750,000 / .11 = \$6,818,181$. If you set aside a reserve for replacement, you need to subtract that amount from the net income to arrive at your bid.

Why does cap rate cause so much confusion? The problem lies in the definition of net income. Even accountants seem to have difficulty specifying exactly what net income really is. In arriving at net income, do you deduct a management fee? A franchise fee? A reserve for replacement? Debt service? Depreciation?

Even if you have a consistent definition of net income, the timing of the net income will impact the cap rate. For example, assume you are looking to buy a hotel that is priced at \$6,818,181. The owner has given you a financial statement for the previous 12 months. You have put together a current 12-month budget as well as a stabilized projection of income and expense three years from now when the hotel is expected to reach a stabilized level of occupancy. The table on this page shows the net income under each of these scenarios along with the cap rate that would be necessary to yield the \$6,818,181 price.

This table shows that when you talk to someone about the cap rate used to buy the hotel, you need to

define exactly which accounting period was used in the calculation. Each of these cap rates is correct, but only when applied to the appropriate time period.

Hotel cap rates vary by property type, geographic location, cyclical forces, supply and demand of hotels for sale, cost of capital and perception of risk. Today, conditions have produced the lowest hotel capitalization rates in memory. Hotel capitalization rates should remain relatively low until investors start to feel that the current upturn in hotel development has gone too far. **LH**

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on the drawing board. But is demand enough to justify the new construction activity?

Despite the new supply, existing hotels in San Antonio are doing well, says John Keeling, senior vice president at PKF Consulting. "For the nine months ended in September, hotels there are running 72.3 percent occupancies and their average rate is \$70. People would kill for that occupancy," he says.

Keeling says occupancy is down a bit from last year, but rates continue on an upward curve.

"Everybody in the world is building in San Antonio," says Stephen Rushmore, president of Hospitality Valuation Services and an LH columnist. He says the city doesn't need any more rooms than are now under construction, but says if anything should be built, it should be full service. "Limited-service hotels won't attract group business, and San Antonio is a group town. For it to grow demand wise, it needs hotels that will attract groups."

—M.R.

Cap Rate under Various Conditions

| | Historical 12 Month | Current 12 Month | Stabilized |
|------------|------------------------|---------------------|------------|
| Net income | \$675,000 | \$750,000 | \$900,000 |
| Cap rate | 9.9% | 11% | 13.2% |

MARKET UPDATE

San Antonio: Too Many Rooms, or Too Few?

With tourist attractions like the Alamo, Riverwalk and Sea World, San Antonio has become a popular destination, especially for groups. It's also favored by hotel developers, judging from the nearly 1,300 new rooms expected to open there this year and more



I'll Take the Fruit Basket
Top requests by Ritz-Carlton guests

- Fresh fruit
- Mineral water
- Quiet room
- Chocolate chip cookies
- Fitness facilities
- Nonsmoking rooms
- Extra pillows
- Fax machines
- Wine/beer

Source: Ritz-Carlton Hotels