

Hotel Values Have Declined- But Not as Much as Some Predict

Hotel values have not declined as much as you might think. While we are going through a horrendous period for the hotel industry, the good news is this decline is a demand induced decline not a supply induced decline. Historically hotels recover significantly quicker from a decline in demand rather than an oversupply.

Most investors purchase hotels based on a discounted cash flow procedure where the annual cash flows are discounted to the present value and added to the discounted value of an assumed sale at the end of a 10-year holding period. About 40% of the total value comes from the assumed sale of the property. Thus, an investor looking at a hotel today might see 2 to 4 years of low cash flow, but most hotels will recover quickly and ultimately sell for a good price at the end of the holding period.

Let's look at a side-by-side example.

An investor looked at purchasing a hotel on January 1, 2020- not knowing it will be adversely impacted by COVID-19. The hotel was operating at a stabilized occupancy and generating a net income of \$1M per year. The Net Income was expected to increase at 3% per year during the 10-year holding period. The investor valued the hotel using the Mortgage-Equity Appraisal Model.

The same investor looked at the same hotel- this time in March 2020. The hotel had closed and was not expected to open for 6 to 9 months.

The following is a side-side comparison of the projection of Net Income, the Valuation Parameters and the Estimated Values for Pre-Virus and Post Virus.

The Pre-Virus projection shows a 3% yearly increase in Net Income. The Post Virus projection shows no Net Income during 2020. In 2021, the Net Income is expected to recover to 50% of its stabilized level- \$500K. In 2022, the Net Income is projected to grow to \$750K. By 2023, the Net Income will recover to the initial level of \$1M. After that it will grow in tandem with the Pre-Virus projection.

Year	Projected Net Income	
	Pre-Virus	Post Virus
2020	\$1,000	\$0
2021	\$1,030	\$500
2022	\$1,061	\$750
2023	\$1,093	\$1,000
2024	\$1,126	\$1,125
2025	\$1,159	\$1,159
2026	\$1,194	\$1,194
2027	\$1,230	\$1,229
2028	\$1,267	\$1,266
2029	\$1,305	\$1,304
2030	\$1,344	\$1,343

The Mortgage-Equity Appraisal Model uses a weighted cost of capital to value the hotel. The parameters of the Debt and Equity financing are set forth below. The parameters for the Post Virus valuation take into account the greater risk and the higher cost of debt capital. After the recovery the debt and equity parameters were returned to the Pre-Virus levels.

	Mortgage-Equity Parameters	
	Pre-Virus	Post Virus
Equity Yield	16.0%	16.5%
Mortgage Interest Rate	5.00%	6.00%
Loan to Value Ratio	70%	65%
Mortgage Amortization (years)	25	25
Terminal Cap Rate	9.00%	9.00%
Selling Expenses at Reversion	2.0%	2.0%
Inflation Rate after Stabilization	3.0%	3.0%

Using the Mortgage-Equity Appraisal Model with the projections of Net Income and the Mortgage-Equity Parameters set forth above- the following table shows the Market Value of the hotel each year under the Pre-Virus and Post Virus assumptions.

Year	Estimated Value		
	Pre-Virus	Post Virus	Percent Difference
2020	\$13,200	\$10,000	-24.2%
2021	\$13,600	\$11,400	-16.2%
2022	\$14,000	\$12,400	-11.4%
2023	\$14,500	\$13,500	-6.9%
2024	\$14,900	\$14,900	0.0%

As this table shows the value of the Post Virus assumption shows a decline of 24% during 2020. In 2021, the decline in value recovered to 16%. By the end of 2024 the value of the Post Virus hotel equaled the value of the Pre-Virus hotel.

Based on my experience in downcycles dating back to 1972, I think while hotel values have declined somewhere between 20%-30% as shown in these calculations, I think the value recovery will be shorter and most hotel markets will regain their values by 2022.

The bottom line is:

If you are a hotel owner- hold on, don't sell, don't give your hotel to your lender- a significant recovery will take place in a relatively short period of time.

If you are a hotel buyer- don't wait- buy now. There has not been a buying opportunity like this since 2010.

If you have valuation issues with your lender, need a joint venture partner with some cash to get you through this downturn or want to acquire distressed hotels- contact me at srushmore@hvs.com

Hotel Market Analysis & Valuation Software- Software to Perform Hotel Market Studies and Valuations- Powerful Models to Analyze Hotel Projects

Hotel Market Analysis and Valuation Software 6.0 is the only non-proprietary computer software designed specifically to assist in the preparation of hotel market studies, forecasts of income and expense, and hotel valuations. The software provides the framework, along with the mathematical calculations, to develop detailed forecasts of occupancy, average room rates, revenues and expenses that can be used as a basis for hotel market studies and appraisals. The tool consists of three separate software programs:

- Hotel Market Analysis and ADR Forecasting Model
- Hotel Revenue and Expense Forecasting Model
- Hotel Mortgage-Equity Valuation Model

Hotel Market Analysis Valuation Software was created by Steve Rushmore for his hotel consulting firm- HVS. It has been updated and enhanced by Professor Jan deRoos of the Cornell Hotel School.

For more information contact- www.hotelvaluationsoftware.com