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Value is then calculated as follows:

Table 1

Number of rooms:	200	
Net income before debt service:	\$950,000	
Financial structure		
Mortgage:	75% of value	
	11% interest	
	25-year term (11.7%)	
	constant	
Equity:	25% of value	
	18% equity return	
Weighted cost of capital		
Mortgage:	$.75 \times .117$	= .088
Equity:	$.25 \times .180$	= .045
Weighted cost of capital:		<u>.133</u>
Value:	$\frac{\$950,000}{.133}$	= \$7,145,000

Today

In two years, assumes Rushmore, net operating income rose 10 percent per year to keep pace with inflation. Thus, income reached \$1.15 million. At the same time, however, interest rates rose to 15 percent. Table 2 shows the effect on the motel's value.

Table 2

Net income before debt service:	\$1,150,000	
Financial structure		
Mortgage:	75% of value	
	15% interest	
	25-year term (15.4%)	
	constant	
Equity:	25% of value	
	18% equity return	
Weighted cost of capital		
Mortgage:	$.75 \times .154$	= .116
Equity:	$.25 \times .180$	= .045
Weighted cost of capital:		<u>.161</u>
Value:	$\frac{\$1,150,000}{.161}$	= \$7,145,000

At first blush, it appears that the motel has not lost any value. However, in constant dollar terms, the property actually lost 20 percent of its value despite the success of the owner in raising profits 10 percent each year. (Note that if the equity interest would now require more than an 18 percent return in light of continued inflation, the value of the motel would actually have dropped in nominal dollars.)

Tomorrow

Suppose that in the next year or so, interest rates dropped back so that a mortgage on this property can be obtained for the same 11 percent as two years ago. Assume also that the motel's income declines but the owner is successful in retaining half the gain achieved

How Interest Rates Affect Real Estate Values

Interest rates for all types of capital have remained high despite recent gains in fighting inflation. As a result, the "real" return (the nominal interest rate minus the inflation rate) is running around 6 percent, far above the 2 to 3 percent return historically demanded by lenders. It is obvious that lenders still fear a resurgence of inflation and no one knows at what point (assuming inflation continues to decline) they will accept lower nominal interest rates.

If interest rates do drop suddenly, what will it mean for real estate values? It will mean a great deal since the most common method of valuing commercial real estate is the income approach, in which net operating income is divided by a percentage rate representing the weighted cost of invested capital.

An example prepared by Stephen Rushmore, MAI, president of Hospitality Valuation Services, Inc., Mineola, N.Y., illustrates very well what happens when interest rates change.

Two Years Ago

Mr. Rushmore assumes that two years ago, a motel generating a net operating income of \$950,000 could have been financed with an 11 percent, 25-year mortgage in an amount equal to 75 percent of market value. He further assumes that the equity funds would require a return of 18 percent.

in the past two years, so that net income stabilizes at \$1.05 million. Consider what happens then to the motel's value.

Table 3

Net income before debt service = \$1,050,000

Financial structure: Same as Table 1

Weighted cost of capital: Same as Table 1

Value: $\frac{\$1,050,000}{.133} = \$7,895,000$

The value of the property has now risen in nominal dollars by \$750,000. The property has likely gained in constant dollar value as well but this depends on the assumed rate of inflation.

Observation: As the examples above indicate, interest rate changes have a very substantial effect on property values. Normally, interest rate changes do not occur in a vacuum but are accompanied by changes in the economy, the effects of which also must be considered on the particular property. However, if we are very fortunate to avoid a severe economic downturn while interest rates fall significantly, many types of real estate may experience a sudden jump in value as the weighted cost of capital declines while operating income remains stable.



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Now, you can take courses with Steve without leaving your living room. He is developing a whole series of online courses covering topics such as “**How to Value a Hotel**”, “**How to Use Hotel Market Analysis & Valuation Software**”

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If you are an experienced appraiser looking to specialize in valuing hotels or a new valuer starting your career, you need to obtain a hotel valuation certification. By successfully completing Steve Rushmore’s course and a final project, you will become a **Certified Hotel Appraiser (CHA)** or a **Certified Hotel Valuer (CHV)** the world's only hotel valuation certification. For more information: www.chvsc.org

Learn "How to Value a Hotel" from the creator of the Hotel Valuation Methodology

Hi- I'm Steve Rushmore and I would like to tell you about my online course- "**How to Value a Hotel.**" It teaches how to perform a hotel valuation using my **Modern Hotel Valuation Methodology**. Designed for experienced appraisers looking to specialize in valuing hotels or new valuers starting their careers, this course provides all the knowledge and tools needed to evaluate hotel markets, forecast income and expense, and value all types of hotels. For the final project, students value an actual hotel.

You will be working with the latest version (6.0) of my **Hotel Market Analysis and Valuation Software**-three powerful software models that have become the hotel industry standard for hotel valuations and investment analysis throughout the world. By the end of the course, you will be able to perform your own hotel market analysis and valuation plus many other applications.

The course consists of video lectures, readings, hands-on software case studies, quizzes, and a final project valuing an actual hotel. It should take about 20-35 hours to complete.

Most importantly, I will play a vital role during your learning process- through the wonders of Zoom- you can reach out to me with your questions and I will personally assist. After completing the course, I will also be available to mentor your professional development. Hopefully, this will be the start of a long-term friendship.

Upon successfully completing the course and final project you will receive the Certified Hotel Appraiser (CHA) or a Certified Hotel Valuer (CHV) certification. These certifications recognizing your hotel valuation skills will set you apart from other appraisers and consultants. For more information: www.hotel-learning-online.com

Hotel Valuation Software- For Performing Hotel Market Analyses, Financial Projections and Valuations

Hotel Market Analysis & Valuation Software was developed by Steve Rushmore for his firm- HVS. It was then enhanced by Professor Jan deRoos of the Cornell Hotel School. This software has been the most downloaded product on the Cornell website and is used by thousands of hotel professionals around the world. It consists of three models:

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

This software package also provides answers to a wide range of key hotel investment questions such as How much is my hotel worth? What can I do to maximize value? What is the likely impact of new competition? How much value will a refurbishment add? Is my market strong enough to support adding more hotel rooms? What is the impact of my brand adding another hotel to the market?

If your role includes responsibility for performing hotel valuations and associated financial analyses- you need to include this software in your business toolbox.

Hotel Market Analysis & Valuation Software v. 6.0 is written as Microsoft Excel files (which runs on both Windows and Apple OS X operating systems) and comes with a detailed users' guide and case study. Version 6.0 contains significant enhancements over Version 5.0 which is no longer distributed.

HOTEL VALUATION SOFTWARE



Steve Rushmore is the Founder of HVS and the **Creator of the Hotel Valuation Methodology**. He has authored eight textbooks on hotel valuation and investing, along with over 350 articles on similar topics. In addition, Steve has taught thousands of industry professionals around the world. His online course- "**How to Value a Hotel**" is used by the leading hotel schools and consulting organizations. Contact Steve at steve@steverushmore.com or visit his website www.steverushmore.com

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Over 250 hotel appraisers around the world have earned this prestigious certification which is perfect for anyone looking to specialize in valuing hotels.



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