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How Much Should That Hotel Loan Cost You?

The biggest expense for most hotels is neither energy nor franchise and management fees. It is the debt service paid on the mortgage loan. A typical 200-room, full-service, first-class hotel probably pays $1 million per year in interest and principle to the first mortgage lender. If the hotel's total revenue is $6 million, debt service would amount to about 17 percent of gross. Lowering the interest rate half a percent would put another $45,000 in the owner's pockets each year.

Lenders set interest rates on hotel loans by evaluating many factors, such as their cost of capital (highly influenced by the Federal Reserve) and the perceived risks of an investment. Higher risks translate to increased interest, and hotels have always been considered risky.

Since the ultimate interest rate depends on these factors, along with your negotiating skills, you need to know what the loan should cost before you shop.

The best source of hotel mortgage interest rate information is the American Council of Life Insurance. ACLI publishes information on the mortgage loans its members originate during a quarter. While this data provides a good benchmark to determine what your hotel interest rates should be, these interest rates are usually four to five months old by the time they are published.

Hotel borrowers need a money market instrument whose yield is published daily and is closely tied to movements in hotel mortgage rates. This correlation can be identified through a regression analysis. After evaluating more than 15 money market instruments, including the federal funds rate, prime rate, FHA home mortgage rate and various U.S. treasury notes and bonds, I found the highest correlation (964) to be Moody's Average A Corporate Bond Yield. The regression formula resulting from comparing the quarterly hotel interest rates reported by the ACLI to the Moody's Average A Corporate Bond Yield is: $Y = 2.76078 = .78228(X)$

Substituting the known Average A Corporate Bond Yield for X in the above equation and solving for Y results in an estimate mortgage interest rate. For example, the Average A Corporate Bond Yield on June 28, 1996 was 7.86 percent. Solving for Y results in an estimated mortgage interest rate of 8.9 percent.

Hotel owners and lenders using this regression approach to estimate interest rates should update data quarterly and rerun the regression analysis to obtain a new formula. For a copy of the input data used to develop this regression formula, contact Judy MacCrate, HVS International, 516/248-8828, ext. 275. LH

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