Making Alan Greenspan Your Partner

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Hotel Investment Strategies

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Between November 1998 and November 1999 the value of your hotel was adversely affected by the federal government to the tune of approximately 10%. While United States Federal Reserve Board Chairman Alan Greenspan was controlling inflation through monetary policy, he was indirectly reducing your cash flow by increasing mortgage interest rates. Assuming you were unable to offset this erosion of profits by either raising revenues or lowering expenses, it was likely the value of your hotel has dropped. Let me explain how this happens.

One of the ways the Federal Reserve Board controls U.S. inflation is by adjusting the interest rates. As interest rates go up, borrowing goes down and there is less money available to buy commodities, which in turns keeps prices from rising. While interest rates are somewhat market-driven, the Federal Reserve does control what is called the "discount rate." This is the rate charged by the Reserve Banks when they extend credit to your neighborhood bank. When the stock market anxiously awaits the results of the monthly Federal Reserve meeting, they want to know whether this discount rate has been raised or lowered.

In most instances, all financial interest rates tend to rise and fall in tandem with the discount rate. The following table shows each time the federal discount rate has changed since July 1992, along with the resulting interest rates for some of the other money market instruments:

Money Market Rates

	Federal Discount Rate	% Chg	Fed Funds	% Chg	Prime Rate	% Chg	Hotel Mortgage	% Chg
7/2/92	3.00%		3.76%		6.02%		9.47%	
5/17/94	3.50	16.7%	4.01	6.6%	6.99	16.1%	9.38	-1.0%
8/18/94	4.00	14.3	4.47	11.5	7.51	7.4	9.50	1.3
11/16/94	4.75	18.8	5.29	18.3	8.15	8.5	9.64	1.5
2/2/95	5.25	10.5	5.92	11.9	9.00	10.4	9.14	-5.2
1/31/96	5.00	-4.8	5.56	-6.1	8.50	-5.6	7.79	-14.8
10/15/98	4.75	-5.0	5.07	-8.8	8.12	-4.5	7.47	-4.1
11/19/98	4.50	-5.3	4.83	-4.7	7.89	-2.8	7.60	1.7
8/25/99	4.75	5.6	5.07	5.0	8.06	2.2	8.19	7.8
11/18/99	5.00						8.80	7.4

Between 1992 and 1995 the Federal Reserve increased the discount rate four times going from 3% to 5.25%. They then lowered it twice to 4.5% in November 1998, and today we are back up to 5%. At the same time, the federal funds and the prime rates practically mirrored these changes. The hotel mortgage interest rates as reported by the American Council of Life Insurance followed a somewhat similar track, rising during the early 1990's as the Fed moved interest rates higher, falling in the mid-90's when credit loosened and then rising again at the end of the decade when the Fed started increasing the discount rate again.

So how does the Federal Reserve control the value of my hotel? Let me show you with a simple example:

Hotels are valued by buyers and sellers using a valuation method known as the income approach where the hotel's projected profit is divided by a percentage rate called a capitalization rate to arrive at a value. The capitalization rate is essentially the cost of capital used to acquire the hotel which is generally made up of mortgage financing and equity capital.

Let's assume you were buying a hotel last October 1998. Its projected profit for the next 12 months is US$1 million. As an investor you are looking for an 11% return on your equity. The current interest rate for hotel loans is 7.47% and you can borrow 65% of the purchase price. The capitalization rate is the weighted cost of the capital used for the purchase of the hotel:

Mortgage: 65% x 7.47% = .0485
Equity: 35% x 11.0% = .0385
Capitalization Rate .087

Dividing the projected profit by the capitalization rate yields the value:

$$\frac{\$1{,}000{,}000}{.087} = \$11{,}500{,}000$$

Between October 1998 and November 1999, the Federal Reserve increased the discount rate three times, which raised the cost of hotel mortgages to 8.8%. When this interest rate is inserted into the formula and the other variables are held constant, the hotel's value falls US$1,050,000 or approximately 10%:

Mortgage: 65% x 8.8% = .0572
Equity: 35% x 11.0% = .0385
Capitalization Rate .0957

Dividing the projected profit by the capitalization rate yields the value:

$$\frac{\$1{,}000{,}000}{.0957} = \$10{,}450{,}000$$

Of course, there are many offsetting factors which also impact value such as increasing profits or changing the equity returns. But the bottom line remains: part of your hotel's value is controlled by the Federal Reserve which, can raise or lower the sales price of your hotel investment at their whim. ♦

By Stephen Rushmore, *MAI, CHA, CRE, president and founder of HVS International, a global hotel consulting firm with offices in New York, Miami, Denver, San Francisco, Vancouver, Mexico City, London, New Delhi and Singapore. Mr. Rushmore can be contacted at 1.516.248.8828 Ext. 204.*

Where Hotel Professionals Learn how to Make Successful Hotel Investments

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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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