

# Rushmore on Hotel Valuations

**Creator of the Hotel Valuation Methodology**

## Headlines from Steve Rushmore:

- **Today is the best hotel buying opportunity in the past 30 years!**
- **If you are not bidding on every hotel listed for sale you are missing out on what I predict is huge short-term value increases!**
- **If you currently own a hotel either don't sell or if you must sell, read my article before establishing your listing price- It should be higher than you think!**

Most hotel analysts, brokers, and owners who did not experience the inflationary period of the late 1970s and early 1980s when inflation ran as high as 18% are missing the true upside impact inflation has on hotel operating results and values.

To subscribe to “Rushmore on Hotel Valuation” send your email address to [steve@steverushmore.com](mailto:steve@steverushmore.com) or connect on LinkedIn

## Rushmore on Hotel Valuations

- These inexperienced and miss-informed analysts and pundits fear hotel room rates won't keep up with the underlying rate of inflation.
- They fear escalating hotel operating expenses will quickly erode hotel profits.
- They fear rising mortgage interest rates will put most hotels into foreclosure and bankruptcy.

You know what? They are totally wrong? Inflation is the best thing that can happen to hotel values! Let me give you unequivocal proof to support this premise.

You first might want to read my prior two newsletters where I show that hotel room rates almost always exceed the underlying rate of inflation. Also, how to adjust hotel capitalization rates to account for the rising cost of capital.

In this newsletter, I will show the following:

- 1) Hotel room rates almost always rise faster than the underlying rate of inflation and in many instances, this can be as much as 2 to 1 (hotel room rates rise at twice the rate of inflation).
- 2) While hotel operating expenses such as labor, energy costs, property taxes, maintenance, and repairs, etc. will rise due to inflation- these expense increases will be

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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 my course "**How to Value a Hotel**" you will become a **Certified Hotel Appraiser (CHA)**. For more information: [www.certifiedhotelappraiser.org](http://www.certifiedhotelappraiser.org)

### Steve Rushmore Announces his new Online Course: "**How to Value a Hotel**"

This online course teaches how to perform a hotel valuation using Rushmore's **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. For more information: [www.hotel-learning-online.com](http://www.hotel-learning-online.com)

more than offset by rising room rates resulting in increased bottom-line EBITDA.

3) Although the cost of capital, particularly mortgage interest rates, will rise during inflationary periods, producing higher capitalization rates (which lowers values), the increased EBITDA (discussed previously) will more than offset any value diminution caused by higher cap rates.

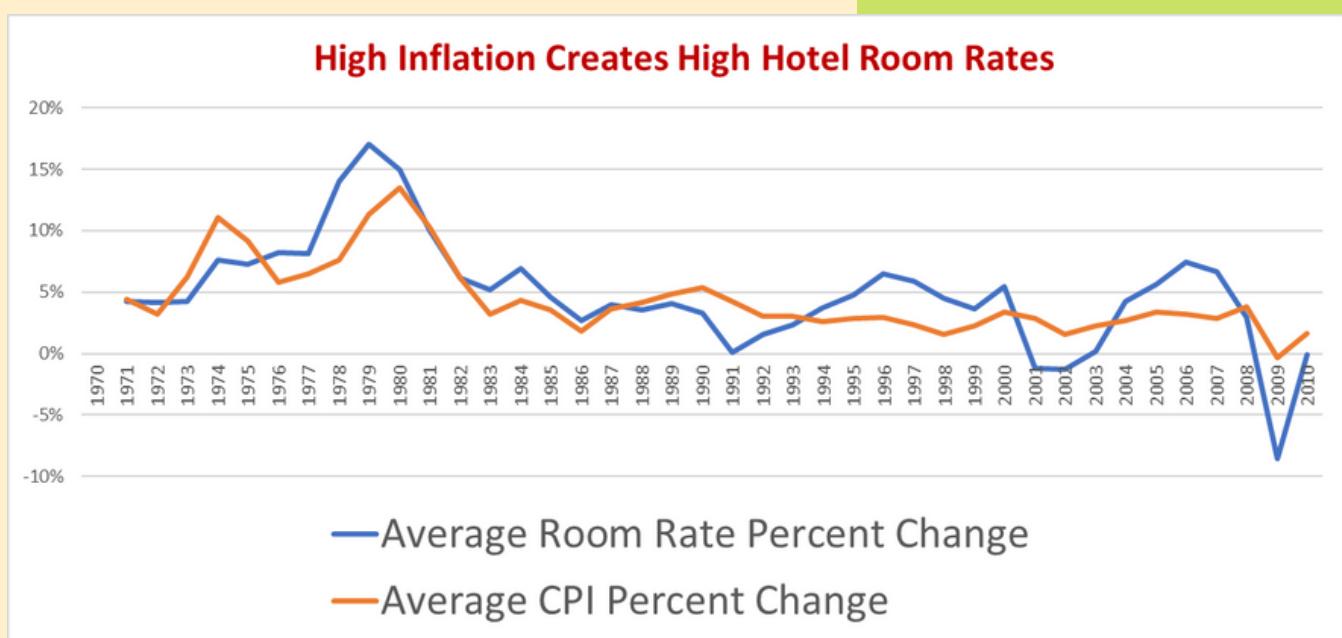
My research shows the net result of the current inflationary environment on a typical U.S. hotel is a value enhancement of approximately 25%!

### History of Inflation and Hotel Room Rates

The following graph which shows Average Room Rate Percentage Change (ADR- Blue Line) and the Average Consumer Price Index Percentage Change (CPI- Brown Line)



**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](mailto:steve@steverushmore.com) or visit his website [www.steverushmore.com](http://www.steverushmore.com)



Whenever the blue line is above the brown line hotels were able to increase their room rates faster than the rate of inflation. The graph shows that between 1970 and 2010, except for a few short periods of time, hotel room rates rose more than the CPI inflation.

### Side-by-Side Proof That Inflation is a Huge Benefit for Hotel Valuations

To demonstrate this value enhancement, the following side-by-side example will be used:

Hotel A and Hotel B are identical 125-room hotels in all respects.

-Hotel A operates in the low inflationary environment typical of the period 2014 to 2018.

-Hotel B operates in the high inflationary environment we are currently experiencing.

Both hotels will be valued using a 5-year discounted cash flow model based on projections of income and expenses under the two different inflationary environments. Also, the discount rates utilized in the discounted cash flow model will reflect the cost of capital under the two different inflationary environments.

To quantify the difference in value between a low-inflation environment and a high-inflation environment we will project identical occupancies for both hotels but will assume



### Where Hotel Professionals Learn how to Make Successful Hotel Investments

Now, you can now 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**" For more information: [www.hotel-learning-online.com](http://www.hotel-learning-online.com)



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differing Average Daily Rates (ADR) growth and Expense increases due to the two different inflation assumptions.

The following tables show all the projections under the Low Inflation Assumptions and the High Inflation Assumptions.

## Occupancy

<b>Occupancy</b>	<u>Base</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
Low Inflation Assumptions	70%	70%	71%	72%	73%	74%
High Inflation Assumptions	70%	70%	71%	72%	73%	74%

With the pent-up travel demand and the recovering commercial and group demand segments, occupancy is projected to grow slowly over the five-year period.

## Revenue Inflation

<b>Revenue Inflation</b>	<u>Base</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
Low Inflation Assumptions		3%	3%	3%	3%	3%
High Inflation Assumptions		17%	16%	15%	14%	13%

Since occupancy growth is identical under both inflation assumptions- any growth in revenue comes from an increase in the hotel's average daily rate (ADR). Under the low inflation assumption, ADR growth is projected to remain level at 3% each year. Under the high inflation assumption, ADR growth is projected to start at 17% in Year 1 declining one percentage point each year until it reaches 13% in Year 5.

## Average Daily Rate (ADR)

<b>Average Daily Rate</b>	<u>Base</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
Low Inflation Assumptions	\$185	\$191	\$196	\$202	\$208	\$214
High Inflation Assumptions	\$185	\$216	\$251	\$289	\$329	\$372

The average daily rate for both inflation assumptions starts at \$185 for the Base Year. It then escalates at the revenue

inflation projections in the table above. At Year 5 the ADR under the low inflation assumptions is \$214 compared to \$372 under the high inflation assumptions. It is this difference in ADR that creates huge value differences because ADR growth has very little impact on expenses- essentially most of the increase in rooms revenue drops directly to the bottom line.

## Expense Inflation

<b>Expense Inflation</b>	<u>Base</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
Low Inflation Assumptions		3%	3%	3%	3%	3%
High Inflation Assumptions		10%	10%	10%	10%	10%

The revenue and expense forecasting model in the Hotel Valuation Software package allows the analyst to input different inflation assumptions for each expense item each year. Under the low inflation assumption, all expense items are projected to grow at 3% per year over the projection period. Under the high inflation assumption, these expenses are projected to grow at 10% each year.

## Projection of Net Operating Income

<b>Operating Income (\$000)</b>	<u>Base</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
Low Inflation Assumptions	\$2,330	\$2,452	\$2,586	\$2,729	\$2,879	\$3,032
High Inflation Assumptions	\$2,330	\$2,916	\$3,557	\$4,257	\$4,991	\$5,755

The projection of Net Operating Income utilizes the revenue and expense forecasting model in the Hotel Valuation Software package. The first step is to load the Base Year financial statement into the model. This financial statement is identical for both inflation assumptions. The occupancy and average daily rate are then imputed for each projection year along with the projected expense inflation rates. The forecasting model utilizes a fixed and variable revenue and expense algorithm to project each item of revenue and expense over the 5-year period.

This results in a projection of Net Operating Income which is EBITDA After a Reserve for Replacement shown in the table above.

The inflationary growth in the Net Operating Income is shown in the table below.

<b>Net Operating Income Inflation</b>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
Low Inflation Assumptions		5%	5%	5%	5%
High Inflation Assumptions		22%	20%	17%	15%

This table shows the significant percentage growth in Net Operating Income due to high inflation even though expenses are also rising at 10% per year. This proves the premise that high hotel expense inflation will not adversely impact the bottom line.

## **Hotel Valuation**

Now that the Net Operating Income has been projected it can be valued using our proprietary mortgage-equity hotel valuation model. This model calculates value based on the actual cost of mortgage and equity capital. In today's financial environment where interest rates are increasing almost weekly, mortgage equity is the only valuation method that will accurately adjust for higher debt-service costs in real-time. Those appraisers still using an overall discount rate in their DCF models are shooting in the dark and developing values that cannot be substantiated in these dynamic markets.

The following table shows the typical hotel financing costs for both the Low and High Inflation Assumptions. The financing costs under the Low Inflation Assumption were those costs typically available during the low inflation period of 2016 to 2018. The financing costs under the high inflation assumption are those costs typically found in today's market.

<b>Financing and Equity Assumptions</b>	<b>Low Inflation</b>	<b>High Inflation</b>
Mortgage Interest Rate	3.5%	8.0%
Loan to Value Ratio	65%	60%
Mortgage Amortization (Years)	25	25
Terminal Cap Rate	6%	9%
Selling Expenses at Reversion	2%	2%
Equity Yield	16%	16%

With the Federal Reserve increasing the federal funds rate almost monthly to try to reduce the rate of inflation, hotel mortgage interest rates have skyrocketed from 3.5% in 2018 to 8% in 2023 (more than double).

Lenders' unfounded belief that hotel lending is more risky today than in 2018 are requiring more equity so the loan-to-value ratio has dropped from 65% to 60%. However, they have maintained a 25-year mortgage amortization period.

The terminal capitalization rate is the cap rate applied to the 6th year's NOI to determine the hotel's sales price at the end of the 5-year period. Because the cost of capital today is higher than in 2018, the terminal capitalization rate is currently 9% compared to 6% in 2018. This is significant since a large part of a hotel's value comes from the sale at the end of the holding period. The selling expenses at reversion is expressed as a percentage of the sales price and thus remains the same at 2%.

Equity yield is the return to the equity component. Unlike mortgage rates that are tied to the financial markets, hotel equity yields usually reflect whether it is a buyer's or seller's market.

Many buyers bidding for a particular hotel- creates a seller's market and buyers need to reduce their equity yields (which increases their bid) in order to become the winning bidder.

## Rushmore on Hotel Valuations

When there are few buyers bidding on a particular hotel, the seller has less ability to push pricing and buyers can win the bid with a lower price which creates a higher equity yield. Under both inflation scenarios, I used a 16% equity yield which reflects a moderate seller's market which was present in 2018 and today.

Using the projected Net Operating Income and the financing and equity assumptions in my mortgage-equity valuation model results in the following valuation:

	<b>Hotel A</b>	<b>Hotel B</b>
<b>Valuation</b>	<b>Low Inflation</b>	<b>High Inflation</b>
<b>(\$000)</b>	<b>\$44,000</b>	<b>\$55,000</b>
<b>Difference</b>		<b>+25%</b>

In summary, two hotels with identical physical facilities, locations, initial financial performance, and projected levels of occupancy were matched with each other. Hotel A operated in a low inflationary environment (similar to 2018) and Hotel B operated in a high inflationary environment (similar to 2023).

Using Hotel Valuation Software's financial forecasting and valuation models, Hotel A was valued at \$44,000,000 and Hotel B was valued at \$55,000,000 which was 25% higher than Hotel A. This proves that during periods of high inflation hotels are able to generate greater profits and higher values in spite of increased operating costs and cost of capital.

Since most hotel analysts, brokers, and owners don't recognize the benefits of inflation on hotel operating results and value- it is a great time to buy under-valued hotels.

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# Learn "How to Value a Hotel" from the creator of the Modern 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 the 75 short lessons. You can start at any time and proceed at your own pace during your free time.

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.

This course and 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?

So why should you take this course? Valuing a hotel is not a simple process. You need to understand the interrelationship between a hotel's operational and real estate components and how this impacts the hotel valuation process. My course will lead you step-by-step through this process so upon completion, you will have learned **How to Value a Hotel**. For more information:

[www.hotel-learning-online.com](http://www.hotel-learning-online.com)

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## **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**

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