

# How to Value a Hotel- An Introduction

## Case Study

You are considering the purchase of a 250-unit hotel. This 9-year-old property is operated under a national franchise as a mid-rate lodging facility. Its occupancy has stabilized in the 70% range over the last several years; future trends indicate no significant changes in the supply and demand environment, and prospects for a continuation of a stable economy and occupancy levels are good.

The improvements consist of 250 guestrooms, a 180-seat restaurant, a 125-seat cocktail lounge, 8,000 square feet of meeting and banquet space, an outdoor swimming pool, and adequate parking. The facilities are well maintained and in good physical condition.

You have evaluated the operating history of the property and have collected the following information:

### Statement of Income and Expense

The statements of income and expense show the subject property's actual revenues and operating costs for the past three years. Based on this financial history and anticipated future trends, you developed a **stabilized projection** of income and expenses representing your estimate of earnings over the foreseeable future (far right column).

	Year One		Year Two		Year Three		Stabilized	
Number of Rooms	250		250		250		250	
Occupancy	72.0%		74.0%		71.0%		73.0%	
Average Rate	\$ 85.00		\$ 89.25		\$ 93.71		\$ 98.50	
Rooms Occupied	65,700		67,525		64,788		66,613	
<b>Revenues</b>	<b>\$(000)</b>	<b>Percent</b>	<b>\$(000)</b>	<b>Percent</b>	<b>\$(000)</b>	<b>Percent</b>	<b>\$(000)</b>	<b>Percent</b>
Rooms	\$ 5,585,000	55.1%	\$ 6,027,000	55.4%	\$ 6,071,000	55.0%	\$ 6,561,000	55.3%
Food	\$ 2,839,000	28.0%	\$ 3,030,000	27.9%	\$ 3,104,000	28.1%	\$ 3,313,000	27.9%
Beverages	\$ 1,278,000	12.6%	\$ 1,364,000	12.5%	\$ 1,397,000	12.7%	\$ 1,491,000	12.6%
Telephone	\$ 226,000	2.2%	\$ 242,000	2.2%	\$ 247,000	2.2%	\$ 264,000	2.2%
Rentals and Other Income	\$ 200,000	2.0%	\$ 212,000	1.9%	\$ 218,000	2.0%	\$ 233,000	2.0%
<b>Total Revenue</b>	<b>\$ 10,128,000</b>	<b>100.0%</b>	<b>\$ 10,875,000</b>	<b>100.0%</b>	<b>\$ 11,037,000</b>	<b>100.0%</b>	<b>\$ 11,862,000</b>	<b>100.0%</b>
<b>Departmental Expenses</b>								
Rooms	\$ 1,257,000	22.5%	\$ 1,336,000	22.2%	\$ 1,377,000	22.7%	\$ 1,464,000	22.3%
Food & Beverages	\$ 3,159,000	76.7%	\$ 3,350,000	76.2%	\$ 3,466,000	77.0%	\$ 3,675,000	76.5%
Telephone	\$ 230,000	101.8%	\$ 243,000	100.4%	\$ 253,000	102.4%	\$ 267,000	101.1%
Rentals and Other Income	\$ 121,000	60.5%	\$ 128,000	60.4%	\$ 133,000	61.0%	\$ 141,000	60.5%
<b>Total Departmental Expenses</b>	<b>\$ 4,767,000</b>	<b>47.1%</b>	<b>\$ 5,057,000</b>	<b>46.5%</b>	<b>\$ 5,229,000</b>	<b>47.4%</b>	<b>\$ 5,547,000</b>	<b>46.8%</b>
<b>Departmental Income</b>	<b>\$ 5,361,000</b>	<b>52.9%</b>	<b>\$ 5,818,000</b>	<b>53.5%</b>	<b>\$ 5,808,000</b>	<b>52.6%</b>	<b>\$ 6,315,000</b>	<b>53.2%</b>
<b>Undistributed Operating Expenses</b>								
Administrative & General	\$ 779,000	7.7%	\$ 822,000	7.6%	\$ 856,000	7.8%	\$ 904,000	7.6%
Marketing	\$ 570,000	5.6%	\$ 603,000	5.5%	\$ 627,000	5.7%	\$ 662,000	5.6%
Prop. Oper. & Maintenance	\$ 517,000	5.1%	\$ 547,000	5.0%	\$ 567,000	5.1%	\$ 601,000	5.1%
Energy Costs	\$ 501,000	4.9%	\$ 527,000	4.8%	\$ 552,000	5.0%	\$ 581,000	4.9%
<b>Total UDOEs</b>	<b>\$ 2,367,000</b>	<b>23.4%</b>	<b>\$ 2,499,000</b>	<b>23.0%</b>	<b>\$ 2,602,000</b>	<b>23.6%</b>	<b>\$ 2,748,000</b>	<b>23.2%</b>
<b>Income Before Fixed Charges</b>	<b>\$ 2,994,000</b>	<b>29.6%</b>	<b>\$ 3,319,000</b>	<b>30.5%</b>	<b>\$ 3,206,000</b>	<b>29.0%</b>	<b>\$ 3,567,000</b>	<b>30.1%</b>
<b>Fixed Charges</b>								
Management Fee	\$ 354,000	3.5%	\$ 381,000	3.5%	\$ 386,000	3.5%	\$ 415,000	3.5%
Property Tax	\$ 250,000	2.5%	\$ 263,000	2.4%	\$ 276,000	2.5%	\$ 289,000	2.4%
Insurance	\$ 100,000	1.0%	\$ 105,000	1.0%	\$ 110,000	1.0%	\$ 116,000	1.0%
Reserve for Replacement	\$ 253,000	2.5%	\$ 272,000	2.5%	\$ 276,000	2.5%	\$ 297,000	2.5%
<b>Total Fixed Charges</b>	<b>\$ 957,000</b>	<b>9.4%</b>	<b>\$ 1,021,000</b>	<b>9.4%</b>	<b>\$ 1,048,000</b>	<b>9.5%</b>	<b>\$ 1,117,000</b>	<b>9.4%</b>
<b>Net Income</b>	<b>\$ 2,037,000</b>	<b>20.1%</b>	<b>\$ 2,298,000</b>	<b>21.1%</b>	<b>\$ 2,158,000</b>	<b>19.6%</b>	<b>\$ 2,450,000</b>	<b>20.7%</b>

## **Cost Data**

Discussions with local real estate professionals indicate that the eight-acre parcel of land comprising the subject property has a current market value of \$500,000 per acre. Construction costs for similar lodging facilities are at an average of \$80,000 per unit and the property recently completed refurbishments, at a cost of \$14,000 per unit. The hotel is nine years old and suffers from no physical obsolescence.

## **Sales of Comparable Hotels**

A review of several hotel transactions shows that three similar hotel properties were recently sold. The date pertaining to these three sales is as follows.

### Sale #1:

Number of Rooms:	280
Restaurant:	140 seats
Lounge:	100 seats
Meeting Space:	5,000 square feet
Selling Price:	\$24,080,000

### Sale #2:

Number of Rooms:	240
Restaurant:	200 seats
Lounge:	180 seats
Meeting Space:	10,000 square feet
Selling Price:	\$22,800,000

### Sale #3:

Number of Rooms:	300
Restaurant:	190 seats
Lounge:	171 seats
Meeting Space:	9,000 square feet
Selling Price:	\$27,600,000

## Mortgage Data

Based on your relationship with a local bank, you are able to finance the purchase of this hotel at the following market terms:

Mortgage Interest:	10.0%
Mortgage Term:	30 years
Mortgage Constant:	10.53%
Loan-to-Value Ratio:	75%

## Valuation

Using this data, estimate the highest price that you would be willing to pay for this property.