

Rushmore on Hotel Valuations

Creator of the Hotel Valuation Methodology

Adjusting Hotel Cap Rates for Escalating Interest Rates

Over the past six months interest rates have increased almost 40%. Since the basis of hotel discount and capitalization rates is the cost of capital- it is likely these rates have also increased.

The question is- By How Much?

Hotel Valuation Procedures

Appraisers utilize one of two procedures for valuing hotels.

Discounted Cash Flow with an Overall Discount Rate:

Most appraisers employ a 10-year discounted cash flow approach where the hotel's projected Net Operating Income is discounted to the present value using an overall discount rate. At the end of the projection period the reversionary value is established by capping the 11th year

Most appraisers have no idea what the impact of rising interest rates have on hotel capitalization rates.

My article provides a simple solution.

Since retiring from HVS, I have been working with hotel consulting organizations and schools teaching the Art and Science of performing Hotel Market Studies and Valuations. I also decided to start again my newsletter- "Rushmore on Hotel Valuations," where I focus on timely topics for hotel investors and students. This newsletter looks at Cap Rates in an inflationary economy. To obtain a complementary subscription to "Rushmore on Hotel Valuations"- send me an e-mail- steve@steverushmore.com

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NOI by a terminal cap rate and the resulting value is discounted to the present value. The sum of the discounted yearly NOI's plus the discounted reversionary value results in the value of the hotel.

The weakness of this procedure is that the basis of establishing the overall discount rate comes from sources such as investor surveys and market transactions which can take months to compile. In a volatile interest rate environment like where we are today- deriving accurate and timely overall discount rates is almost impossible.

Discounted Cash Flow Using Mortgage and Equity

Rates:

The second procedure known as the Mortgage Equity Approach utilizes up-to-the-minute financial data to develop a hotel valuation. It is based on the premise that most hotel buyers structure their acquisitions using a combination of mortgage debt and equity capital. By knowing the projected NOI, plus the cost and amount of each capital component, a hotel's value can be easily calculated.

Projecting the NOI is identical under both procedures. The cost of equity capital is generally not tied directly to movements in interest rates but rather reflects factors such as general hotel risks and whether the property attracts investor interest. What does change in a volatile interest rate environment is the hotel's mortgage interest rate. Since debt capital can represent 70% to 80% of the purchase price- knowing the cost of this capital (mortgage interest) is critical.

Like the overall discount rate, obtaining current actual hotel mortgage interest rate data can be difficult. Fortunately, there is a very close relationship between hotel mortgage interest rates and the rates of other money market instruments which are published daily.

Based on my research using regression analysis, Average A Corporate Bond Yield produced the highest coefficient of correlation when regressed against actual hotel mortgage interest rates. The following is the regression formula:

$$Y = 0.955X + 0.779$$

Where: Y = Estimate Hotel Mortgage Interest Rate
X = Current Average A Corporate Bond Yield
(Coefficient of Correlation is 94%)



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 Perform a Hotel Market Study and Valuation 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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If you want to determine today's Hotel Mortgage Interest Rate, simply look up today's Average A Corporate Bond Yield (available at www.ycharts.com) put it into the regression formula as "X" and solve for Y.

Recent Example- See the table below:

Let's say on February 23, 2022, you valued a hotel for \$16,300,000. At that point in time, the Corporate A Bond Yield was 2.91% which indicated a mortgage interest rate of 3.55%. Immediately after your initial valuation interest rates started to rapidly escalate and by August 27, 2022 (about 6 months later), the Corporate A Bond Yield had risen to 4.37%- an increase of 50%. Using the interest rate regression analysis, the current rate on a hotel mortgage would be 4.95%- an increase of 39%. Assuming your 10-year projection of NOI remains about the same- the value of the hotel drops to \$15,300- a decline of 6%.

If you were to use the Discounted Cash Flow Procedure with an Overall Discount Rate- the rate as of February 23, 2022, would have been 7.60%. On August 27, 2022, the rate would have been 8.57%- a 13% increase. These are calculated Overall Rates based on the value obtained by the Mortgage-Equity approach.

	Corporate A	Hotel Mortgage		Overall
6 Months	Bond Yield	Interest (Calc)	Value	Discount Rate (Calc)
February 23, 2022	2.91%	3.55%	\$16,300	7.60%
August 27, 2022	4.37%	4.95%	\$15,300	8.57%
Change	+50%	+39%	-6%	+13%

Conclusion

While it is obvious that between February 23 and August 27 the Overall Discount Rate probably rose- the question is- by how much? I have no idea how this increase can be accurately quantified and thus my conclusion: In a volatile interest rate environment, only the Mortgage Equity procedure produces hotel valuations that can be validated by up-to-the-minute market data.

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Steve's software models for performing hotel market studies, financial projections and valuations. The three software models sell for \$250. Send me an e-mail and I will give you a coupon that will reduce the price to \$50. For more information on my software- visit my website: www.hotelvaluationsoftware.com



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The next issue of Rushmore on Hotel Valuations will focus on how inflation impacts hotel revenues and valuations.

To Subscribe: E-Mail steve@steverushmore.com

Learn How to Value a Hotel from Steve Rushmore

The Creator of the Hotel Valuation Methodology

Since retiring from HVS, I have been working with hotel consulting/brokerage firms and leading hotel schools teaching the Art and Science of Performing Hotel Valuations and Market Studies.

Prior to COVID, I gave hundreds of face-to-face seminars all over the world. Today I teach virtually. My latest course- **How to Perform a Hotel Market Analysis, Make Financial Projections and Value a Hotel Using Hotel Market Analysis and Valuation Software** is designed for entry-level hotel analysts/brokers, experienced industry professionals, and hotel school students looking to acquire new skill sets.

In addition to learning the hotel valuation process and successfully completing the course, graduates receive the **Certified Hotel Valuation Software Consultant (CHVSC)** certification recognizing their newly acquired hotel analytical skills. This certification is becoming an industry standard for hotel analysts/brokers, appraisers, consultants, asset and revenue managers, and owners.

Most importantly, I am personally involved with the students during the entire course through emails and frequent Zoom calls. So, if you want to learn directly from the “guru” on this topic, my course should be part of your continuing education.

If this piques your interest- I can send you a brochure with all the details. Or go to my website for further information.

<https://www.hotel-learning-online.com/courses/how-to-use-hotel-market-analysis-and-valuation-software-work-copy>

Happy to do a Zoom call to explore how we can work together to provide this valuable learning experience.

All the best

Steve

Founder HVS and Hotel Learning Online steve@steverushmore.com

The World's Most Popular Software for Hotel Valuations

Hotel Market Analysis & Valuation Software 6.0 is the only non-proprietary computer software designed specifically to assist in the preparation of hotel market studies, forecasts of income and expense, and hotel valuations. The software provides the framework, along with the mathematical calculations, to develop detailed forecasts of occupancy, average room rates, revenues and expenses that can be used as a basis for hotel market studies and appraisals. The tool consists of three separate software programs:

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

Hotel Market Analysis & Valuation Software was created by Steve Rushmore for his hotel consulting firm- HVS. It has been updated and enhanced by Professor Jan deRoos of the Cornell Hotel School.

For more information: www.hotelvaluationsoftware.com



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If you are serious about your professional growth in the hotel industry, you should consider becoming a **Certified Hotel Valuation Software Consultant (CHVSC)**. This certification demonstrates proficiency using Hotel Valuation Software to perform hotel market studies, make financial projections and value hotels. It will make you more competitive when applying for jobs in hotel valuations/consulting, asset and revenue management, hotel development and ownership.

By taking my online course- **How to Perform a Hotel Market Analysis, Make Financial Projections and Value a Hotel Using Hotel Market Analysis & Valuation Software** and successfully completing a final project, you will become a **Certified Hotel Valuation Software Consultant**. Adding this CHVSC Certification to your resume and LinkedIn profile will certainly set you apart from all the other hotel industry professionals. Upon earning the CHVSC certification you will receive (via e-mail) a certificate suitable for framing. Your name will also appear in an online directory of CHVSC members www.chvsc.org

Contact me Anytime- steve@steverushmore.com