

Rushmore on Hotel Valuations

Creator of the Hotel Valuation Methodology

How to Determine a Hotel's Feasibility and Land Value in 60 Seconds

By Steve Rushmore, CHA, MAI

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Several times a month, I get a call that usually goes like this:

"Hi Steve, Hope you are doing well. I have a "golden" opportunity to purchase this amazing hotel site in an incredible hotel market. It's being offered for \$10 Million- should I buy it?"

I know they are not looking to retain me for a full-blown hotel market study (at this time)- they just want a "quick and dirty, go or no-go" response.

This is how I can provide them with an answer in just about 60 seconds.

I start by asking the following four simple questions and then perform some quick calculations.

- How many hotel rooms do you want to build on this site?
- What will they cost to build?
- When the hotel opens what will be its stabilized occupancy?
- How about its average daily rate?

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Let's assume my friend provides the following answers to these questions:

- Number of hotel rooms: 200 rooms
- Cost to build, including land: \$250,000/room
- Stabilized occupancy: 75%
- Average Daily Rate: \$250

The first step is to see if the land cost is reasonable. If the cost of land is out of the ballpark- there is no need to perform any further analysis.

Calculations to Determine the Economic Land Value for a Hotel

Steve Rushmore's Economic Land Value Formula:

$(\text{Number of Rooms} \times \text{Average Daily Rate} \times 365 \times \text{Occupancy} \times 4\%) / .07 = \text{Economic Land Value}$

Calculations:

$(200 \times \$250 \times 365 \times 75\% \times 4\%) / .07 = \$7,820,000 = \text{Economic Land Value}$

Based on this formula, the Economic Land Value for a 200-room hotel is \$7,820,000. With the offering price of the land at \$10,000,000, the hotel project does not seem to be economically viable. So, I would then tell my friend, "Forget about it!"

However, the usual response is- "But this is an incredible hotel site- what needs to be done to make it work?"

There are basically two levers that can enhance the Economic Land Value: Increase the room count or upgrade the quality of the hotel so it achieves a higher average daily rate or a combination of both.

In this example, to achieve an Economic Land Value of over \$10,000,000, the room count needs to increase from 200 to 260. Alternatively, the quality of the hotel needs to be enhanced so that the average daily rate will rise from \$250 to \$325.

Here are the two calculations:

$260 \times \$250 \times 365 \times 75\% \times 4\% / .07 = \$10,168,000$

$200 \times \$325 \times 365 \times 75\% \times 4\% / .07 = \$10,168,000$

As you can see, by either increasing the room count or average daily rate, the \$10,000,000 land cost is reasonable.

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While it seems easy to “make the numbers work,” this is not always the case. Increasing the room count by 60 might not be feasible based on the size of the site or zoning regulations. Also, increasing the quality of the hotel so its room rate will rise by \$75 might not be justified by the local market and competitive environment. In these situations, you need to convince the land seller to reduce the price or look for another site.

Now, let's look at the logic behind my Economic Land Value formula. Occasionally the land under a hotel is not owned by the owner of the hotel building but leased from the owner of the land. This is called a ground lease. The owner of the hotel building pays ground rent to the owner of the land. Often, the amount of the ground rent is calculated as a percentage of the hotel's annual Rooms Revenue. This percentage ranges from a low of 3% to a high of 10% of Rooms Revenue. The typical ground rent percentage is around 4%.

To determine the annual ground rent, you first calculate the Rooms Revenue: $\text{Number of Rooms} \times \text{Average Daily Rate} \times 365 \times \text{Percentage of Occupancy} = \text{Rooms Revenue}$. The annual ground rent is then calculated by multiplying the Rooms Revenue by the ground rent percentage. Once you have the annual ground rent, you can convert that into the Economic Land Value by dividing the annual ground rent by the Land Value Capitalization Rate, which in this example is .07. The land under a hotel is a fairly safe investment because the owner of the hotel building is unlikely to stop paying ground rent and allow the landowner to evict the building owner. As a result, I typically base the land value capitalization rate on the 30-mortgage rate in this example is 7% or .07.

Let's continue with the example. My friend determined that another 60 rooms can be constructed on the site which means the \$10,000,000 land cost is economically viable. Now we need to determine the economic viability of the overall hotel project- this is called a Feasibility Analysis. For a hotel project to be feasible, its Total Economic Value upon opening needs to be greater than the Total Cost of Development (including land).

The Total Cost of Development is calculated by taking the estimated cost to build the hotel plus land, which in this case, let's assume it to be \$250,000/room (including land) and multiply this number by the room count of 260 rooms, which totals \$65,000,000. Thus, if the Total Economic Value is equal to or greater than \$65,000,000, then the hotel project is feasible.

The Total Economic Value can be quickly estimated using the following formula:

$$\text{Average Daily Rate} \times 1,000 \times \text{Room Count} = \text{Total Economic Value}$$

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Using the data in the case the Total Economic Value is calculated as follows:

$$\$250 \times 1,000 \times 260 = \$65,000,000$$

In this example, the Total Economic Value is identical to the Total Cost of Development (including land) so the project is barely feasible. Most hotel developers would like to see the Total Economic Value between 5% to 15% above the Total Cost of Development.

So, what is the basis of the Total Economic Value calculation? There is a long-standing rule of thumb in the hotel business that happens to be fairly accurate. A hotel's Total Economic Value per room can be estimated by taking the average daily rate and multiplying it by 1,000. In this example, the \$250 average daily rate would create a Total Economic Value of \$250,000/per room. Since the hotel will be 260 rooms the Total Economic Value would be \$65,000,000.

This rule of thumb is fairly accurate for stabilized occupancies ranging from 60% to 75% with the normal number of amenities such as food and beverage outlets, etc.

Going back to my 60-second calculation. I start by calculating the Economic Land Value to determine if the land had a reasonable cost. I then looked at the average daily rate and the Total Cost of Development on a per-room basis to see if there was enough average rate to support the cost. If both of these calculations result in a positive finding, then the project is probably feasible.

Some Final Observations:

Let's say that the \$10,000,000 land cost is supported by sales of comparable land and zoning only allows for the construction of 200 hotel rooms, and the local hotel market can only support an average daily rate of \$250, why is this land price too high (for a hotel)? This is an example of a real estate term, "Highest and Best Use." To estimate the "Market Value" of land- you need to base it on the use that will produce the highest economic return to the landowner. In this example, the highest and best use might be a residential development, fast food restaurant, strip shopping center, etc.- but not a hotel. You might have noticed that during my discussion of the hotel's land value and the ground lease approach, I used the term "Economic Land Value," not "Market Land Value." Specifically, the Economic Land Value in this example is the value of the land for the development of a hotel which might not be the highest and best use of this site.

Caution- Rules of Thumb and the quick and dirty calculations set forth in this newsletter are no substitute for a thorough hotel market analysis, financial projections, and valuation made by a

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skilled hotel consultant. If you want to learn this process and become a hotel consultant, take a look at my online course- “How to Perform a Hotel Market Analysis and Valuation,” at

<https://www.hotel-learning-online.com/courses/copy-of-how-to-perform-a-hotel-market-analysis-make-financial-projections-and-value-a-hotel-using-hotel-market-analysis-and-valuation-software>

If you are a hotel consultant, asset or revenue manager, hotel operator, lender or owner and looking for more articles and information on this topic (and many more on hotel investing), go to www.howtovalueahotel.com

As always- I would love to connect with you on LinkedIn <https://www.linkedin.com/in/steve-rushmore-mai-cha-39910018/> or email me at steve@steverushmore.com

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Who is Steve Rushmore?



Steve Rushmore, MAI, CHA, Founder of HVS, has provided consultation services for more than 15,000 hotels during his 50-year career and specializes in complex issues involving hotel valuation, feasibility, and financing.

As a leading authority and prolific author on the topic of hotel valuations, Steve has written all five hotel valuation textbooks and two seminars for the Appraisal Institute and is known as the “Creator of the Modern Hotel Valuation Methodology.” He has also authored three reference books on hotel investing and has published more than 300 articles. Steve developed the Hotel Market Analysis & Valuation Software used by HVS and thousands of hotel appraisers/consultants, owners, and lenders throughout the world.

Steve lectures extensively on hotel valuations and has taught hundreds of classes and seminars to more than 20,000 industry professionals. He is also a frequent lecturer at major hotel schools and universities including Cornell, Glion, Hong Kong Polytechnic, EHL, Florida International University, IMHI, Michigan State, Penn State, Houston, NYU, and the Harvard Business School.

Steve’s most recent contribution to hotel valuation education is his online course- “How to Value a Hotel.” Designed for experienced appraisers looking to specialize in valuing hotels or new valuers starting their careers, the 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. Upon successfully completing Steve’s course- students receive the Certified Hotel Appraiser (CHA) or Certified Hotel Valuer (CHV) certification recognizing their unique knowledge and skills used to value hotels.

Steve has a BS degree from the Cornell Hotel School, an MBA from the University of Buffalo, and attended the OPM program at the Harvard Business School. He held the MAI and FRICS appraisal designations and is a CHA (certified hotel administrator).

In his free time, Steve enjoys tennis, skiing, hiking, diving, sailing, and cooking with his wife (who is a trained Chef). He holds a commercial pilot’s license with instrument, multi-engine, and seaplane ratings.

For more information as to what Steve is up to these days- www.steverushmore.com

Important Websites for Performing Hotel Market Studies and Valuations



www.howtovalueahotel.com

www.howtovalueahotel.com -Over 350 downloadable articles, books, software, and courses related to hotel analysis, valuations, investing, and finance- most are free.



www.certifiedhotelappraiser.org - If you appraise hotels consider becoming a Certified Hotel Appraiser- The world's only certification for hotel appraisers. Set yourself apart from all other appraisers with this professional certification.



www.iaha.org - International Association of Hotel Appraisers- Where the world's leading hotel appraisers come together to exchange ideas and enhance the hotel valuation methodology and procedures.



www.hotellearningonline.com - Hotel Learning Online- Learn how to perform a hotel market analysis, make financial projections, and value a hotel using the latest version of Hotel Market Analysis & Valuation Software.

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Where Hotel Professionals Learn how to Make Successful Hotel Investments

Now, you can 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



The World's Only Hotel Valuation Certification

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 Steve Rushmore’s course and a final project, you will become a **Certified Hotel Appraiser (CHA)** or a **Certified Hotel Valuer (CHV)** the world's only hotel valuation certification. For more information: www.chvsc.org

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 **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

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If you currently appraise hotels or want to learn how, obtaining a Certified Hotel Appraiser (CHA) or Certified Hotel Valuer (CHV) certification will distinguish you from all other appraisers.

Created by Steve Rushmore, CHA, MAI, the CHA and CHV certifications can be earned based on your hotel valuation experience or by completing Steve's online course, "How to Value a Hotel."

More than 250 hotel appraisers and valuers worldwide have achieved this prestigious certification, which is ideal for those seeking to specialize in hotel valuation.

In addition, these certifications are also important differentiators for hotel consultants, asset managers, operators, brands, owners, and lenders to demonstrate your unique qualifications.



For more information on the Certified Hotel Appraiser (CHA) and Certified Hotel Valuer (CHV) certifications, click here:

www.certifiedhotelappraiser.org