



BOCCONI STUDENTS
for
REAL ESTATE

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Hotel Valuation Peculiarities

- ▶ Rigid layout that cannot easily adapt to other uses of the building
- ▶ Building components may become obsolete
 - ▶ Core structure, machinery, finishing and furniture
- ▶ Specialized know-how required for proper management
- ▶ Fluctuations in operating performances and temporary wide market variations
 - ▶ Ex. Olympic games

Types of Hotel Management Options

- ▶ Lease Agreement
- ▶ Lease + Turnover Agreement
- ▶ Service Management Agreement
- ▶ Direct Management

Lease Agreement



- ▶ Most PASSIVE form of hotel ownership
- ▶ Owner of the hotel (lessor) leases the property to a lessee
- ▶ Lessee runs the hotel under own name and account, at their own risk
- ▶ Lessor collects fixed rent and pays some fixed charges (property tax, property insurance, maintenance)

Lease+Turnover Agreement

- ▶ Similar to Lease Agreement, but BENEFICIAL to hotel owner
- ▶ Owner collects maximum between a given % (usually 20-27%) and a given guaranteed amount
- ▶ More profitable than a Lease Agreement under favorable conditions, equal to Lease Agreement under unfavorable conditions

Service Management Agreement

- ▶ Hilton, Novotel, Sheraton, etc.
- ▶ Management company serves as operator for property owner
- ▶ Management company receives a base fee on revenues (usually 2-4%) and incentive fees to align interests, but does not take on economic risks
- ▶ Hotel Owner receives P&L net of management fees and other charges



Direct Management

- ▶ Most RISKY management form
- ▶ Hotel owner takes full responsibility (good or bad) for finances and operating of the hotel
- ▶ All P&L goes directly to the owner
- ▶ Rare nowadays

Valuation Techniques

- ▶ Economic Methodologies (preferred):
 - a. Direct Capitalization Approach
 - b. Discounted Cash-Flow Approach
- ▶ Direct Comparison Approach: this approach presents some drawbacks, so it's rarely used

Direct Capitalization Approach

- ▶ Used when net income generated is stable and future changes are not expected
- ▶ Use either EBITDAR multipliers or Net Operating Income and Cap Rates
 - ▶ Earnings before Taxes, Depreciations, Amortizations and Rents
- ▶ Main difference: EBITDAR multipliers are unaffected by type of management

Discounted Cash-Flow Approach

- ▶ Evidence from the international market suggests that this is the preferred approach
- ▶ Provides the best-supported value estimate
- ▶ Consider the sustainability of the rent for the user
 - ▶ Use a comparison of EBITDAR and rent expenses

Forecast of Hotel Profit and Loss

- ▶ Required to use the Economic Approaches
 - ▶ Lease: assesses the sustainability of rent
 - ▶ Lease + Turnover: forecasts rents
- ▶ Owner gets hotel P/L if under Management Agreement or Direct Management

Forecast of Hotel Profit and Loss cont.

- ▶ 1. Market Analysis
 - ▶ Economic analysis of hotel's market
 - ▶ Supply/Demand analysis of reference market
 - ▶ Forecast of room rates and occupancy
- ▶ 2. Forecast of Income and Expenses according to USALI standards
 - ▶ Uniform System of Accounts for the Lodging Industry

TABLE 11.15 10-year forecast of income and expense of the hotel (years 1 to 10)

	Year 1		Year 2		Year 3		Year 4		Year 5		Year 6		Year 7		Year 8		Year 9		Year 10	
Number of Rooms	250		250		250		250		250		250		250		250		250		250	
Occupied Rooms	69,350		73,000		71,175		67,525		67,525		67,525		67,525		67,525		67,525		67,525	
Occupancy	76%		80%		78%		74%		74%		74%		74%		74%		74%		74%	
Average Rate (£)	87.60		89.95		92.13		94.44		96.33		98.26		100.22		102.23		104.27		106.36	
RevPAR (£)	66.58		71.96		71.86		69.89		71.28		72.71		74.16		75.65		77.16		78.70	
Revenue	(£ 000)	% Gross																		
Rooms	6,075	53.6%	6,566	54.2%	6,557	54.1%	6,377	53.8%	6,505	53.8%	6,635	53.8%	6,767	53.8%	6,903	53.8%	7,041	53.8%	7,182	53.8%
Food and Beverage	4,652	41.1%	4,933	40.7%	4,936	40.7%	4,839	40.9%	4,935	40.9%	5,034	40.9%	5,135	40.9%	5,237	40.9%	5,342	40.9%	5,449	40.9%
Other Income	597	5.3%	619	5.1%	626	5.2%	628	5.3%	641	5.3%	654	5.3%	667	5.3%	680	5.3%	694	5.3%	708	5.3%
Total	11,324	100%	12,118	100%	12,119	100%	11,844	100%	12,081	100%	12,323	100%	12,568	100%	12,820	100%	13,077	100%	13,338	100%
Departmental expenses (*)																				
Rooms	1,436	23.6%	1,496	22.8%	1,510	23.0%	1,508	23.6%	1,538	23.6%	1,569	23.6%	1,600	23.6%	1,632	23.6%	1,665	23.6%	1,698	23.6%
Food and Beverage	3,175	68.2%	3,297	66.8%	3,333	67.5%	3,339	69.0%	3,405	69.0%	3,473	69.0%	3,543	69.0%	3,614	69.0%	3,686	69.0%	3,760	69.0%
Other Expenses	297	49.7%	304	49.2%	309	49.4%	314	50.0%	320	50.0%	327	50.0%	333	50.0%	340	50.0%	347	50.0%	354	50.0%
Total	4,908	43.3%	5,097	42.1%	5,153	42.5%	5,161	43.6%	5,264	43.6%	5,369	43.6%	5,476	43.6%	5,586	43.6%	5,698	43.6%	5,812	43.6%
Departmental income	6,416	56.7%	7,021	57.9%	6,966	57.5%	6,683	56.4%	6,817	56.4%	6,954	56.4%	7,092	56.4%	7,234	56.4%	7,379	56.4%	7,527	56.4%

Undistributed operating expenses																				
Administrative & General	883	7.8%	912	7.5%	926	7.6%	934	7.9%	953	7.9%	972	7.9%	991	7.9%	1,011	7.9%	1,031	7.9%	1,052	7.9%
Marketing	471	4.2%	487	4.0%	494	4.1%	498	4.2%	508	4.2%	518	4.2%	529	4.2%	539	4.2%	550	4.2%	561	4.2%
Prop. Operations & Maint.	442	3.9%	456	3.8%	463	3.8%	467	3.9%	476	3.9%	486	3.9%	496	3.9%	505	3.9%	516	3.9%	526	3.9%
Utilities	294	2.6%	304	2.5%	309	2.5%	311	2.6%	318	2.6%	324	2.6%	330	2.6%	337	2.6%	344	2.6%	351	2.6%
Total	2,090	18.5%	2,159	17.8%	2,191	18.1%	2,210	18.7%	2,254	18.7%	2,300	18.7%	2,345	18.7%	2,392	18.7%	2,440	18.7%	2,489	18.7%
Gross Operating Profit (GOP)	4,326	37.784	4,862	37.784	4,776	37.784	4,473	37.784	4,563	37.784	4,654	37.784	4,746	37.784	4,842	37.784	4,939	37.784	5,038	37.784
Management Fee	340	3.0%	364	3.0%	364	3.0%	355	3.0%	362	3.0%	370	3.0%	377	3.0%	385	3.0%	392	3.0%	400	3.0%
GOP after management fees	3,986	34.784	4,498	34.784	4,412	34.784	4,118	34.784	4,200	34.784	4,284	34.784	4,369	34.784	4,457	34.784	4,547	34.784	4,638	34.784
Fixed expenses																				
Property Taxes	231	2.0%	236	1.9%	240	2.0%	245	2.1%	250	2.1%	255	2.1%	260	2.1%	265	2.1%	271	2.1%	276	2.1%
Insurance	33	0.3%	34	0.3%	34	0.3%	35	0.3%	36	0.3%	36	0.3%	37	0.3%	38	0.3%	39	0.3%	39	0.3%
Incentive Management Fee	399	3.5%	450	3.7%	441	3.6%	412	3.5%	420	3.5%	428	3.5%	437	3.5%	446	3.5%	455	3.5%	464	3.5%
Reserve for Replacement	340	3.0%	364	3.0%	364	3.0%	355	3.0%	362	3.0%	370	3.0%	377	3.0%	385	3.0%	392	3.0%	400	3.0%
Total	1,002	8.9%	1,083	8.9%	1,079	8.9%	1,047	8.8%	1,068	8.8%	1,090	8.8%	1,111	8.8%	1,134	8.8%	1,156	8.8%	1,179	8.8%
Net Operating Income (NOI)	2,984	26.3%	3,416	28.2%	3,333	27.5%	3,071	25.9%	3,132	25.9%	3,195	25.9%	3,258	25.9%	3,324	25.9%	3,390	25.9%	3,458	25.9%

*Departmental expenses are expressed as a percentage of departmental revenues.

Direct Comparison Approach

- ▶ Used to value standardized properties
 - ▶ Properties are more comparable
- ▶ Value per room as a standardized measure
- ▶ Can establish a range of values to test the reasonability of economic methods of valuation