CASE STUDY: FEASIBILITY OF A HOTEL PROJECT IN SOUTHERN CALIFORNIA

A Project

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ABSTRACT

The development of new hotels is growing rapidly in the United States. According to Smith Travel Research (STR), the reported number of new hotel projects either in construction, final planning, or in the planning stages as of February 2016 is 4,057, totaling to 497,409 new rooms soon entering into the United States market. Industry experts predict that development will continue to grow at a vigorous pace for at least the next couple years. Therefore, it has become increasingly important for developers to thoroughly investigate whether the overall environment appears suitable to support a hotel facility prior to making a commitment towards a project. This study will focus on analyzing the competitive lodging market in which the proposed upper-midscale hotel would compete. Secondary data such as historical performance data from Smith Travel Research (STR) and archived market data from Coldwell Banker Richard Ellis (CBRE) will be analyzed and used to project the performance of the proposed hotel. The conclusion will give a suggestion for whether the hotel project is financially feasible.
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CHAPTER 1: FEASIBILITY OF A PROPOSED HOTEL PROJECT IN SOUTHERN CALIFORNIA

The United States lodging industry plays a major role in the overall economic growth of the country. In 2014 alone, the industry created 30,000 new hotel jobs and more than 100,000 new travel-related jobs. The industry also provided billions of dollars in tax revenues to communities across the country (American Hotel & Lodging Association, 2015). Such trends reinforce the industry’s influence on creating new jobs, growing communities, and promoting tourism and travel across the United States (American Hotel & Lodging Association, 2015). Therefore, it is equally important to understand how the cyclic nature of the economy impacts the lodging industry. In particular, the economics behind the supply and demand relationship has long been a topic of high debate among hoteliers as it relates directly to hotel performance (Wright, 2013). A couple questions that commonly arise are whether the creation of new supply automatically generates new demand and whether the influx of new demand stimulates an increase in supply (Wright, 2013). Studying the historical influence of the economy on the lodging industry puts into perspective how hotels have performed during recession periods, in years of stability, as well as in times of growth. Ultimately, such information helps hoteliers determine when it is economically feasible to build new hotels.

For example, the economic prosperity of the 1920s produced one of the greatest hotel-building booms in America’s history (Rushmore & Baum, 2002). The Great Depression of the 1930s caused this surge in hotel development to come to a halt. The high levels of unemployment and lost personal wealth from the stock market collapse caused commercial and leisure travel to come to a standstill as well, resulting in the
lowest-ever average occupancy rate and revenue growth for the industry (Woodworth & Mandelbaum, 2010). Consequently, the depression forced many hoteliers out of business. However, it also offered an opportunity for several hotel companies to significantly expand their holdings as many inexperienced investors were eager to sell their properties at greatly reduced prices (Rushmore & Baum, 2002). During this time, acquisitions made by hotel companies such as Hilton and Sheraton fueled the establishment of national hotel chains in the decades to come (Rushmore & Baum, 2002).

With the economy on the upswing in the 1950s, the industry saw yet another boom in terms of the number of motel rooms, especially those resulting from the construction of the interstate highway system (Woodworth & Mandelbaum, 2010). In addition, the emergence of franchising also contributed significantly to this increase in supply. After witnessing hotel developers’ ability to benefit from the name recognition of motel franchises, many non-hoteliers were enticed into the lodging business (Rushmore & Baum, 2002). As a result, the Holiday Inns chain, which started with only four motels in the early 1950s, grew to more than 100 motels nationally by 1960 (Rushmore & Baum, 2002). By the late 1950s and early 1960s, companies such as The Marriott Corporation and the Howard Johnson Company, which were known primarily for their food service businesses, also became key players in the lodging industry. From that point forward, many other hotel companies began to expand their chains through franchising (Rushmore & Baum, 2002).

In the 1980s, hotel franchisers realized that creating new products for other price segments would enable two or more hotel products to exist in the same market without directly competing against one another (Rushmore & Baum, 2002). Accordingly, Holiday
Inns, a mid-priced lodging chain, established the upscale Crowne Plaza and also ventured downscale with the development of the Hampton Inn brand. Marriott also ventured downscale with the Courtyard brand before downscaling further to create the Fairfield Inn brand. Additionally, hotel companies produced entirely new products such as the all-suite hotel, the extended stay facility, and the microtel (Rushmore & Baum, 2002). This assortment of franchises and new products resulted in hotel developers rushing to build new properties. An estimated 920,000 hotel rooms were added to the United States lodging industry’s inventory during this decade (Woodworth & Mandelbaum, 2010).

The impact of two deep recessions caused the United States hotel industry to regress in the 2000s. The terrorist attacks of 9/11 in 2001 and the financial crisis in late 2008 both led to unpredictable fluctuations in demand that seriously affected hotel performance and growth for an extended period of time (Kosová & Enz, 2012). While the impact in reducing occupancy levels and room rates was abrupt and dramatic after the 9/11 attacks, the effects of the financial crisis accrued more gradually (Kosová & Enz, 2012). The only shining light in a decade plagued by two recessions was a period of strong profit growth from 2004 to 2007 as the industry was struck by severe declines in profits in the remaining years (Woodworth & Mandelbaum, 2010).

Since climbing out of the recession in 2010, United States hotels have realized an overall surge in performance, largely in part to the lack of new supply entering the market (Rivard, 2014). Other factors, such as strong business activity, solid job growth, falling unemployment rates, lower energy prices, and improved consumer confidence, contributed substantially to the year over year increases in the nationwide lodging demand over the last five years and also made it possible for hoteliers to drive rates and
improve their bottom lines (Furbay, 2015). Given that supply growth has been at a relative standstill, the presence of low interest rates and readily available financing have made markets across the nation prime for new hotel projects (Rivard, 2014).

With the United States lodging industry in the midst of such a robust operating and development period, many investors and developers have shifted their focus towards the development of new hotels (Sahlins, 2015; Furbay, 2015). Industry experts believe that new hotel rooms are expected to enter the United States lodging market at a vigorous pace for the next two to four years (Sahlins, 2015). As a result, interest among developers in researching the feasibility of new builds has resurfaced (Furbay, 2015).

The purpose of this study is to conduct a feasibility study to determine whether the proposed upper-midscale hotel project in a developing city in Southern California should be pursued. Secondary data such as a Smith Travel Research (STR) report and archived market data from Coldwell Banker Richard Ellis (CBRE) will be utilized to conduct the feasibility study. Analysis of both sources of data is expected to provide a practical estimation to the hotel developer in forecasting the proposed hotel project. The findings are expected to assist answering the question of whether a hotel should be built in the suggested market. Ultimately, findings from this study will help the hotel developers determine whether the hotel project is financially feasible.
CHAPTER 2: LITERATURE REVIEW

Overview of the Hotel Industry Economic Cycle

The United States hotel industry encountered a period of steady growth after experiencing a major setback from the downfall of the economy in 2001. According to an industry analysis conducted by Pannell Kerr Forster (PKF), a global network of legally independent firms providing accounting and business advisory services around the world, the industry experienced a breakthrough in the development of new hotels in 2007. Smith Travel Research (STR), a single source of hotel data covering daily and monthly performance, forecasts, annual profitability, pipeline, and census information, reported an average of only 0.4 percent net increases in annual supply from 2003 through 2006 before climbing to 1.3 percent in 2007 (Mandelbaum, 2008). This spike in new supply entering the market contributed to the decline in average occupancy from the previous year. However, Pannell Kerr Foster’s (PKF) analysis also revealed that the typical United States hotel achieved an average gain of 7.2 percent in net operating income (NOI) due to a six percent growth in revenue per available room (RevPAR) in that same year (Mandelbaum, 2008).

In the months following 2007’s strong growth in RevPAR, and consequently NOI, the United States economy experienced a financial collapse that severely impacted the lodging industry (Rushmore, 2010). Smith Travel Research (STR) reported that the average occupancy rate and RevPAR fell from 63.1 percent and $65.52 in 2007 to 60.4 percent and $64.37 in 2008, respectively (American Hotel & Lodging Association, 2015). The economy took a dive for the worse in the following year (2009), resulting in the average occupancy rate plummeting to 54.7 percent with a $53.50 RevPAR (American
Hotel & Lodging Association, 2015). As a result, hotel values across the United States decreased dramatically. Many hotels that were up for sale could be purchased at bargain prices ranging anywhere between 33 to 50 percent of the replacement cost (Rushmore, 2010).

In response to the sudden downshift in performance as an industry, hoteliers across the nation implemented the strategy of lowering average rates in order to generate demand for hotel rooms (Rivard, 2014). By late 2010, this strategy proved to be effective as the occupancy began to rebound. Hoteliers immediately took an aggressive approach to driving the average rates after sensing this strong return of demand. Smith Travel Research (STR) reported that the average rate rose 3.8 percent in 2011, 4.2 percent in 2012, and increased again by 3.9 percent in 2013 (Rivard, 2014). This boost in overall performance as an industry was possible because of the lack of new supply entering the market (Rivard, 2014).

To put this lack of supply into perspective, the hotel supply growth from 2010 to 2013 was less than one percent on average, annually (Rivard, 2014). For a five-year period starting in December 2009 and ending in December 2014, the supply of hotel rooms entering the United States market grew only 3.2 percent. On the other hand, the demand for hotel rooms grew approximately 5.3 percent (Sahlins, 2015). With the stalled introduction of new supply, occupancy in 2014 reached 64.4 percent, approximately a seven percent increase since 2010. The RevPAR climbed to $74.12, marking five consecutive years of growth over the five-year period (American Hotel & Lodging Association, 2015).
The United States hotel industry reaped substantial benefits from such remarkable performance growth. Hotel values reached peak levels in 2014 due to the nationwide lodging demand increasing year after year and RevPAR growth reaching one of the highest on record (Furbay, 2015; Mellen, 2015). Capitalization rates remained steady as competition for quality assets remained strong (Mellen, 2015). Hotel transaction activity, too, was very robust in that year. Real Capital Analytics (RCA) reported that the total transaction volume increased 22 percent over that of 2013 for hotels that sold at a price greater than $2.5 million. The total volume reached $30 billion, falling short by only $2 billion to prior peak volume levels achieved in 2006 and 2007 (Mellen, 2015). Real Capital Analytics (RCA) also reported that the total volume for hotels priced at $10 million or greater increased by 25 percent. The number of hotels that sold in this price range increased by a dramatic 46 percent as market transaction activity was dominated by the sale of limited-service and select-service hotels (Mellen, 2015).

Additionally, the increasing demand and improving operating and performance metrics, along with the return of favorable financing terms, made the ground fertile for new hotel supply (Furbay, 2015). As hotel values and sales prices increased, investors and developers shifted gears towards constructing new hotels rather than buying existing products. Despite rising construction costs, these new construction projects became a more viable route due to the fact that many of these investors and developers have held land since before the recession (Furbay, 2015). With land in a market that is witnessing significant growth, investors and developers stand to profit considerably from new construction (Furbay, 2015).
According to the Smith Travel Research (STR) Pipeline Report (February 2016), the current number of hotel rooms in construction, final planning, and planning is 497,409 between the 4,057 projects under contract in the United States. This total represents a 14.2 percent increase in the number of rooms under contract in the previous year (HNN, 2016). With industry experts expecting this growth trend to continue for the next few years, many developers have either engaged or re-engaged in researching the feasibility of new hotel projects (Sahlin, 2015; Furbay, 2015).

Feasibility Studies

Consultants frequently conduct feasibility studies to determine whether a hotel project is financially feasible. Typically included in such studies are the analysis of the local lodging market, research on the area’s economics, and a forecast of future performance (Major, 2015). As an example, HVS Global Hospitality Services (HVS), a consulting firm specializing in hotel valuations, performed feasibility studies to determine whether building a hotel was financially feasible in the midst of an economic downturn. The results of these studies revealed several reasons to support why development while at the bottom of the economic cycle can make sense. The first reason was that land values in various markets declined by 25 to 50 percent, creating instant savings for developers interested in those markets (Rushmore, 2010). A second reason was that many cities encouraged new development by granting approvals quicker and incentivizing certain projects. Hotel brands and management companies were also willing to give developers a hand by providing financing, reduced fees, and favorable contract provisions. However, Rushmore (2010) stated that HVS Global Hospitality Services (HVS) found the biggest benefit of starting a hotel project during the recession period to
be the construction cost savings. With the lack of new construction financing causing
demand for supplies, equipment, and construction labor to remain low, the cost of
materials and labor continued to dive. Nonetheless, these reduced costs could not be fully
taken advantage of as limited financing ultimately caused a drastic decline in hotel
development (Rushmore, 2010).

There are three important steps a hotel consultant follows when conducting a
valuation of a hotel asset (Sangree, 2012):

(1) **Market Analysis**

The market conditions in a selected area have a significant impact on the
feasibility of a new hotel in that the strength of the local lodging market affects how
many rooms can be sold and the rates that can be charged (Downtown and Business
District Market Analysis, 2010). Performing a market analysis is crucial to gauging the
potential of a new lodging facility in that it enables developers to gain an understanding
of travel and visitation trends, existing competition, traveler market segments in the area,
and projected room night demand (Downtown and Business District Market Analysis,
2010). The components included in a market analysis are a study of the area economics,
market segments, existing competition, and latent demand (Rushmore et al., 2012)

**Area economics.** Performing economic studies for hotels requires a thorough
analysis of the site and improvements, an understanding of competitive supply and
demand forces, and a well-researched estimate of the market area’s historic and potential
demand for transient accommodations (Hennessey, 1986). Setting parameters for the
primary market area for a proposed hotel allows the appraiser to determine where the
demand and the competitive supply are located. Four factors to consider when
establishing these boundaries include the following: (1) travel time between a source of demand and the subject property; (2) means of transportation; (3) sources of demand (demand generators); and (4) location of competitive hotels. (Rushmore, 2012). In addition to these four factors, understanding the local trends of the area is also an integral component for estimating future lodging demand (Hennessey, 1986).

**Market segments.** The basis of a hotel feasibility study is to define major types of hotel demand, identify customer characteristics, and estimate future growth trends (D’Antonio, 2013). The process begins with dividing the overall market into various segments – commercial, meeting and groups, and leisure - based on the nature of travel (D’Antonio, 2013). Distinguishing between the three market segments is also a necessary step for quantifying room night demand by market segment because each segment generally exhibits unique characteristics relating to future growth potential. Taking such characteristics into consideration when making projections for each segment allows future demand to be forecasted more accurately (Rushmore, 2012).

**Commercial.** Commercial demand mainly consists of business travelers and potentially also high-volume corporate and government accounts depending on the location of the hotel (D’Antonio, 2013). This type of demand is strongest from Monday through Thursday nights and is relatively constant throughout the year. Demand from this segment typically declines on Friday and Saturday nights as well as during holidays (Rushmore, 2012; D’Antonio, 2013). When analyzing a market and forecasting future growth trends, a sizeable commercial demand base is critical since it is the most recession-proof of the three segments (D’Antonio, 2013).
**Meeting and groups.** The meeting and groups segment includes individuals and/or groups of ten or more individuals attending events such as meetings, seminars, conventions, and trade association shows (Rushmore, 2012). Demand from this segment typically peaks in the spring and fall months. The primary categories considered in the analysis of meeting and groups demand are corporate groups, associations, and SMERFE (social, military, ethnic, religious, fraternal, and educational) groups (D’Antonio, 2013). Corporate groups typically meet during the business week and tend to be the most profitable for hotels. On the other hand, SMERFE groups are generally more price sensitive and have a habit of meeting on weekends and/or during the summer months and holiday seasons (D’Antonio, 2013). Overall, the process of analyzing meeting demand requires a determination on whether building a new hotel with extra meeting space will produce additional meeting and group demand (D’Antonio, 2013).

**Leisure.** The leisure segment includes individuals and families traveling for purposes that include sightseeing, recreation, or visiting friends and relatives (Rushmore, 2012). Demand from this segment is strongest on Friday and Saturday nights and all week during holiday periods and the summer months. Since leisure travelers tend to be the most price-sensitive, high unemployment and difficult economic times have a negative impact on leisure demand (Rushmore, 2012; D’Antonio, 2013). Additionally, conducting a feasibility for a hotel proposed in a high leisure market is quite risky from a lender’s perspective (D’Antonio, 2013).

**Competition.** Determining which hotels represent primary or secondary competition and which provide no competition at all can be rather subjective (Rushmore, 2012). In general, hotels that attempt to capture the same types of transient visitors and
market segments and offer similar facilities, amenities, and services are considered primary competitors to the subject property (Rushmore, 2012). Hotels that become competitive because they attract some of the same visitors within one or more of the identified market segments are considered secondary competitors. Such hotels mainly become competitive when the primarily competitive hotels in the market area are sold out. Another instance where such hotels can be in demand is when they are situated adjacent to demand generators (Rushmore, 2012). When performing a demand analysis, the evaluation of the subject hotel’s ability to isolate from the pressure of its competitors helps determine how the hotel will perform in comparison to its competitors (Becerra, Santaló, & Silva, 2012). Existing literature in the hotel industry indicates that accommodation selection decisions are influenced by attributes such as location, hotel category and size, brand name, room rate, room features, reputation, and nearby attractions (Becerra, Santaló, & Silva, 2012).

**Latent demand.** New hotels are capable of bringing new demand into the market through latent demand, which can be classified as either (1) unaccommodated demand or (2) induced demand (Wright, 2013). Unaccommodated demand is generated when travelers are unable to stay in a market due to all the hotels being sold out. The entrance of new supply is said to turn this potential demand into actual accommodated room nights for the market (HVS India Journal, 2010). Induced demand refers to the additional room nights that a new demand generator is expected to bring to a market upon entrance. Overall, a new hotel may act as a demand generator in that it has the potential to increase the exposure and awareness of a market and open up new sources of potential demand.
through its brand affiliation, reservation system, sales team, and unique facilities and amenities (HVS India Journal, 2010; Wright, 2013).

Proper analysis of latent demand is critical when forecasting the potential effect of new supply on the market-wide occupancy (Wright, 2013). However, measuring existing levels of unaccommodated demand and the potential of a new hotel to induce demand can be quite challenging. A general rule to follow for unaccommodated demand is that it exists in markets with occupancies greater than 70 percent (Wright, 2013). An important practice for estimating the unaccommodated demand present in a market is to determine when that market generally sells out as well as how many room nights are being turned away. The best potential for hotel developers is in markets with year-round unaccommodated demand (Wright, 2013).

The potential of a new hotel to induce demand in a market depends on several factors: brand affiliation, location, amenities and services offered, existing products in the market, and the size of the proposed hotel (Rushmore, 2012; Wright, 2013). Analyzing the effects of comparable hotel projects on the same or similar markets is generally the best approach to forecasting the amount of induced demand a new hotel will bring to the market of interest (Wright, 2013).

(2) Financial Analysis

Forecasting the financial performance for a proposed hotel requires the analysis of the past performance of other hotels already existing in the market area (Downtown and Business District Market Analysis, 2010). A resource frequently used in such an analysis is the Smith Travel Research (STR) report, which provides key historical data in terms of occupancy, average daily rate (ADR), and revenue per available room (RevPAR) for the
selected market. Such measures allow developers to refine proposed hotel concepts to effectively serve the market area and ensure financial success (Downtown and Business District Market Analysis, 2010).

Future occupancy projections are important because the feasibility and financial success of hotels are extremely sensitive to occupancy (Overstreet, 1989; O’Neill, 2011). When forecasting hotel occupancy levels, it is important to take into account the historical and anticipated levels of demand and demand growth, which may occur as a result of improving economic conditions, tourism visitation, or simply as a result of a new supply of rooms entering the market area (Downtown and Business District Market Analysis, 2010; O’Neill, 2011). An evaluation of the reasonableness of the occupancy projected for the proposed hotel is equally important as the projections should reflect the historic seasonal demand patterns in the market area (Downtown and Business District Market Analysis, 2010).

For a proposed hotel, it is assumed that the occupancy will build up to a stabilized level in three years as a new property is expected to capture an increasing share of market demand in its first few years of operation (O’Neill, 2011). Once a stabilized level is reached, the occupancy percentage ceases to increase year over year (Eckenstahler, 1994; O’Neill, 2011).

Since effective pricing has a critical impact on the bottom-line for a hotel, projecting average room rates is also crucial to the financial analysis process. In order to maximize profit, careful consideration of not only the rates charged by competitors but also the changing economic conditions as well as price sensitivity of travelers to the area are required when setting prices (Downtown and Business District Market Analysis,
Analyzing the expected market segments, comparing the expected quality level and appeal of the subject hotel with that of competitors, and analyzing the room rates charged by competitors in terms of the rates set for different room types, discounting, and the variations in rates by season are key steps to follow to ensure that the hotel is competitively priced relative to its competition (Downtown and Business District Market Analysis, 2010).

Once completed with forecasting the annual occupancy and average room rate, a comparison should be made with the market area averages presented in the STR report. If the projections are near or above the market area averages, the addition of new supply into the market area should be considered (Downtown and Business District Market Analysis, 2010). While more detailed feasibility work is required, this assessment is sufficient enough to provide developers with an important market overview of lodging development opportunities in the market area (Downtown and Business District Market Analysis, 2010).

(3) Valuation Analysis

The primary focus of any valuation technique is to assess the current market value to secure financing, for expansion and sometimes to assist with operations, and to determine the market value or selling price at which a property is expected to change hands on the open market (Andrew et al., 2007). In arriving at a market value for hotels, there are three different approaches to valuation that are considered: income capitalization approach, sales comparison approach, and cost approach (HVS India Journal, 2010). According to Nilsson, Harris, & Kett (2002), the income capitalization approach is the most effective method for assessing the market value of a hotel. However,
the authors advise that at least one other approach, if not both, should be utilized to support the income capitalization approach in determining the final value for a hotel.

**Income capitalization approach.** Hotels are income-generating facilities that are purchased and sold based on its ability to generate a profit (Jackson, 2008). The income capitalization approach attempts to relate the profit generating capability of a hotel to its value (Jackson, 2008). According to *HVS Hospitality Services*, the income capitalization approach is often selected as the preferred valuation method for operating properties because it most closely stimulates the investment rationale and strategies of knowledgeable buyers (HVS India Journal, 2010; Rushmore, 2012). That is, it evaluates a property’s ability to generate financial returns as an investment by estimating the operating cash flow and using it in the direct capitalization technique and/or discounted cash flow analysis (HVS India Journal, 2010).

*Direct capitalization* is one of the simplest techniques that can be used in the income capitalization approach. In this method, a hotel’s net operating income (NOI) from a complete year of operations is divided by a carefully selected capitalization rate to develop a fair market value for the hotel (Waud, 2013). The capitalization rate, which consists of both a risk component and a growth component for income over a holding period, is ultimately selected based on sale prices and annual income figures from recent transactions in the market area (Waud, 2013). Although capitalization rates can be an important value factor to consider, the direct capitalization method is not always the most suitable technique for establishing a fair market value for a hotel (Waud, 2013). A discounted cash flow analysis is a more thorough technique to utilize in that the value of
a hotel is developed based on the analysis of a multi-year income projection rather than only one year’s income (Waud, 2013).

*Discounted cash flow* is a method that can be used to convert a hotel’s income stream into a net present value. The process requires the selection of an appropriate discount rate, which represents either the “free and clear” internal rate of return to an all-cash buyer or a blended rate of debt and equity return requirements, to the net operating income (Major, 2014). A hotel’s reversionary value at the end of a five-year holding period is then calculated by capitalizing a projected sixth year’s net income with a capitalization rate that is intended to reflect what a potential buyer is willing to pay in order to acquire the property at that specific point in time (Mellen, 1983; Major, 2014). Transactional costs such as brokerage and legal fees should then be deducted from the reversionary value to arrive at a net reversionary value (Major, 2014). Each year’s forecasted net operating income before debt service and depreciation, as well as the reversionary value, are then converted to a present value by multiplying the cash flow by the discounted rate to each year in the forecast. The sum of the present values for the forecasted years equates to the net present value of the hotel (Major, 2014).

According to a study by HVS on sales transactions for limited-service hotels in the United States in 2015, an average discount rate of 12.2 percent was applied to the net operating income, which, on average, was equivalent to 38 percent of the room revenue (Mellen, 2016). Additionally, the study noted that the average capitalization rate applied to limited-service hotel transactions in 2015 was 9.2 percent (Mellen, 2016). In another study by HVS, it was reported that the typical transactional cost is typically three percent of the total sale proceeds (Major, 2014). Since these are the most recently reported
values, they will be utilized in performing a valuation for the proposed hotel at the end of its first five complete years of operations.

**Sales comparison approach.** The sales comparison approach is concerned with recent transactions involving hotel purchases (Jackson, 2008). In this approach, recently sold hotels in a specific market are used to determine what that market is prepared to pay for a similar hotel. Factors such as the cost of replacement and recent income generation potential are not considered (Sikich, 1993; Jackson, 2008). Instead, adjustments are made to the sale price of comparable hotels to compensate for differences between those hotels and the hotel of interest (Andrew *et al.*, 2007; HVS India Journal, 2010). However, the level of difficulty associated with obtaining comparable sales and making adjustments makes this approach unreliable in determining the value of hotels. Differences between hotels in terms of the levels of service, conditions of physical improvements, location, and characteristics of the local market also make this approach unreliable (Lesser, 1992; Jackson, 2008). Even with the aforementioned shortcomings, the sales comparison approach can serve to provide a range of values that provides support for the income capitalization approach (Jackson, 2008).

**Cost approach.** The cost approach is commonly used for estimating the value of newly constructed properties. It focuses on asset replacement rather than on the current market value of the hotel or the future net income the hotel may generate (Stefanelli, 1982; Jackson, 2008). In this approach, asset replacement is calculated by computing the cost of replacing the building, subtracting any depreciation resulting from physical deterioration, functional obsolescence, and economic obsolescence, and adding the value of the land, as if vacant and available, back to the depreciated value (HVS India Journal,
The drawback to this approach is that value of the hotel in terms of both a property and as a business are ignored. Additionally, as a building ages and market conditions change, it becomes increasingly difficult to accurately quantify the value of a property. As a result, this approach is usually given little weight in hotel valuation (Rushmore, 1975; Lesser, 1992; Jackson, 2008).
CHAPTER 3: METHODOLOGY

Data Collection

Secondary data was obtained from a Smith Travel Research (STR) report consisting of monthly and daily historical market performance data presented in the following ways: data by measure, percentage change by measure, percentage change by year, twelve-month moving average, twelve-month moving average with percentage change, day of week analysis, raw data, and classic data. From this report, this study will use monthly performance data from January 2010 to March 2016, and daily performance data from April 2013 to March 2016.

Additional secondary data obtained was archived market data produced by Coldwell Banker Richard Ellis (CBRE), the world’s largest commercial real estate services and investment firm. The report consists of an evaluation of the subject site and its relationship to potential demand generators, an analysis of the existing properties within the competitive market, and an analysis of economic data pertinent to the competitive hotel market.

Acquiring the reports listed above required an agreement to keep certain information pertaining to the project confidential. In order to uphold this confidentiality, generic names were assigned to not only the proposed site location but also to all the competitive hotels, demand generators, local attractions, nearby freeways, etc. that will be named in this study.

Data Measurement

The variables to be measured will be different for each of the following analysis methods utilized in this study: market analysis, financial analysis, and valuation analysis.
The main variables that will be used in this study for market analysis are location, access and visibility, surrounding developments, the relationship to demand generators, and competitive supply. Location refers to the positioning of the site in terms of the street, city, and state. Access refers to the proximity of the site to freeways and interstates. Visibility takes into consideration the ability to see the site off the nearby freeways and interstates. Surrounding developments include any industrial, commercial, or retail development that is either planned or in progress in the market area. Relationship to demand generators and area amenities pertains to the potential the proposed hotel has to absorb demand created by local businesses, attractions, and events in the market area. The competitive supply includes hotels in the market area that attempt to capture the same types of transient visitors and market segments and offer similar facilities, amenities, and services as the proposed hotel.

The three main variables that will be used in this study for financial analysis are occupancy rate, average daily rate (ADR), and revenue per available room (RevPAR). Occupancy is a performance measure displayed as the percentage of available rooms sold during a specific period of time. It is calculated by dividing the number of occupied rooms by the number of available rooms. Average Daily Rate (ADR) is a measure of the average rate paid for rooms sold. It is calculated by dividing the total guest room revenue by the number of rooms sold in the market. Revenue per Available Room (RevPAR) is a performance measure that represents the revenue produced by each guest room available. It is calculated by (1) multiplying occupancy and ADR together or (2) by dividing the total guest room revenue by the total number of rooms available.
The main variables that will be used in this study for valuation analysis are net operating income, discount rate, capitalization rate, transactional costs, discounted cash flows, and net present value. Net operating income (NOI) is income produced by the hotel after all expenses are deducted. A discount factor is applied to the net operating income to produce a discounted cash flow. A capitalization rate specific to the market is used to estimate the investor’s potential return on the investment. Dividing the NOI for a sixth year by the capitalization rate produces a gross sale value for the hotel. Deducting transactional costs from this value generates a net sale value which is added to the NOI for the fifth year of operation. The discounted cash flows for the first five years are summed together to produce a net present value for the proposed hotel.

**Method & Data Analysis**

**Market analysis.** For the market analysis, a site evaluation will be conducted by inspecting the site relative to its location, access and visibility, surrounding developments, the relationship to demand generators, and the competitive supply. Site evaluation determines whether the proposed site is suitable for the development of a hotel.

**Financial analysis.** For the financial analysis, historical performance data of existing properties in the competitive market area, in terms of occupancy, ADR, and RevPAR, will be analyzed in order to forecast the performance the proposed hotel could reasonably expect to achieve for its first five years of operations. Historical and forecasted performance, together, determine the potential success of a hotel from a financial standpoint.
Valuation analysis. For the valuation analysis, the income capitalization method will be used to estimate the proposed hotel’s value at the end of a five-year holding period by capitalizing a projected sixth year’s net income. Ultimately, the income capitalization approach establishes a current market value at which the proposed hotel is expected to change hands in the open market.
CHAPTER 4: RESULTS

Market Analysis

Site evaluation. The proposed site for the upper-midscale product to be built is located in City X, which is a Southern California city booming with development. The proposed hotel is an upper-midscale franchised hotel designed to be four stories in height and have 94 guestrooms, complete with facilities and amenities such as a breakfast room, business center, fitness center, outdoor swimming pool, and approximately 104 parking spaces.

Location. The proposed site sits north of Interstate 7 and west of the 266 Freeway. The immediate area is currently comprised of existing and planned commercial, industrial, and retail developments. For example, just north of the site is an open developable area upon which a new apartment complex is planned. Major industrial and commercial developments, along with a school, sports facility, airport, and distribution center, also exist slightly further north. The area directly south of the site is filled with office space occupied by major corporations and medical companies. Additionally, commercial uses including a shopping mall, restaurants, coffee shops, and an auto repair shop can be found east of the site while the department of motor vehicles (DMV) and additional medical offices are located just west of the site.

Access and visibility. Interstate 7 is a major transportation passageway between the east and west coast of the United States. The proposed hotel will be highly accessible for travelers heading westbound and eastbound on the Interstate 7 as the distance from the hotel to the interstate is approximately one-third of a mile. Assuming adequate signage, the property will have excellent visibility from both the westbound and
eastbound lanes of the freeway. Additionally, visibility from the south should also be
good as the proposed hotel is approximately one-half mile west of the 266 Freeway,
which is a local freeway that begins approximately 90 miles northwest from its endpoint
at Interstate 7.

\textit{Surrounding developments.} Coupled with an easing of restrictions on
development, City X has benefited significantly from the availability of large, relatively
inexpensive commercial and industrial sites, which have led to the relocation of major
corporations in the area and a new wave of build-to-suit construction. With high-quality
projects under construction, and planned developments in the works, a beautification of
the area surrounding the proposed site is well underway.

One of the several key ongoing projects nearby to the proposed site is the
development of a 125-acre retail and entertainment shopping center with more than 1.35
million square feet of retail space. At the moment, the shopping center includes major
retailers such as Target, 24 Hour Fitness, Nordstrom Rack, a state of the art movie theater
complex, and several restaurant chains. Additional retailers are expected to be added in
the near future as the northwest quadrant of the shopping center remains available for
development.

Another key development project approved by the county is the construction of a
340-unit gated apartment complex directly northwest of the proposed hotel site. This
complex is scheduled to open in 2017 and will include a retail component, a sidewalk
café, and a produce market. It will be the second apartment complex to open in the
immediate area, with the first being a 306-unit luxury apartment complex that caters to
upwardly mobile professionals.
Additionally, a major investment company is underway with the development of two warehouse and distribution centers just west of the proposed site. The two centers will collectively size to over 1.1 million square feet and will be accompanied by a one-million square foot LEED-Silver certified industrial facility being developed by a nationally recognized real estate development firm.

**Demand generators.** The proximity of various types of demand generators to the proposed site is an indicator that the hotel to be built has strong potential to capture its fair share of demand across all three market segments. For example, the immediate area surrounding the proposed site includes major demand generators such as educational institutions, major corporations, medical companies and facilities, as well as medical centers and hospitals, all of which produce individual corporate demand and some group demand. The remaining group room demand is yielded by SMERFE (Social, Military, Ethnic, Religious, Fraternal, Educational) business, corporate meetings, university and medical center related demand, and leisure groups such as sports teams that utilize the baseball and soccer fields nearby to the proposed site. Since the intersection of Interstate 7 and the 266 Freeway is also nearby, a notable amount of drive-in demand is expected to be produced by leisure travelers visiting the Southern California area. Some of the many attractions located within reasonable proximity to the proposed site include Disneyland, Hollywood, several beaches, and various mountain and hiking trails. More local attractions include a popular craft brewery and a downtown area which is comprised of numerous restaurants, coffee houses, shopping, and local bars with unique character.
**Competitive supply.**

Table 1 presents characteristics of the competitive properties in terms of location by city, distance from the proposed property, and type of hotel by class, number of rooms, and the opening date.

Table 1

<table>
<thead>
<tr>
<th>Hotel</th>
<th>Location</th>
<th>Distance (miles)</th>
<th>Type</th>
<th>No. Rooms</th>
<th>Open Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hotel 1</td>
<td>City A</td>
<td>6.4</td>
<td>Upper Midscale</td>
<td>99</td>
<td>Jun-67</td>
</tr>
<tr>
<td>Hotel 2</td>
<td>City B</td>
<td>5.6</td>
<td>Upper Midscale</td>
<td>110</td>
<td>Sep-08</td>
</tr>
<tr>
<td>Hotel 3</td>
<td>City C</td>
<td>2.7</td>
<td>Upper Midscale</td>
<td>85</td>
<td>Jun-15</td>
</tr>
<tr>
<td>Hotel 4</td>
<td>City X</td>
<td>1.4</td>
<td>Upper Midscale</td>
<td>60</td>
<td>Jan-05</td>
</tr>
<tr>
<td>Hotel 5</td>
<td>City X</td>
<td>0.8</td>
<td>Upper Midscale</td>
<td>79</td>
<td>Oct-06</td>
</tr>
<tr>
<td>Hotel 6</td>
<td>City D</td>
<td>3.4</td>
<td>Upper Midscale</td>
<td>94</td>
<td>Sep-06</td>
</tr>
</tbody>
</table>

Source: Smith Travel Research

The proposed hotel is a 94-unit upper-midscale, franchised hotel to be built in the heart of a major development area in City X, CA, and is expected to attract a broad spectrum of leisure and business guests. Given the location, size, and target market of the proposed hotel, six upper midscale franchise hotels located within a seven-mile radius of the proposed destination have been selected to include in the competitive set for the STR report. The amenities and services provided by the hotels in this particular competitive set include complimentary breakfast and wireless internet access, a business center, fitness center, and swimming pool, as well as either a guest laundry facility or off-site laundry services. Additional amenities and services such as complimentary weekday newspaper services, complimentary local calls, and in-room movies are also offered by some of
these hotels, perhaps, as either a brand standard or a way of differentiating their products from the competition, or both.

Financial Analysis

**Historical market growth trend.**

Table 2 provides historical market performance data in terms of occupancy, ADR, and RevPAR. The number of occupied rooms and available rooms are provided by STR to demonstrate any changes in supply the market has experienced in the last several years.

**Table 2**

**Historical Market Growth Trend (2010 - 2015)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Occupied Rooms</th>
<th>Available Rooms</th>
<th>Occupancy</th>
<th>ADR</th>
<th>RevPAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>82,839</td>
<td>161,450</td>
<td>51.3%</td>
<td>$87.96</td>
<td>$45.13</td>
</tr>
<tr>
<td>2011</td>
<td>90,755</td>
<td>161,330</td>
<td>56.3%</td>
<td>$86.98</td>
<td>$48.93</td>
</tr>
<tr>
<td>2012</td>
<td>98,859</td>
<td>161,330</td>
<td>61.3%</td>
<td>$84.90</td>
<td>$52.03</td>
</tr>
<tr>
<td>2013</td>
<td>115,632</td>
<td>161,330</td>
<td>71.7%</td>
<td>$84.54</td>
<td>$60.59</td>
</tr>
<tr>
<td>2014</td>
<td>116,854</td>
<td>161,330</td>
<td>72.4%</td>
<td>$86.48</td>
<td>$62.64</td>
</tr>
<tr>
<td>2015</td>
<td>136,881</td>
<td>179,520</td>
<td>76.2%</td>
<td>$94.41</td>
<td>$71.98</td>
</tr>
<tr>
<td>Average</td>
<td>106,970</td>
<td>164,382</td>
<td>65.1%</td>
<td>$87.84</td>
<td>$57.16</td>
</tr>
</tbody>
</table>

Source: Smith Travel Research

Table 2 indicates that the supply of hotel rooms in the City X market remained the same from 2010 to 2014. The opening of Hotel 3 in June 2015 accounts for the increase in supply to the market for the year 2015 in the table above. Even with the addition of these rooms, the number of occupied rooms in the market continued to increase year over year.

A change in the market worth noting is the year over year decline in the average rate from 2010 to 2013. In that time, the average room rate fell from approximately
$88.00 to roughly $84.50. The decline would have had a negative impact on the market had the occupancy rate not increased dramatically from 51.3 percent to 71.7 percent in that four-year span. Additionally, the RevPAR growth indicates that the market continued to improve in performance each year for the 2010 to 2013 time period.

In the years to follow, the performance of the market continued its trend upward. The occupancy and average rate both increased in 2014 and again in 2015 despite the addition of supply to the market in June of that year. The climb in RevPAR from $62.64 in 2014 to $71.98 in 2015 suggests that the current state of the overall competitive hotel market is very healthy.

**Day of week analysis.**

Table 3 presents market performance data for each day of the week by year for the past few years as well as a three-year average of the daily market performance. Such information provides insight on how demand activity changes throughout the week.
Table 3

Day of Week Analysis over Three-Year Period

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Occupancy</td>
<td>ADR</td>
</tr>
<tr>
<td>Sunday</td>
<td>58.7%</td>
<td>$81.54</td>
</tr>
<tr>
<td>Monday</td>
<td>67.4%</td>
<td>$81.69</td>
</tr>
<tr>
<td>Tuesday</td>
<td>73.1%</td>
<td>$82.97</td>
</tr>
<tr>
<td>Wednesday</td>
<td>73.3%</td>
<td>$83.99</td>
</tr>
<tr>
<td>Thursday</td>
<td>73.6%</td>
<td>$85.17</td>
</tr>
<tr>
<td>Friday</td>
<td>75.0%</td>
<td>$86.72</td>
</tr>
<tr>
<td>Saturday</td>
<td>81.6%</td>
<td>$89.89</td>
</tr>
<tr>
<td>Average</td>
<td>71.8%</td>
<td>$84.78</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>April 2015 - March 2016</th>
<th>Three-Year Average</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Occupancy</td>
<td>ADR</td>
</tr>
<tr>
<td>Sunday</td>
<td>62.2%</td>
<td>$91.03</td>
</tr>
<tr>
<td>Monday</td>
<td>71.7%</td>
<td>$92.11</td>
</tr>
<tr>
<td>Tuesday</td>
<td>77.3%</td>
<td>$94.24</td>
</tr>
<tr>
<td>Wednesday</td>
<td>79.0%</td>
<td>$93.98</td>
</tr>
<tr>
<td>Thursday</td>
<td>77.5%</td>
<td>$96.04</td>
</tr>
<tr>
<td>Friday</td>
<td>81.2%</td>
<td>$98.61</td>
</tr>
<tr>
<td>Saturday</td>
<td>88.6%</td>
<td>$102.36</td>
</tr>
<tr>
<td>Average</td>
<td>76.8%</td>
<td>$95.80</td>
</tr>
</tbody>
</table>

Source: Smith Travel Research

Analysis of the data presented in Table 3 revealed a key pattern in the day-to-day performance of the overall competitive market. From April 2013 to March 2016, the market yielded year over year increases in occupancy, ADR, and RevPAR, further suggesting that the competitive market is gaining strength and becoming healthier each year.

Table 3 also points out that the average occupancy for the three years climbed from 60.6 percent on Sunday to 69.2 percent on Monday and increased again by approximately five-and-a-half percent on Tuesday. Aside from a slight decrease in
occupancy from Wednesday to Thursday, the trend of increasing occupancy continued through to Saturday. Overall, the year over year growth in occupancy for both the weekdays and the weekends strongly represents the market’s ability to generate both commercial and leisure demand.

Similarly, the ADR for the three years gradually increased from $85.81 on Sunday to $95.96 on Saturday, indicating that the hotels in the competitive market have historically generated more daily room revenue as the week progresses. Moreover, the combination of a higher ADR and occupancy level on Friday and Saturday suggests that the competitive market has historically performed more efficiently on those two days. Since RevPAR serves as an indicator of the overall strength of the market, the significantly higher RevPAR for Friday and Saturday further supports this statement.

**Market projections.**

The occupancy and ADR of the competitive market in Table 4 were estimated based on the analysis of the historical occupancy and average daily rates achieved, the anticipated impact of new supply entering the market, and the changing economic conditions for the proposed hotel.
Table 4

Performance Projections for the Competitive Market

<table>
<thead>
<tr>
<th>Year</th>
<th>Occupied Rooms</th>
<th>Available Rooms</th>
<th>Occupancy</th>
<th>ADR</th>
<th>RevPAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>157,731</td>
<td>192,355</td>
<td>82.0%</td>
<td>$113.00</td>
<td>$92.66</td>
</tr>
<tr>
<td>2017</td>
<td>153,884</td>
<td>192,355</td>
<td>80.0%</td>
<td>$117.00</td>
<td>$93.60</td>
</tr>
<tr>
<td>2018</td>
<td>163,418</td>
<td>209,510</td>
<td>78.0%</td>
<td>$121.00</td>
<td>$94.38</td>
</tr>
<tr>
<td>2019</td>
<td>176,799</td>
<td>226,665</td>
<td>78.0%</td>
<td>$125.00</td>
<td>$97.50</td>
</tr>
<tr>
<td>2020</td>
<td>176,799</td>
<td>226,665</td>
<td>78.0%</td>
<td>$129.00</td>
<td>$100.62</td>
</tr>
<tr>
<td>2021</td>
<td>176,799</td>
<td>226,665</td>
<td>78.0%</td>
<td>$133.00</td>
<td>$103.74</td>
</tr>
<tr>
<td>2022</td>
<td>176,799</td>
<td>226,665</td>
<td>78.0%</td>
<td>$137.00</td>
<td>$106.86</td>
</tr>
<tr>
<td>2023</td>
<td>176,799</td>
<td>226,665</td>
<td>78.0%</td>
<td>$141.00</td>
<td>$109.98</td>
</tr>
</tbody>
</table>

For example, with the competitive market already performing above its long-term level of stabilization, the occupancy level is expected to drop slightly to 80 percent in 2017 before stabilizing at 78 percent in 2018 and thereafter. In addition, the expectation that the market will absorb the new supply of hotel rooms entering in mid-2018 without affecting the market occupancy levels leads to the anticipation that the competitive market will realize substantial year over year growth in ADR and RevPAR over the projection period.

In 2016, the market is projected to achieve a $109.00 ADR and an $89.39 RevPAR. By 2023, the ADR and RevPAR are targeted to reach $141.00 and $109.98, respectively. This anticipated growth in ADR and RevPAR is needed to compensate for the economic changes associated with the increase in operational costs that will incur as a result of the California minimum wage increasing incrementally to $15 per hour over the next several years as well as any other unforeseen economic changes that may impact profitability in the years to come.

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Proposed hotel projections.

In addition to the historical occupancy and average daily rates, projections for the proposed upper-midscale hotel also considered the location and quality level of the competitive hotels in the market area. Estimates of the occupancy and ADR for the proposed hotel are presented in Table 5.

Table 5

<table>
<thead>
<tr>
<th>Year</th>
<th>Occupied Rooms</th>
<th>Available Rooms</th>
<th>Occupancy</th>
<th>ADR</th>
<th>RevPAR</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>12,523</td>
<td>17,155</td>
<td>73.0%</td>
<td>$123.00</td>
<td>$89.79</td>
</tr>
<tr>
<td>2019</td>
<td>26,076</td>
<td>34,310</td>
<td>76.0%</td>
<td>$127.00</td>
<td>$96.52</td>
</tr>
<tr>
<td>2020</td>
<td>26,762</td>
<td>34,310</td>
<td>78.0%</td>
<td>$131.00</td>
<td>$102.18</td>
</tr>
<tr>
<td>2021</td>
<td>26,762</td>
<td>34,310</td>
<td>78.0%</td>
<td>$135.00</td>
<td>$105.30</td>
</tr>
<tr>
<td>2022</td>
<td>26,762</td>
<td>34,310</td>
<td>78.0%</td>
<td>$139.00</td>
<td>$108.42</td>
</tr>
<tr>
<td>2023</td>
<td>26,762</td>
<td>34,310</td>
<td>78.0%</td>
<td>$143.00</td>
<td>$111.54</td>
</tr>
</tbody>
</table>

The proposed hotel is anticipated to achieve an occupancy level of 73 percent and ramp up to 76 percent in its first full year of operation. Since the hotel is a high-quality, upper-midscale product affiliated with an established and recognizable brand and situated adjacent to the freeway and new shopping and commercial developments, the proposed hotel is also expected to capture its fair share of the market at a stabilized occupancy level of 78 percent by 2020. Taking into account that such factors position the proposed hotel to capture both commercial and leisure demand, the ADR for the six months of operation in 2018 is estimated to be $119.00 with a RevPAR of $86.87. While this ADR is two dollars higher than the ADR for the competitive market in 2018 (Table 5), the consequence of attaining a lower occupancy level in comparison to the competitive market is a lower RevPAR. Given that the proposed property is newer and of higher
quality than its competitors, the ADR and RevPAR are both expected to be higher than that of the competitive market for the remaining of the projection period once stabilization is reached in 2020.

**Valuation Analysis**

**Discounted cash flow.**

Table 6 demonstrates how a discounted cash flow analysis is utilized for estimating the fair market value of a proposed hotel. Ultimately, the developers will use this value to determine if the hotel project is financially feasible.

**Table 6**

<table>
<thead>
<tr>
<th>Year</th>
<th>Projected Revenue</th>
<th>Net Operating Income</th>
<th>Discount Factor at 12.2%</th>
<th>Discounted Cash Flow</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>$1,540,347</td>
<td>$585,332</td>
<td>0.891265597</td>
<td>$521,686</td>
</tr>
<tr>
<td>2019</td>
<td>$3,311,601</td>
<td>$1,258,408</td>
<td>0.794354365</td>
<td>$999,622</td>
</tr>
<tr>
<td>2020</td>
<td>$3,505,796</td>
<td>$1,332,202</td>
<td>0.707980717</td>
<td>$943,174</td>
</tr>
<tr>
<td>2021</td>
<td>$3,612,843</td>
<td>$1,372,880</td>
<td>0.630998857</td>
<td>$866,286</td>
</tr>
<tr>
<td>2022</td>
<td>$3,719,890</td>
<td>$1,413,558</td>
<td>0.562387573</td>
<td>$794,968</td>
</tr>
<tr>
<td>2023</td>
<td>$3,826,937</td>
<td>$17,215,831</td>
<td>*</td>
<td>$8,629,206</td>
</tr>
</tbody>
</table>

**Estimated Value** $12,754,942

2024 Net Operating Income $1,494,914
Capitalization Rate 9.2%
Total Sale Proceeds $16,249,067
Less: Transactional Costs @ 3.0% $487,472.00
Net Sale Proceeds $15,761,595

*2023 net income of $1,454,236 plus sales proceeds of $15,761,595*
In the initial step, the RevPAR and the total number of available rooms from Table 5 are multiplied together to determine the projected room revenue through 2023. Assuming that the occupancy remains the same and the average daily rate increases to $147, the calculated RevPAR of $114.66 is multiplied by the total number of available rooms, 34,310, to produce a potential revenue of $3,933,985 that could be generated in 2024.

In the following step, the assumption that the proposed hotel will achieve a net operating income equivalent to 38 percent of the room revenue is used to determine the net operating income for each of the projected years, as well as for 2024. A discount factor of 12.2 percent is then applied to the each of the calculated net operating incomes in order to arrive at a discounted cash flow for each year except 2023. The net operating income for 2024, which is calculated to be $1,494,914, is then divided by a capitalization rate of 9.2 percent in order to produce a sale value of $16,249,067. Deducting three percent of this value for transactional costs results in a net sale value of $15,761,595. After adding this value to the net operating income for 2023, the new net operating income value, $17,215,832, is multiplied by the discount factor to arrive at a discounted cash flow of $8,629,206. Overall, the sum of the discounted cash flows for the years 2018 to 2023 produces an estimated net present value of $12,754,942 for the proposed hotel.
CHAPTER 5: CONCLUSION

The past decade has been marked by notable changes in hotel development activity in the United States in that the activity level is significantly higher today than it was in the several years following the financial crisis of 2008. The continuous rise in demand since the financial crisis coupled with consistent RevPAR growth, readily available financing, and low interest rates has instilled confidence in hoteliers to focus once again on building new hotels. As of February 2016, Smith Travel Research (STR) reports that approximately half a million new hotel rooms are either in construction, final planning, or in the planning stages (HNN, 2016). With such a large supply of rooms expected to enter the United States market in the near future, many hotel developers have turned to companies such as HVS and PKF, which was recently acquired by CBRE to perform feasibility studies on whether potential hotel projects should be pursued. Similarly, this study explores the feasibility of a hotel project in a Southern California city booming with development.

Three different types of analysis are used in this study: a market analysis, a financial analysis, and a valuation analysis. The results of such analyses have provided some fascinating insights into whether the developers should proceed with building this particular upper-midscale hotel. The items covered in this study are related to site evaluation, financial performance, and the value of the hotel in the open market. The findings from the site evaluation indicate that the selected site is suitable for hotel development as it is positioned in a location surrounded by major commercial, industrial, and retail development in addition to having ease of access to the nearby freeways as well as excellent visibility from those same freeways. In addition, the educational institutions
as well as numerous corporate offices, medical facilities, distribution centers, and industrial buildings, collectively, should serve as an excellent source of commercial demand for the hotel. With Disneyland, Hollywood, and several other major attractions a short driving distance away, the proposed hotel is expected to capture a substantial amount of leisure demand as well.

The findings from historical performance data presented by STR suggest that the year over year growth in market occupancy levels for both the weekdays and the weekend is a strong indicator that commercial and leisure demand have both increased significantly over the last several years. Since the average daily rates increased year over year as well, the market also experienced continuous RevPAR growth in those years. With the ongoing development and relocation of major corporations to the area, the performance of the competitive supply in the market is projected to improve dramatically over the next several years. Taking into consideration that the ongoing and planned development is taking place in the immediate area surrounding the proposed site, the proposed upper-midscale hotel is expected to outperform competitive the market after stabilizing in its third year of operations. As a result, the findings from the valuation analysis indicate that the proposed hotel is expected to be profitable if built. A major indicator of that is the year over year growth in the net operating income projected for the forecasted years. Overall, the findings from the different methods of analysis performed in this study make a strong case in favor of recommending to build the proposed upper-midscale hotel in City X, California.
This research examined only one source of secondary data in the market analysis. Although CBRE is well-recognized for their market study services, future studies should examine market data from multiple sources to understand the market of interest from multiple perspectives, especially when making a determination on whether the proposed site is suitable for the development of a hotel. Supplemental to examining market data from multiple sources, interviews with key contacts for the major businesses and industries in the market area as well as with general managers of other hotels and representatives of the city and chamber of commerce should be conducted to further validate that the information received from companies such as CBRE is accurate.

Additionally, the discount and capitalization rates utilized in the valuation analysis are average rates for all limited-service hotels in the United States market in 2015. If possible, future studies should utilize rates specific to the market of interest in order to estimate a value that more accurately reflects the potential value of the proposed hotel.
REFERENCES


