



Building Success. Together.

# **An Intermediate Guide to Hotel Underwriting**

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## Course Objectives:

- Define the difference between full service and limited-service hotels
- Identify demand generators for hotel stays
- Learn how to estimate income & operating expenses for hotels
- Understand feasibility studies for new hotels
- Discover the significance of what **RevPAR**, **PIP** and **ADR** mean and how they are used
- Learn how to read and understand a **STR** report and which components are most valuable
- Discuss loan structure that can enhance probability of repayment
- Regulatory pitfalls when reviewing appraisal to determine the “real property value”
- How to identify seasonality of a property and how to account for it when structuring the loan

## Hotel Lending

- Hotel Lending is a blend between a loan for a business and for a building.
- Underwriting both is key
- The deal relies on a combination of the strength of the **brand**, **management**, and **property characteristics**.

# Full-Service Vs Limited Service

Is the hotel providing the experience or a need for the accommodations –  
Or is it BOTH?



## Full Vs Limited Explanation



### FULL

- Higher scale amenities
- More about the “Experience”
- Bars/Restaurants
- Full service dining options
- Conference rental space/meeting rooms



### LIMITED

- essential amenities
  - provides basic needs of travelers
  - More streamlined experience
  - Cost Effective/budget conscious
- Complimentary breakfast/small  
cafe'/vending

# Hotel Income



**Primary source of income for most hotels is room revenue**



**Other sources of revenue include:**



**Conference/Meeting space rental**




**Restaurant/Bar income**




**Rental income from 3<sup>rd</sup> party**

# Hotel Expenses

 **Labor/Payroll expense- 15-35%**

 **Franchise Royalties- 5-10%**

 **Utilities- 5-10%**

 **Insurance (Property & Liability)- 5-7%**

 **Property Taxes- 5-7%**

 **Other Expenses (supplies, repairs and maintenance)- varies**

# Occupancy, ADR, & RevPAR

Occupancy =  
occupied rooms /  
rooms available

ADR (average daily  
rate) = total room  
revenue/occupied  
room days

RevPAR (revenue  
per available  
room) = occupancy  
x ADR

## The Property - Demand Generators



A good initial starting point for reviewing a property would be determining where the hotel's location is in relation to demand generators.

***Ask... what are the outside economic drivers that affect this hotel?***

# The Property - Demand Generators



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**Beaches**

**Venues**

**Convention Centers**

**Airports**

**Tourism Areas**

**Hospitals**

**Halfway points between destinations**

**Capital Cities**

***Ask... what are the outside economic drivers that affect this hotel?***

## Property Demand Generators - Recreation



BEACHES



AMUSEMENT PARKS



MOUNTAINS/MOUNTAIN SPORTS



CASINOS



MUSIC VENUES



AIRPORTS

# Property Demand Generators - Commercial



CONVENTION  
CENTERS



HOSPITALS



TRANSPORTATION  
HUBS



CONSTRUCTION  
PROJECTS



GOVERNMENT



MAJOR  
EMPLOYERS

## STR Report

See handout of actual STR Report

# Credit Risks Associated with Hotel Lending

- Special use property
- Fixed costs (taxes, insurance, utilities)
- Brand required PIP (Property Improvement Plan)
- Weak management



## The Property - Management

Another key component when accessing the performance of the property is the management.

- Look at financial performance and online reviews of management's existing properties





# The Property – Franchise

## Branding Standards



## PIP (Property Improvement Plan)

- Required capital investment by the franchisor to maintain brand standards
- Typically required every 5-7 years, depending on brand level
- Full service & premium brands have more rigorous brand standards and PIP cost



## Components of a Hotel Appraisal



Real Property \$2,500,000  
Furniture/Fixtures/Equip \$300,000  
“Enterprise” Value \$200,000  
**Total Value \$3,000,000**

How much could/should/would you  
lend on this property?

## Components of a Hotel Appraisal

Bank policy advance rates:

-80% on commercial real estate

-50% on used equipment

$\$2,500,000 \times 80\% = \$2,000,000$

$\$300,000 \times 50\% = \$150,000$

$\$200,000 \times 0\% = \$0$

**Total Loan \$2,150,000 (71.7% of total appraisal)**

## Properly Structuring The Hotel Loan

- Choose an appropriate amortization for the property type/age.
- Provide an irregular payment structure for seasonal properties.
- Consider a maintenance or replacement reserve.
- Escrowing for property taxes and insurance can help both the borrower AND the bank.
- Covenants (Minimum DSC of 1.25x, no additional debt)



## Reporting Requirements

- STR Report
- Quarterly Financials
- Annual individual guarantor tax returns
- Property Inspections



# The Big Picture

To successfully underwrite in Hotel Lending,  
You must consider three crucial components to receive the  
“Big Picture”

- The Property itself (condition, location, etc.)
- Management and Experience (past performance)
- Borrower Post Closing Liquidity (strength of guarantor)



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