SUMMIT
INVESTMENT RESEARCH

Hospitality Investors Trust's Updated NAV Highlights Issues with Non-Listed REIT Valuations

On 6/19/17, the board of Hospitality Investors Trust approved an estimated net asset value per share of $13.20 as of 3/31/17, which is a significant 39% decline from its previously reported $21.48 as of 3/31/16. An obvious question for investors is how did the value of a non-listed REIT with a stabilized hotel portfolio decline so much in one year, despite higher operating income and higher market prices. However, the critical question for investors is how and why the "independent" board of Hospitality Investors Trust previously approved a clearly unsupportable and inflated net asset value.

The board of Hospitality Investors Trust highlighted three factors for the significant valuation decline. First, they noted that the recent valuation utilized less aggressive assumptions. Second, they pointed to higher terminal cap rates, which means that they now project a lower liquidation price in the cash flow model. Third, they highlight stock dilution, as Hospitality Investors Trust suspended its cash distribution in April 2016 and began paying a stock distribution. However, they fail to recognize that the improved portfolio performance and higher market prices over the past year supported a higher value.

A discounted cash flow model relies on three key assumptions that determine the estimated value. These are the annual rent growth, terminal cap rate, and discount rate. Hospitality Investors Trust did not disclose their rent growth assumptions. Compared to their previous $21.48 NAV as of 3/31/16, Hospitality Investors Trust had a higher terminal cap rate: 8.2% at 3/31/16 and 8.6% at 3/31/17, which would reduce the reported value. And, Hospitality Investors Trust utilized a higher discount rate: 9.2% at 3/31/16 and 9.6% at 3/31/17, which would also reduce the reported value.

Of the three factors highlighted by the board of Hospitality Investors Trust for the valuation decline, the higher terminal cap rates and stock dilution would account for less than half of the valuation decline. The majority of the valuation decline would be based on the "less aggressive" assumptions. Like the higher terminal cap rate, the higher discount rate has only a small impact on the valuation. As a result, the rent growth assumptions would be the critical factor for the lower net asset value; however, the board of Hospitality Investors Trust does not disclose these rent growth assumptions.

Based on Summit's market value estimate as of 3/31/17, which is available by subscription, Hospitality Investors Trust's $13.20 NAV at 3/31/17 is now a reasonable valuation. However, Summit's market value estimate as of 3/31/16 is nearly half of their previously reported $21.48 NAV, and Summit can find no reasonable or supportable basis for the previous $21.48 NAV. This result raises the critical question of how and why the "independent" board of Hospitality Investors Trust previously approved the clearly unsupportable and inflated NAV. The inevitable shareholder lawsuits will hopefully answer this question.