

The Price You Paid for Your Hotel Isn't Market Value - By David C. Lennhoff, MAI, SREA, CRE

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The recent strong market has resulted in an inevitable increase in real estate assessments for most hotels. Although some increases are justified, and in line with market value, others represent overly optimistic opinions. Property owners need to be vigilant if they want to ensure they receive fair property tax assessments.

As an owner, you should routinely review your assessments. If an irregularity is suspected, this calls for a meeting with the assessor. To make this an important and effective meeting, you must be prepared. So, what should you expect? The assessor will confront you with sales comparables. Recent hotel sales have been at record levels and you will need to be prepared to explain why those prices are not indicative of the market value of your property.

Furthermore, if your own property has been involved in a recent transaction, you can bet you'll be asked to explain that price. If you can't explain why these amounts should not be considered prima-facie evidence of your property's value, then, in all likelihood your concerns will be summarily dismissed by the assessor.

Three Reasons a Sale Price Might Not Be Market Value

Assessors continually view the sales comparison approach as the most meaningful and reliable method for valuing property. Not the case with hotels. In fact, appraisal texts often suggest the method has little, if any, application to a hotel real property valuation other than as a check on the conclusions reached by the more appropriate income and cost approaches. Here are three good proofs of this truth, which hotel owners can use in making a case to the assessor.

1. Sales Reflect the Total Assets; Assessments Should Reflect Only the Real Property

Most hotel transactions represent the sale of the total assets of the business, meaning they include not just the real property (bricks and mortar) but the tangible and intangible personal property, too. In addition, the sales price is not often properly allocated among the tangible and intangible components on the deed. Thus, the assessor gets the impression that either the nonrealty components do not exist or have such little significance that they can be ignored. Much to the contrary, many times the tangible personal property is substantial-as in hotels that feature expansive art collections, such as the Washington DC Park Hyatt. And the intangibles can contribute even more, most of the time exceeding 20+% of the total assets.

Although some assessors will attempt to adjust the sales price of an operating hotel to reflect the value of only the real estate, it is a near impossible task. The difficulty arises when assessors try to value franchise affiliation, restaurants, spas and reputation (the operating business), and separate it from the real estate value. Such adjustments are too speculative to be credible.

With hotels, unallocated sales are most times meaningless in terms of an indication of the real property's value. On the other hand, allocations of the total assets on the recorded deed present strong evidence of at least an effort to separate the categories. When the allocation is done by an expert, this becomes even more compelling evidence of the real property contribution to the total price paid. Unfortunately, day in and day out no allocation exists. Although there may be various reasons for not allocating, the reality of the situation remains, if the price has not been allocated, the assessor interprets that to mean the purchase price represents the value of the real property. This can be a nearly insurmountable obstacle to a resolution of a discrepancy between market value and the assessment.

The assessor sees any allocation done at the time of an assessment appeal as only a 'tactic' to lower taxes. This perception is unfortunate because the failure of an uninformed buyer to recognize the significance of allocating the purchase price does not constitute a mere tactic to reduce an assessment.

A similar obstacle recurrently emerges when a loan has been underwritten on the hotel based on an appraisal in which the value wasn't allocated. These appraisals are repeatedly discovered through the legal process as a case moves closer to litigation. In such appraisals, frequently the appraiser doing the appraisal lacks the necessary depth of understanding about the issues. In fact, in many instances the title describing these appraisals appears as 'An Estimate of the Market Value of the Hotel.' This, by itself, is meaningless because market value acts as a modifier of sorts, and must be accompanied by the answer to the question, market value of what? Is it the market value of the total assets or just the real property? Usually, a report written with a title as indicated above represents an estimate of the value of the total assets, masquerading as the value of the real property. As such, it suffers the same drawbacks as trying to use the sales comparison approach to value, and is inapplicable to the value of the real property for all the same reasons.

2. Multiple Properties Sold Simultaneously Provide No Proof of Market Value

Hotel transactions regularly comprise more than one property. Moreover, any allocation of the total price among the various properties is often cursory at best and not truly representative of the individual property market value. These portfolio transactions are next to impossible to use as comparable sales.

3. Buyer Motivations Bear No Relationship to Market Value

Buyers commonly purchase for reasons unrelated to market value. Sometimes their business structure allows an otherwise overpriced purchase to be an acceptable investment. Perhaps a need to get money out the door motivates the buyer, or maybe income tax reasons drive the decision, or it might simply reflect the need to make an entry into a particular market. A purchase of this type might represent investment value to the particular investor, but it does not constitute market value. REITS often make these types of purchases, and they never come close to being comparable to any other purchase.

When the Assessor Uses Your Hotel as a Comparable

Assessors are particularly likely to zero-in on a recent transaction completed by the taxpayer contesting his taxes, as they well should. In pure real estate plays, a transaction usually provides excellent evidence of the market value of the property as of the date it sold. Of course, adjustments for conditions of sale and perhaps financing might distort the price, but everything else being equal, an appraiser will be hard pressed to find a transaction of another property so similar in physical and locational characteristics.

Conclusions

Using individual sales comparables or the sales comparison approach, including the sales price of the taxpayer's own property, usually provide poor indicators of a property's market value. At best, transactions involving a going business concern (such as a hotel) that show the sales price on the deed merely indicate what the real property couldn't possibly be worth. Owners and their representatives need to attend any meeting with the assessor fully prepared to educate the assessor as to why an unallocated purchase price could not possibly equal market value.

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