New Approach Produces Hotel Property Tax Reductions - By Jim Popp, Esq.

2008-01-09

A two step process has become the most common method used to value a hotel for property tax purposes. The first step calls for applying the income approach, which values the total assets of a hotel's business. The next step requires an allocation of the total assets of the business to segregate the real property, personal property and business enterprise components.

Although this approach is well accepted in the appraisal community and the appraisal literature, it often draws opposition from property tax authorities. To address this opposition, the following alternative valuation method has been employed successfully in negotiations with tax authorities. Its success results from the fact that the approach is similar to the methodology tax authorities frequently use on less complex properties. That makes it easy to explain and tax authorities are comfortable with its use.

The key issue in this alternative valuation method involves the use of fee simple principles applied to the income approach. A distinction exists in the application of the income approach generally used for property tax purposes (the fee simple approach) and the application used for acquisitions, due diligence or financing considerations (leased fee approach).

In using fee simple, income parameters are developed from the overall market rather than from the specific parameters of the property being assessed. Specifically, the fee simple approach determines market rent/income and occupancy and utilizes these factors in developing market values. Conversely, the leased fee approach uses the actual rent/income of the property and the actual occupancy. The differences in resulting value may be significant.

The concept of the fee simple income approach has been generally applied and accepted with regard to office buildings, apartments, retail centers and similar properties and is uniformly used by tax authorities. They are familiar with its application and derivation. Generally, the fee simple income approach has not been explicitly applied to hotel properties.

However, several hotel owners and appraisers have successfully applied the approach to hotel properties. They determined the fee simple characteristics of the hotel in comparison to its leased fee characteristics and then made an adjustment to deduct the business enterprise component from the income stream.

Of course, the first step requires the taxpayer to determine the hotel's competitive set. Then, a review of the income attributes of the competitive set is conducted to determine such components as REVPAR, room rates and occupancy. The market place rate for these components should be determined and then applied to the taxpayer's hotel. For example, if the REVPAR of the competitive set equals $100 and the REVPAR of the hotel property comes in at $120, the income stream of the hotel for purposes of the property tax income approach should be adjusted to the market REVPAR of $100.

The result of this adjustment process produces the fee simple income approach value attributable to the total assets of the hotel's business. The next step calls for subtracting the remaining business enterprise value portion. The hotel's brand name represents the most significant business value component. Some, but not all of this was subtracted in the REVPAR analysis. The remainder of the brand name is removed in this step. In addition, deductions should be made for such business intangibles as work force in place, working capital and profit centers.

This alternative approach has been used successfully in the property tax trial of a major brand full service hotel. In point of fact, a most practical use of the approach lies in negotiations with tax authorities. The breaking of the process into steps provides tax authorities with a more understandable and comfortable approach under which to evaluate possible tax reductions.

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