HVS

How to Lower the Property Taxes on Your Hotel or Restaurant

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Property tax assessors intend to assess property fairly. They want a given property's assessment to be both representative of its market value and logical in comparison to similar properties. But their job is difficult, particularly for complicated assets. Property tax appeals for hotels— particularly fullservice assets with multiple profit centers and extensive personal property— are especially complex, requiring an expert in the field of hotel appraisals and seasoned in a proven methodology.

The following serves as a cursory guide for owners who think their hotel's assessment might be illogically high, including the key steps to waging a successful appeal.

Can we make a case?

A successful appeal requires a legitimate case for a meaningful reduction. Sometimes the case is obvious. Maybe the economy has declined, but your assessment has not. Or perhaps a wave of new hotel inventory has entered the market, causing rooms revenue to fall off. Capitalization rates may have climbed as the result of either increased capital costs or constricting debt markets. Assessors should respond to these external (economic) factors, but adjustments could be overlooked or delayed, to the detriment of your tax burden.

In today's relatively robust economy, a property tax appeal is more often associated with internal (property-specific) factors. The explanation and analysis of external factors such as those noted above are usually based on economic indicators that are beyond debate. In contrast, property-level factors that affect tax assessments tend to be more esoteric, requiring expert analysis. Here are some examples of internal factors that can adversely affect a hotel's market value.

The subject property has reached a juncture in its life cycle. With increased age, its ability to compete with newer hotels with more preferred brand affiliations has declined. The industry terms this "functional obsolescence," an often incurable condition that systemically sends the property into a lower echelon of the market.

The property's franchise agreement is expiring but can be renewed, provided ownership completes a comprehensive renovation and redesign. In other words, the property's functional obsolescence is curable. The cost will be several million dollars, but is necessary for the subject property to keep pace with the market and maintain both its franchise and its competitive position. The cost of this "keeppace" renovation represents a substantial reduction to the property's "as is" market value.

Sometimes a hotel is of relatively new construction, but its grade is over-improved relative to the market's economic capacity. Revenue levels are low when compared to the cost of operation. Even when optimally managed, the hotel's profit ratio will remain below national industry standards, and the property's market value will be well below its construction cost.

Making Nuanced Arguments

Assessors are often not equipped to account for internal factors. For example, the subject property may have a healthy, stable income and at the same time require a multimillion-dollar renovation in order to maintain both its

Summary

Factors both internal and external to a hotel property affect its value, and in turn, its property tax burden. In most cases, an experienced hotel appraiser, employing a proven appeal protocol, is needed to determine whether a property is unfairly assessed.

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brand and performance level over the long term. This capital obligation should reflect a dollar-for-dollar reduction in the property's "as is" market value. Potential buyers of the property recognize this reality, which bears out in the hotel transactions market. It is less obvious or simple to explain, however, in the courtroom.

Furthermore, assessors often base their valuations on an income projection that assumes a nationalaverage net profit ratio. This methodology is often insensitive to the specific design limitations of the subject hotel. The national averages are informative to some extent, but there are situations where the assessor's practice overstates the property's true economic potential. In fact, an estimate of a given property's stabilized net income should be based on a combination of the hotel's historical performance and the operating results of truly comparable properties. Assessors, however, through no fault of their own, often lack access to genuinely comparable market data.

These issues highlight the importance of finding an expert who can a) communicate the nuances that form the basis of an appeal, and b) validate their conclusions with market-derived data.

Personal Pitfalls

Personal property is an important variable in a property tax appeal. Because hotels are sold with their furnishings in place, a given hotel's sales price includes both real and tangible personal property components. Replicating the methods of hotel buyers and lenders, an appraiser's valuation methodology will initially render a total property value inclusive of tangible personal property. For a property tax appeal valuation, the tangible personal property component is then removed, in order to isolate the real property component.

The methodology used for allocating value to the hotel's real property depends on the assessment and taxation policy of the taxing authority and often requires sensitivity to a number of theoretical and practical issues. For example, in counties or municipalities where personal property is assessed, it is often appropriate to use the assessed value reported by property ownership. But if personal property is taxed at a different rate than real property, the variation must be accounted for in the methodology.

For jurisdictions where personal property is not taxed, the matter of determining the correct valuation methodology is open to debate. Often the current book value will serve the purpose, but if the hotel's interiors include valuable artwork or custom-designed furnishings, it might make sense to hire a personal-property appraiser.

An appraiser with expertise in hotels will also give careful consideration to the removal of income/value attributable to intangible personal property components such as business value and goodwill.

Selecting The Right Expert: The Rushmore Approach

Knowing when a case exists and how to communicate it are fundamental for a successful appeal of a hotel's taxable value. Equally elemental is the selection of an appraiser who knows and applies the Rushmore Approach, a valuation methodology conceived by HVS founder Steve
Rushmore and refined by HVS professionals over 35 years of practice. The Rushmore Approach replicates the underwriting and due-diligence practices of actual hotel buyers and lenders. Importantly, it is also the approach most widely accepted and used by property tax assessors. Use of the Rushmore Approach assures that a common language will be spoken in the courtroom, avoiding confusion over terminology and methodology.

The process of hiring an appraiser should occur in tandem with the process of determining whether or not a case can be made for a value reduction. Following a cursory review of a hotel's recent financials and a discussion of the significant issues facing the property (for example, the precense of an expiring franchise or the need for a major "keep-pace" renovation), an appraisal expert in property tax appeals will in most cases be able to quickly determine whether it makes sense to proceed.

Conclusion

Lodging facilities rank among the most complicated kinds of real estate. Comprehensive, authoritative hotel appraisals address the complexity in full, taking all relevant factors— internal and external—into account in establishing a property's value. To ensure success, hotel property tax appeals should be performed by professionals with the experience necessary to ascertain the key issues affecting market value. They also need access to the data and other resources crucial to supporting their conclusions.

Finally, the use of the Rushmore Approach to valuation is essential, because it is the only universally accepted appraisal methodology for hotels, motels, resorts, and other lodging properties. True to the underwriting practices of actual hotel real estate market participants, the Rushmore Approach is the industry's lingua franca. In the process of approaching a property tax assessment appeal, make sure you engage an appraiser who speaks it well.

About Erich Baum

Erich Baum is a Senior Vice President with the HVS Boston office and has performed and overseen thousands of hotel appraisal and consulting assignments throughout North America, including an extensive list of assignments involving residential components and property tax appeal cases. Erich co-authored the 2001 edition of the Appraisal Institute's hotel valuation textbook, has written numerous articles on issues related to hotel appraisal and consulting, and regularly serves as an expert witness. Erich is a state-certified appraiser, and is a graduate of Cornell's School of Hotel Administration. For more information, contact Erich at +1 (603) 502-6625 or .