

The Valuation of Lodging Properties for Property Tax Purposes

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Introduction

Property taxes are a large line-item expense for most lodging properties. To make matters worse, double taxation and even triple taxation of some property components can occur, particularly with leased furniture, fixtures, and equipment (FF&E).

Hospitality properties can be overtaxed through the application of the wrong approach to value, the incorrect application of a correct approach to value, or through the owner's failure to prevent certain mistakes.

Tangibles and Intangibles

The tangible components of value are real estate (land and building) and personal/business property such as FF&E. Intangible components of value include: 1) contracts and assembled workforce; 2) intellectual property such as patents, trademarks, and copyrights; 3) brand, goodwill, and reputation; 4) other assets; and 5) residual income. Intangibles are not subject to ad valorem taxation / property taxes in most U.S. jurisdictions.

The Cost Approach to Value

The Cost Approach is most applicable to newer buildings that have stabilized income and expenses. It is applicable - with adjustments - to new buildings that have yet to reach stabilization. The Cost Approach is less applicable to older buildings, and is sometimes not applicable at all to buildings that are experiencing market or other factors that have caused income production to divert sharply from cost.

One normally does not think of lodging properties as experiencing long delays between being built and reaching "stabilized" occupancy. But, "lease up" should be taken into consideration in determining the market value of a newly constructed lodging property.

The Cost Approach is least applicable, and most damaging for property tax purposes, to lodging facilities that are underperforming. These include properties that face excessive competition, have substantial deterioration, are under franchisor restrictions, or have lost or experienced substantial downgrading in their flag or brand. These factors tend to manifest

themselves in the income and expense figures for the property and are best addressed by the Income Approach.

The Sales Comparison Approach

The Sales Comparison Approach can be very difficult to apply to lodging and hospitality properties. One variation of the Sales Comparison Approach is essentially a modified version of the Income Approach. It uses a gross income or net income multiplier. The other variation of the Sales Comparison Approach uses a unit of comparison such as sales price per room, per square foot, or per bed. Both an income multiplier or a unit of comparison is undesirable for property tax purposes because they fail to separate real estate value from personal property, business value, and intangibles. This can result in the property owner overpaying taxes if only the Sales Comparison Approach is used to determine value for property taxes. Worse yet, the unit of comparison method may not adequately reveal modest to severe limitations confronting a property, such as those mentioned at the end of the Cost Approach discussion above.

The Income Approach

The Income Approach is the most useful way of separating a lodging facility's real estate value and personal property value from intangibles and business value. The most detailed and useful income and expense information comes in the form of *The Uniform System of Accounts for the Lodging Industry* (USALI). But, owners or operators who keep less detailed books need not despair. Less detailed income and expense figures can also be examined with the help of a professional to provide a more useful breakdown of realty and non-realty components. A skilled appraiser with knowledge of the law can use the Income Approach effectively in property tax appeals.

Conclusion

It is difficult in a brief article to give a full overview of property tax advocacy for even the simplest of properties and lodging/hospitality facilities are one of the more complicated property types. This article gave a short summary of the pros and cons of the three approaches to value that are applicable to most hotels, motels, and other lodging facilities. It did not discuss property tax laws and procedures, which vary from state to state. Ultimately, the value of each property is dependent upon its unique economic and physical characteristics and requires individual analysis, whether for general valuation purposes or property tax advocacy.

To get the most favorable treatment when it comes to property taxes, it is important that property owners work with qualified professionals and that they try to do it well before deadlines for property tax returns and property tax appeals.

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