BEWARE OF REVPAR IN PROPERTY TAX VALUATIONS

When making adjustments for property tax purposes, use of RevPAR can inappropriately increase value.

By Greg Hart and Kevin Sullivan

When comparing hotels for valuation purposes, a common method of making adjustments for the difference between properties is to examine revenue per available room (RevPAR), a measurement of hotel performance. If executed poorly, these calculations can distort property value and lead to unfairly heavy tax burdens on hospitality owners.

There are two different ways to calculate RevPAR. The first is to multiply the average rental income per room by the number of rooms occupied, then divide by the number of days in the period. The other method is to divide total guestroom revenue by the number of available rooms and divide that figure by the number of days in the period.

In an article titled "Using RevPAR as a Basis for Adjusting Comparable Sales," published in February 2002 by HospitalityNet.org, appraiser Erich Baum voiced a common argument shared by appraisers who advocate for RevPAR adjustments. Baum contends that the adjustments are appropriate because the revenue a hotel generates is tied to its location and the quality of its product.

The question in valuation for property taxation is whether or not RevPAR incorporates additional, non-real estate values such as quality of brand, management, goodwill, etc., and whether or not the RevPAR adjustment reflects those non-real estate items.

If the appraiser's purpose is to compare values of hotels as a going concern, including all tangible and intangible items, this adjustment may make sense. If, however, the purpose is only to value the tangible real estate and exclude intangible business value, as in an ad valorem tax valuation, a RevPAR adjustment may be inappropriate.

Appraisers generally accept that there is intangible value associated with the going concern value of a hotel. The Appraisal Institute discusses this concept further in the 14th edition of The Appraisal of Real Estate (2013) Chapter 35, "Valuation of Real Property with Related Personal Property or Intangible Property." This is important in the world of ad valorem tax valuations because intangibles are not taxable.

Determining Values

To understand whether RevPAR adjustments are appropriate in a property tax setting, consider a nationally branded hotel that loses its brand. Compare the hotel to its closest competitors using a RevPAR adjustment both with and without its flag. Conversely, look at a non-branded hotel that becomes a nationally branded hotel and adjust its competitors' RevPAR using the same metrics.

Source Strategies produced a study to determine brand values by tracking the subsequent difference in revenue realized by hotels in Texas that gained or lost a nationally branded flag. A detailed examination of the study appeared in the summer 2012 edition of The Appraisal Journal.

Researchers compared hotels on the basis of their RevPAR index, which measures a hotel's performance relative to its competitive set. An index of 100 indicates that a subject hotel is getting its fair share of revenue in comparison to its competitors. An index higher than 100 indicates the subject is realizing more than its fair share of revenue and an index below 100 indicates the subject is realizing less.

Gaining or Losing a Brand

The study tracked five different brands of hotels in Texas between 1990 and 2010 and found that properties which or gained a national brand saw a respective drop or increase in their RevPAR index by as much as 40 percent. Two hotels from the brand study provide an opportunity to test the utility and appropriateness of RevPAR adjustments.

One of the hotels studied was a Hampton Inn in San Antonio. In 2004, its second-to-last year as a Hampton, the hotel was outperforming its competitive set. This is indicated by a RevPAR index of 109. The hotel's average daily rate (ADR) was $55.60, or 9.4 percent higher than its competitors' average of $50.82.

The year after the hotel lost its Hampton Inn brand, it operated as a non-branded hotel. That year the same competitive set outperformed the now non-branded hotel. The subject saw its RevPAR Index drop to 64, and its average daily rate fall to $39.89, or 35.7 percent lower than the $62.12 average in its competitive set.

Using a RevPAR adjustment would require a positive adjustment of 9.4 percent in one year and a 35.7 negative adjustment just two years later for the same real estate.

Now consider the effects of a RevPAR adjustment to a hotel that starts out as an independent hotel and then becomes nationally branded. The study showed that one such hotel in Houston went from unbranded to being a Holiday Inn Express. In 2004, its last year as an independent, this hotel generated less revenue than its competitors, as evidenced by the subject's RevPAR index of 51. The competitors' average daily rate was $29.52, or twice that of the subject's $14.72 ADR.

The year after the subject became a Holiday Inn Express it outperformed the same competitive set, as evidenced by the increase in its RevPAR index to 129. As a nationally branded hotel, the subject's ADR was $40.76, or 29.7 percent higher than the competing set's $31.43 ADR.

In both cases the RevPAR index changed significantly for the subject properties, while the real estate remained unchanged. The comps and methods of comparison remained the same. The only change was the removal or addition of the brand and its resultant change in revenue.

These results indicate that the revenue shift reflects the change in brand and possibly management or goodwill, none of which are a part of the real estate. Rather, they are separate and intangible components of the going concern. Because these items are tied to RevPAR, a RevPAR adjustment will entail adjustments to the differences in both the tangible real estate and intangible items such as brand, management and goodwill. RevPAR adjustments are therefore inappropriate when calculating only the tangible real estate value of a hotel. ■

Greg Hart is an attorney and tax consultant at the Austin, Texas, law firm Popp Hutcheson, PLLC, and Kevin Sullivan is an appraiser and tax consultant with the firm. Popp Hutcheson represents taxpayers in property tax disputes and is the Texas member of American Property Tax Counsel (APTC), the national affiliation of property tax attorneys. Hart can be reached at greg.hart@property-tax.com and Sullivan at kevin.sullivan@property–tax.com.

At **Pioneer Realty Capital** we understand that each loan request is unique and may fall outside general lending guidelines.

We provide our clients with access to non-bank lending sources that include pension funds, life insurance companies, real estate investment trusts, and private debt funds.

With 5-year fixed rates as low as 3%
Why not Call Us Today to experience *tailor-made* capital solutions.

Pioneer Realty Capital, LLC
2363 HWY 287 N, Ste 203
Mansfield, TX 76063
(682) 518-9416
www.pioneerrealtycapital.com