

## Hotel Property Tax Reductions: An Industry Breakthrough

A major flag hotel recently obtained a significant property tax reduction in a case that is expected by many observers to be a breakthrough from the traditional approaches to hotel valuation. The case involving a 1000 room convention hotel was tried to a jury and resulted in a value reduction of \$29 million. The approach utilized in this case could serve as a basis for property tax reductions for hotel owners throughout the United States.

Appraisers for the last 20 years have viewed a hotel property as a going concern consisting of real property, personal property and business enterprise value. The traditional approach estimated income attributable to the going concern and then extracted value attributable to the personal property and to the business enterprise value (generally represented by the management and franchise fee) to arrive at the real property value. This approach was first supported by the hotel industry and now, in a full circle swing is generally accepted by tax authorities.

However, this traditional approach, does not adequately address the real world expectations of an investor to receive not only a return on the investment in the real estate portion of a hotel but to also receive a return on the investment in the business enterprise portion of a hotel. The traditional appraisal methodology would suggest that a deduction of income equal to expense attributable to the management fee and the franchise fee results in the deduction of business value and thus represents a return on the business portion. However, an investor in a hotel does not consider management fees and franchise fees to be indicators of a return on business, as the traditional appraisal approach suggests, but rather, simply a cost of doing business.

The new appraisal strategy, first believed to be publicly addressed at the 1997 annual seminar of the American Property Tax Counsel (APTC), focused on the investor's perspective of return on real estate and return on personal property. The strategy was further developed in conversation with various valuation experts and fine-tuned in conversation with many of the twenty-eight member law firms of APTC. The law firm representing the hotel implemented the new strategy with a litigation team consisting of a MAI valuation appraiser, a hospitality industry expert, an MAI valuation theory and appraisal ethics expert and a fact witness from the hotel company.

In this case, the data indicated that the hotel out performed the competitive market. Thus, in order to appraise the hotel on a fee simple basis and to extract business value for the subject flag in excess of other competing flags, the appraiser stabilized the average occupancies and daily rates to those of the competition in the immediate market. This first step to valuation was quite different from the traditional approach and in and of itself resulted in a significant reduction.

Having stabilized income in relation to the competition, the appraiser then extracted additional income not only attributable to franchise and management but also to start-up costs, marketing and management skill, assembled workforce, working capital, licenses, non-realty related contracts and operating agreements. This step acknowledged that income is created from a whole host of business and real estate sources, not just management and franchise. Next, the income associated with return of and on the personal property was also deducted. Finally, a capitalization rate was selected after evaluation of the return associated with business risk and entrepreneurship as well as traditional real estate return requirements.

The coupling of the stabilized income step with a more refined business value extraction was a different but straight forward and successful method of hotel valuation for property tax purposes. This case represents one of the few successful trials of a case involving the separation of the business value from the going concern value of a major flag hotel. It represents a departure from traditional approaches and a breakthrough for the hotel industry for further successful appeals.

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Popp & Ikard is the Texas representative of the American Property Tax Counsel, a nationwide affiliation of property tax lawyers.