

## Are Your Hotel's Property Taxes on the Decline?

By **Thomas G. Dolan** and Christopher T. Elder, Dec 12, 2008

*An HVS property tax review has the potential to lower a hotel's tax burden and increase its profitability, especially in these troubling financial times.*

From 2003 through 2007, the hotel industry experienced unprecedented growth in terms of revenue per available room (RevPAR) and net operating income (NOI). Ultimately, hotel values recorded the highest levels in history. Normally, hotel owners would consider such increases in value a boon—except when it comes to calculating the hotel's real property taxes. In the midst of increasing capitalization rates and decreasing NOIs, it's time to consider how a hotel's real property assessment should be adjusted. The result could mean substantial savings for hotel owners.

### Valuation Methodologies and Tax Implications

Hotel valuation methodologies place the greatest emphasis on the income capitalization approach, which estimates a property's value in terms of its ability to generate financial returns as an investment. The income capitalization approach takes into consideration the cyclical nature of the hotel industry; hence, in theory, property assessment values should vary according to the cycle's ups and downs. The problem is that many municipalities do not reassess real properties every year, and even if they do, most tax assessors are not versed in the intricacies and fluctuations of the hotel market. This can result in a property tax assessment that doesn't necessarily reflect the true market value of the tangible real estate.

The key factor is stabilization, that is, whether or not a property's revenue was stabilized when it was reassessed. The stabilized year is intended to reflect the anticipated operating results of the property over its remaining economic life, given any or all applicable stages of build-up, plateau, and decline in the life cycle of the hotel. Thus, income and expense estimates from the stabilized year forward exclude from consideration any abnormal relationship between supply and demand, as well as any nonrecurring conditions that may result in unusual revenues or expenses.

Assessors often assume that values consistently increase, but the financial meltdown that began in the summer of 2007 has in fact contributed to the downturn of the hotel industry—and hotel values—in 2008. This decline is expected to continue into 2009 due to increasing cap rates and other less forgiving investment parameters.

In the current economic environment, controlling expenses becomes an integral part of a hotel's profitability. Most often overlooked are so-called fixed expenses, which typically consist of property taxes (real and personal property), insurance, and rent/leases. The perception that these expenses are actually fixed is somewhat misleading. Real property taxes, which are calculated by multiplying the tax rate by the real property assessment, can in fact be controlled through the revaluation of a hotel's real property assessment. The assessment is simply the real property market value multiplied by an equalization ratio, which is often 100 percent, but can also be lower or higher. Contrary to the ten-year discounted cash flow method utilized by many real estate appraisers to determine a hotel's value for financing, a hotel's value for assessment purposes is typically calculated through a direct capitalization method, whereby the appraiser capitalizes a one-year stabilized level of income and expense.

### The Industry Downturn's Effect on Assessments

What hoteliers need to understand is that many hotels may be over-assessed if the municipality based its stabilized level of income and expense or cap rates on data from 2004 through mid-year 2007, when hotel values began to reach their peak in many markets. By the end of 2007, supply had outpaced demand for the first time in five years, and hotels in many cities and towns across the U.S. began to experience lower occupancy as a result. Average rate growth helped RevPAR remain healthy in 2007; however, the downward trend has continued into 2008, which has resulted in revenue growth lower than inflation. Higher expenses have only worsened this situation.

More conservative valuation parameters have brought about increasing cap rates, which have in turn produced the greatest impact on value over the last two years. Mortgage interest rates have increased, amortizations have shortened, and loan-to-value ratios are lower. The lack of transactions in 2008 demonstrates a gap between what buyers are willing to pay and the asking price. More transactions should occur in 2009, but primarily at prices discounted from 2006 and 2007.

The Hotel Valuation Index (HVI), developed by Steve Rushmore and HVS, provides a rigorous analysis of trends in hotel value based on hotel value changes in 65 major markets and the U.S. as a whole. The HVI is developed by means of an income approach, using market area data provided by Smith Travel Research and operational and capitalization rate information from HVS, and is indexed to the 1987 U.S.A. value (1.0000).



### About Thomas G. Dolan

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The following table represents the historical yearly change in the value per room from 2000 through 2008 for each of the 65 major markets and the nation as a whole.

**HVI Change in Value per Key Market 2000-2008**

	2000	2001	2002	2003	2004	2005	2006	2007	2008
Las Vegas	33,464	(21,489)	8,577	49,500	44,225	(10,149)	(18,980)	9,539	(35,664)
Washington DC	21,092	(34,423)	10,825	8,690	51,480	55,734	(19,264)	21,929	(28,910)
Chicago	3,563	(54,108)	(9,106)	1,909	7,931	40,313	59,267	11,961	(15,484)
San Antonio	5,988	(6,765)	16,459	(8,573)	5,912	20,448	25,246	(18,942)	(14,958)
Oahu	42,008	(41,470)	7,682	26,148	71,767	112,335	10,194	(23,046)	(13,957)
Miami	3,885	(38,812)	(27,105)	17,226	52,454	87,337	10,794	49,272	(13,081)
Santa Fe	977	(9,077)	18,751	(10,322)	10,294	13,497	4,984	(14,590)	(11,255)
WPB - Boca Raton	18,630	(19,152)	(9,178)	12,697	55,913	34,646	2,694	(45,062)	(9,354)
Sacramento	14,610	(13,372)	2,304	2,805	9,445	5,287	21,353	(23,991)	(9,240)
Baltimore	18,918	(14,653)	16,068	1,115	12,703	7,781	10,969	(20,508)	(8,680)
Richmond, VA	2,225	(10,224)	1,208	14,218	6,486	7,401	11,304	3,022	(8,431)
Long Island	43,171	(23,349)	(21,818)	(6,880)	(3,990)	22,861	(9,392)	(3,100)	(7,905)
Phoenix	2,879	(24,240)	(7,936)	8,017	29,749	31,397	37,633	(17,697)	(6,785)
Orlando	4,710	(39,816)	3,442	(5,641)	38,495	1,640	7,837	(11,421)	(6,441)
Rochester, NY	(189)	(12,368)	3,515	7,722	(4,505)	5,688	26,369	(996)	(6,170)
Omaha	(5,244)	(1,453)	2,466	1,780	8,204	10,601	22,259	(6,688)	(6,007)
Syracuse	(7,574)	(1,734)	14,277	(1,734)	(1,535)	9,116	(1,207)	3,037	(5,656)
Anaheim	20,155	1,488	(7,340)	10,773	23,055	37,974	26,850	(7,781)	(5,393)
Jacksonville	6,466	(7,126)	7,571	13,432	12,857	21,541	92	(12,303)	(4,883)
Greensboro, NC	2,502	(12,019)	5,184	3,539	(1,117)	3,936	10,734	(14,401)	(4,722)
Buffalo	2,405	(8,461)	1,838	(3,742)	(2,578)	10,535	13,188	7,262	(4,687)
San Diego	16,605	(17,300)	5,381	14,116	13,775	17,817	39,096	(14,358)	(4,196)
Dayton, OH	412	(9,386)	3,699	4,506	(3,632)	2,603	5,275	(9,516)	(3,950)
United States	7,776	(16,623)	(477)	(419)	14,102	16,667	17,608	(5,105)	(3,730)
Charlotte	(10,886)	(21,359)	2,348	(1,233)	6,947	21,951	32,310	9,325	(3,169)
Atlanta	(252)	(19,317)	(4,366)	(9,979)	15,580	24,069	20,776	(14,603)	(3,017)
Los Angeles	21,872	(30,209)	(4,105)	3,580	44,507	40,667	19,094	20,955	(2,731)
Hartford	12,654	(13,774)	(8,505)	(14,544)	17,795	(4,124)	512	(5,363)	(2,504)
St. Louis	5,044	(7,448)	5,687	(7,655)	4,781	8,329	6,967	(1,884)	(2,491)
Columbia	432	(5,154)	8,008	(436)	16,540	16,047	6,723	(5,251)	(2,467)
Raleigh-Durham	3,814	(14,510)	(2,703)	(1,479)	9,685	4,174	24,043	311	(2,099)
Norfolk	4,910	(3,331)	20,821	9,133	(6,096)	(3,694)	2,377	(114)	(1,580)
Indianapolis	10,989	(7,148)	1,075	(603)	12,650	3,890	15,501	(10,577)	(1,452)
New Haven	10,355	(6,882)	1,349	(13,476)	4,851	(121)	2,806	452	(1,315)
Houston	4,739	1,092	(5,719)	(17,639)	7,841	34,096	17,037	3,949	(1,295)
Cincinnati	(3,497)	(16,232)	5,093	3,038	8,876	7,215	11,027	(8,606)	(1,186)
Kansas City	(1,624)	(8,484)	(328)	(10,182)	9,389	7,201	13,906	(4,748)	(1,182)
Tallahassee	4,954	(9,701)	7,105	7,932	16,966	5,720	(1,477)	(25,470)	(886)
Minneapolis	7,283	(19,045)	(3,393)	(8,459)	16,491	23,142	17,164	(6,389)	(782)
Tampa	2,886	(6,694)	(11,353)	(583)	20,551	16,098	8,436	(17,833)	(568)
Cleveland	(3,396)	(18,766)	(4,523)	(5,095)	7,509	1,227	20,586	(3,376)	(568)
New Orleans	10,225	(24,944)	(3,666)	(12,080)	9,373	21,207	(22,877)	(48,627)	(476)
Stamford, CT	25,642	(46,345)	(16,455)	(13,622)	8,038	11,747	13,708	(2,346)	(428)
Portland, OR	(4,884)	(13,445)	124	(2,753)	10,718	23,329	28,995	4,812	(367)
Memphis	(7,189)	(6,540)	3,301	(1,510)	9,781	16,056	17,009	(4,282)	(236)
Philadelphia	2,184	(24,798)	15,070	(7,238)	14,839	16,701	17,446	(3,885)	(189)
Winston-Salem	(1,893)	(7,123)	1,168	2,607	(4,433)	10,061	14,283	4,373	(113)
Dallas	2,543	(35,042)	(4,155)	(9,239)	11,528	27,390	23,664	(8,475)	(96)
Detroit	4,574	(23,212)	(11,324)	(7,702)	5,975	6,136	13,440	(8,919)	237
Nashville	(3,566)	(14,494)	5,561	6,478	9,393	8,478	32,250	(4,600)	716
Pittsburgh	3,359	(18,061)	2,018	(1,560)	9,397	5,289	30,669	(4,107)	719
Wilmington, DL	(3,523)	(12,590)	(838)	14,282	1,065	5,371	18,786	(326)	904
Milwaukee	3,839	(13,020)	4,017	1,643	3,193	11,667	22,668	(8,177)	1,676
Albuquerque	3,690	(4,929)	3,423	(1,772)	1,560	8,247	12,680	(1,568)	1,746
Salt Lake City	(3,419)	(7,013)	38,637	(34,672)	7,029	23,560	31,740	(1,431)	1,999
Seattle	2,103	(24,854)	(9,166)	2,869	18,236	26,647	48,135	(3,103)	2,134
Denver	5,184	(20,353)	(7,383)	(7,376)	10,844	24,893	37,740	7,465	2,922
Austin	20,506	(37,116)	(16,008)	(7,729)	3,389	35,781	46,178	7,914	3,271
Huntsville, AL	1,222	(1,896)	11,957	1,664	4,762	10,780	4,963	9,477	4,073
Oakland	38,817	(32,651)	(35,866)	(24,453)	7,798	14,180	23,038	4,420	4,740
Boston	39,204	(101,244)	(28,647)	(50,489)	47,335	30,630	24,334	44,093	5,919
Tucson	(55)	(13,790)	(6,900)	(2,253)	11,281	28,996	25,594	(8,954)	6,445
New York	48,168	(165,425)	(32,125)	(5,581)	93,403	125,329	63,590	126,198	6,844
Fort Lauderdale	4,777	(11,174)	(11,254)	14,193	38,376	22,321	27,425	(21,508)	9,867
San Jose	69,246	(91,196)	(59,720)	(39,636)	10,849	31,097	43,485	10,556	11,867
San Francisco	57,565	(139,854)	(70,731)	(14,330)	43,795	56,639	36,888	46,027	12,402

The table shows 47 of the 65 markets losing value in 2008, a slight increase over the 43 markets that lost value in 2007. The HVI provides further support that hotel values generally improved from 2001 through 2006, but have fallen sharply in 2007 and 2008.

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#### Questions Hoteliers Need to Ask:

**Q. How often are hotels reassessed, and when was your property's last assessment?**

**A.** Hotels in some municipalities are reassessed every year, others not for decades. Every municipality differs. However, if the hotel was reassessed in the last two to three years, then hotel ownership may have a good argument for an appeal because the assessment was likely based on data or assumptions that were not representative of a "stabilized" year, and cap rates at the time of the last assessment may have been much lower than at present.

**Q. When real property taxes increase, is it as a result of an increase in the assessment, an increase in the tax rate, or both?**

**A.** This is easily determined by examining the tax bill. Taxes will inevitably increase over time, but not necessarily every year. Real property values can vary depending on market conditions. The important point to remember is that while the tax rate is relatively uncontrollable, the tax assessment is not.

**Q. How long do real estate owners have to appeal taxes?**

**A.** Again, this varies from municipality to municipality, but one thing is for sure: It is not too late to prepare an appeal for 2009 and beyond, and it may still be possible to appeal a 2007 or 2008 assessment in some municipalities.

**Q. What were the effects of the credit crunch and the subprime meltdown on an individual hotel's market?**

**A.** Some hotel markets actually improved in 2007 and 2008; however, most markets have declined. Consult the snapshot from the HVI presented earlier in this article, and contact us for help in determining the status of markets not represented in the list.

**Q. Do costs associated with the appeal of an assessment outweigh the potential savings?**

**A.** In most cases, costs can be mitigated with a solid valuation estimate from the owner that shows support for the decline in value. Representation should be handled by a reputable hotel expert that can assess both the tangible and intangible value to produce a well-supported analysis and increase the potential for a warranted reduction. The backing of an HVS analysis can also help avoid a costly litigation process for the assessor and hotel owner.

**Q. How much can a successful appeal return to the NOI?**

**A.** This depends on the reduction in assessed value. Assume a hotel that was over-assessed by \$10,000,000 successfully appeals its assessment. At a tax rate of 3.0 percent, this translates to a \$300,000 reduction in the real property tax burden, which is then compounded yearly. Potentially, this reduction in taxes can result in \$3,000,000 (\$300,000 divided by a capitalization rate of roughly ten percent) of additional value to the hotel.

#### Net Overall Effect

The net overall effect of an appeal can result in substantial gains depending on the extent to which a hotel has been over-assessed. While a portion of these gains may be offset by the cost of the appeal, the benefit can be quantified in two ways. First, the hotel's real property taxes will decrease proportionate to the reduced assessed value, resulting in an increase in NOI. Second, the increase in NOI may result in an increase in the overall going concern value of the hotel, thereby allowing ownership to command a higher value if it chooses to sell, or borrow more money to refinance.

Ultimately, the benefit usually outweighs the risk, and there has never been a better time to file an appeal of a real property tax assessment. This argument is easily supported by nearly two years of declining values, exacerbated by a sluggish economy. While RevPAR has continued to grow in 2008, indications are not so optimistic for next year. In the present economic climate, experts advise hotel owners to exercise discipline and to fix their sights beyond the short term. Even a lengthy appeal process can prove well worth the time, effort, and capital invested. Let our hotel property valuation experts guide you to the light at the end of the tunnel.

For more information please contact **Tom Dolan** (617-424-8912 or [tdolan@hvs.com](mailto:tdolan@hvs.com)) or **Chris Elder** (970-222-1679 or [celder@hvs.com](mailto:celder@hvs.com)).

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