Five Common County Mistakes in Valuing a Hotel or Restaurant for Property Tax Purposes

By Richard D. Williams and Karen A. Smith, Apr 15, 2002

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County Assessors, no matter where they are located, seem to make similar mistakes in valuing a hospitality property for ad valorem tax purposes. The mistakes occur for a variety of reasons, including lack of data, lack of understanding of the intricacies of accurately valuing a hospitality property, lack of manpower, and shortcomings within the software used by the County Assessor. This article sets forth five common mistakes made by County Assessors in valuing hotels and restaurants, and suggests that these are items to be considered in determining whether to protest a value determined by a County Assessor.

The first common mistake is the failure to use actual income and expense data in determining the value of the hotel or restaurant. Instead, County Assessors typically develop models for different categories of properties, such as limited service hotels, full-service hotels, resort hotels, fast-food restaurants, in-line restaurants, or free-standing restaurants. No matter how many models a particular county may have, the models all have the same shortcoming in that a particular property may under-perform or out-perform the model with the result that the value may not be reflective of the subject property's true value. Obviously, a taxpayer may be satisfied with the value determined using a model if the subject property is out-performing the model, and in that case, the taxpayer will not protest the value determined by the County Assessor. If the value determined by the model over-values the subject property, the value should be protested by producing actual income and expense data. Generally, County Assessor are very willing to consider actual income and expense data and particularly if the data is produced prior to the actual hearing.

The second common mistake is under-compensating for business value in determining the value of the hotel or restaurant real estate. It is an accepted fact in the appraisal industry that the market value of a hospitality property consists of four components: value of the land, value of the improvements, value of the business or going concern and/or franchise affiliation, and value of the personal property. For property tax purposes, where the value of the real estate alone must be considered, a deduction has to be made for the value of the business and the personal property. The most appropriate method of estimating the business value of a hospitality property is to take a deduction for management fee and franchise fee from net income, thereby removing income attributable to the business component from the income stream. The amount of a management fee and franchise fee varies depending upon the size of property, the services performed, the location of the property, and the brand affiliation, if any. County Assessors typically use the same percentages for management fees and franchise fees for all properties within a model regardless of the actual management fees and franchise fees paid. The taxpayer should compare the management fees and franchise fees used by the County Assessor to the actual fees paid by the taxpayer, and determine whether an adjustment to these amounts will lower the subject's value. Copies of management and franchise contracts may be necessary to support the requested adjustment.

The third common mistake is not making an adjustment for return on and return of investment in personal property. Both a return on and return of the investment in the subject's personal property must be considered in order to deduct value attributable to the furniture, fixtures and equipment. The return of personal property is removed from the income stream by taking a deduction for the funding of an appropriate reserve for the replacement of the personal property. The return on personal property is determined by multiplying the value of the personal property by an appropriate rate of return. County Assessors may handle personal property in a variety of ways. Some ignore the issue, and force the taxpayer to take an appeal of the matter to a higher level. Some County Assessors deduct the value of the personal property as determined for ad valorem tax purposes (in jurisdictions which separately tax personal property) from the ultimate value determined for the subject. The taxpayer should determine whether the County Assessor has included the personal property in determining the subject's value. Data supporting the value of the personal property may need to be provided to the County Assessor.

The fourth common mistake is applying an inappropriate capitalization rate in determining the value of the hotel or restaurant. The capitalization rate for ad valorem tax purposes consists of two components, a base rate and a tax load. The base rate is the rate frequently in dispute. The tax load is a simple calculation and reflects the actual tax rate imposed by a particular county. The base rate should be reflective of the risks involved with a hospitality property. Rates listed in surveys usually are reflective of major sales, and consequently, may indicate the low end of the range of appropriate capitalization rates if the subject is a more typical property. The base capitalization rate used by the County Assessor should be examined to determine whether the rate is appropriate.

The fifth common mistake is not relying on the income approach in determining the value of the hotel or restaurant. Because hotels and restaurants are purchased on the basis of the income stream produced, the income approach is the most appropriate valuation method. The cost approach may accurately reflect the value of a new property, but as improvements deteriorate and market conditions change, it becomes difficult to quantify appropriate adjustments to value. The market approach may provide some support for the value determined under the income approach, but cannot be relied on as the sole indicator of value because of the numerous adjustments needed to distinguish properties from one another. If a decision is made by a County Assessor not to use the income approach because of a lack of data, it is more likely that the cost approach will be used than the market approach because of the availability of data from cost estimating services. The taxpayer should determine the valuation method used by the County Assessor and if the income approach

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was not used, the taxpayer should offer to provide all of the information set forth in the previous paragraphs of this article.

In conclusion, County Assessors frequently find it difficult to value hotels and restaurants for a variety of reasons. As a result, the value determined by the County Assessor for a particular property may not accurately reflect the true value of the hospitality property. Valuation mistakes typically fall within certain common areas. An experienced appraiser of hospitality properties for ad valorem tax purposes should be requested to review the value determined by the County Assessor and then if the value appears high, should be retained to protest the value.

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