Hotel/Motel Appraisal Misconceptions Set Straight

- Lodging facilities have long economic lives.
- The lodging industry is a growth industry.
- A downtown commercial hotel will easily accomplish 80 to 85% occupancy.
- A poor rooms operation can be offset by a high-volume food and beverage facility.
- A hotel with a 20% of gross bottom line profit must be operated very well.
- If you can operate an apartment building and cook a meal, you can run a motel.

These misconceptions about appraising hotels and motels were the subject of a talk by Stephen Rushmore, MAI, at the recent Central Atlantic Regional Conference. Rushmore, author of *The Valuation of Hotels and Motels* (Chicago: AIREA, 1978), cited data showing that the statements above are often untrue and offered advice to appraisers involved in the valuation of lodging facilities.

In fact, hotels and motels have relatively short economic lives—40.91 years for hotels and 31 years for motels—the result of both functional and economic obsolescence. The appraiser must allow for this relatively short economic life when doing hotel appraisals by realizing a shorter duration of income, the possibility of a lower stabilized net income, the need for more recapture, the probability of higher mortgage constants, the necessity of higher equity dividends, and the possibility of lower overall values.

In fact, the hotel/motel industry is experiencing a growth rate of less than 1% a year. The appraiser should handle the slow growth by realizing that historically the supply has increased faster than the demand. Appraisers must carefully evaluate micro markets to determine the supply and demand relationship.

In fact, it is mathematically impossible for hotels to operate over a certain level of occupancy in many cases. A well-located downtown hotel may operate at 100% occupancy Monday through Thursday, and drop to 30% on Friday, 40% on Saturday, 50% on Sunday. Mathematically the total occupancy for this property could not exceed 74%. Slow periods such as Christmas week, summers, three-day holidays, cause a further decline. The appraiser should be wary of hotels operating on a stabilized basis of 80 to 85% of occupancy and must be sure the trend is likely to continue.

In fact, a high-volume food and beverage facility cannot offset a poor rooms operation. Typical departmental profits for food and beverage operations range from 16 to 22%. From these profits must be subtracted nondepartmental expenses—administration, utilities, repairs and maintenance, etc. When these expenses are properly allocated to a hotel operation, the food and beverage department generally shows a loss. Appraisers should be wary of properties with large food and beverage revenues and relatively low rooms occupancy.

In fact, a "normal" bottom line percentage profit can be anywhere from 5 to 45%, depending on the type of business the property attracts. An appraiser cannot use an arbitrary bottom line percentage, but must work out each expense item to determine its effect on the bottom line.

In fact, operating a motel is not simple. Hotels and motels are highly complicated businesses requiring specialized knowledge and experience in many areas. A lodging facility is a labor-intensive, retail-type business that depends on customer acceptance and highly specialized managment skills.

Southern Pacific RR Markets Prepackaged Industrial Parks

A prepackaged industrial park concept has been developed and marketed with good success by the Southern Pacific railroad along its extensive line through the west. "This is a logical response to some of the political and environmental constraints we see on business development today," said Daniel T. Daggett, vice president and general manager of the railroad's industrial development division. "We have the property ready to go, with all details of subdivision plans, zoning, environmental impact and sometimes landscaping plans accomplished. We do this advance work to assure that the industrial park is an asset, designed with the community's concerns in mind."

The company has more than 70 industrial parks and claims to be the largest such developer in the country. In a recent case of a new park in western Nevada, the Southern Pacific claims to have cut a year or two from the lead time for a new plant through its advance work.

"We worked carefully on the details with the city and regional planning commissions and others," said Doyle S. Gibson, the company's manager of planning and engineering. "We got the land rezoned and annexed to the city after convincing some neighboring property owners to go along. We laid out streets and utilities and had them dedicated to public use."