How to Lower the Property Taxes on Your Hotel or Restaurant

By Richard D. Williams, Jan 17, 2003

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Every taxpayer is interested in lowering their property taxes, but few go about it in the right way. There are some common procedural and valuation methods to employ in protesting the property tax value of a hospitality property. This article sets forth a brief description of some of these methods.

After receiving a notice of the Assessor's determination of value, the taxpayer should realistically consider whether the value appears on its face to be reasonable. While most taxpayers have a feel for the market value of their property, that value usually includes a business component. For ad valorem tax purposes, only the real estate value of the property is subject to tax. Market value comprises real estate value, business value, and personal property value. It usually is necessary to retain an experienced appraiser of hospitality properties to determine the various components of market value.

An experienced appraiser will first determine the overall market value of the hotel or restaurant. This value should be determined using the income approach to value, using the actual income and expenses of the property. If the resulting value is lower than the Assessor's determined value, the actual income and expense information should be given to the Assessor. Many taxpayers only provide isolated actual figures, and try to rely on survey data to obtain a reduction in value. Assessors typically will not determine or accept a value using some actual results and some hypothetical results. Once a decision has been made to provide actual results, provide all of them and only rely on survey data to support the reasonableness of the actual results.

After market value has been determined, the value must be reduced for property tax purposes by first deducting the business value of the hotel or restaurant. This is achieved by taking a deduction for the management fee and franchise fee from net income. The actual management fee and franchise fee paid should be used in making this adjustment. Support for the amounts of the actual management fee and franchise fee may be necessary, if the actual fees paid are higher than those used by the Assessor. If no management fee or franchise fee is charged to the property, which can be the case if the hotel is owned and operated by a hotel chain, an adjustment should be made as well.

The resultant value must then be reduced for property tax purposes by making adjustments for the return on and return of investment in personal property. The return on personal property is determined by multiplying the current value of the personal property by an appropriate rate of return. The rate of return should reflect the cost of capital used to purchase furniture, fixtures and equipment. Typically interest rates for personal property loans are a few percentage points higher than interest rates on loans for hotel or restaurant real estate. 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 appropriate reserve depends on the age, quality, and durability of the personal property, and the amount of guest traffic and resultant use. Reserves typically range from 3% to 5% of total revenue for hotels, and from 1% to 3% for restaurants.

Finally, the net income must be capitalized, using a tax-loaded capitalization rate. The development of an accurate capitalization rate is a key component in the protest of a hospitality property value and requires access to data that may not be readily available to a typical taxpayer. The base rate should be composed of an interest component reflecting the return on capital as well as a recapture component providing for a return of capital. The first component (i.e., return on capital) can be determined using a regression analysis of interest rates for hotel mortgages and utility bond yields. The second component (i.e., equity dividend and equity yield) can be obtained from either a survey of lenders and investors, or from actual sales of hotels or restaurants appraised by the person developing the capitalization rate. Developing a capitalization rate from sales without knowledge of all the circumstances surrounding a sale can be misleading because the sales price may have been influenced by factors such as financing, existing or anticipated income, tax benefits, deferred maintenance, and reserves for replacement. Further, the base rate should be reflective of the risks involved with the particular property. Rates listed in surveys usually are reflective of major sales, and typically are indicative of the lower end of base rates.

After determining the applicable base rate, the tax rate should be determined using the actual tax rate imposed by the taxing jurisdiction for similar properties. The total of the base rate plus the tax rate is the tax-loaded capitalization rate to be applied to the net income of the property. It should be noted that it can be difficult to convince an Assessor to use the taxpayer's capitalization rate. Assessors will argue that the same capitalization rate should be applied to all hospitality properties in a market because all properties in the market face the same risks. While an experienced appraiser or owner of hospitality properties knows that this is false, assessors do not typically have the time or data available to develop individual capitalization rates for properties. Therefore, in order to succeed on a capitalization rate argument, you will need to distinguish your property from other hospitality properties in the market, and you will need to be dealing with an open-minded assessor or hearing officer.

This value is the value for the real estate component of the hospitality property. Compare this value to the value on your property tax notice. If it is lower, you may have a good case for lowered property taxes. The next

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Richard D. Williams, MAI is the President of HVS Food & Beverage Services - Denver. Dick is a graduate of the Cornell University School of Hotel Administration, is a certified general appraiser and a licensed real estate broker, and holds the MAI designation of the Appraisal Institute. Mr. Williams' appraisal and consulting services are grounded in his 40 years' experience in the restaurant business as a chef, managing partner, and owner of several restaurants, including the Buckhorn Exchange in Denver. Dick can be reached by telephone at 303-771-4104 or by email at dwilliams@hvs.com.

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decision is how to convert this lower value into a value accepted by the Assessor.
It is our experience that few taxpayers are able to successfully represent their own properties before the Assessor. There is an art to achieving lowered tax values; and the key is a representative who is experienced with property tax. Retain an experienced professional to meet with the Assessor, or his representative, to present the results. Do not accompany the professional to the meeting. As in any situation involving a tax dispute, it is desirable to be represented rather than attempt to negotiate on your own behalf. A professional is trained to handle pointed questions, which a taxpayer may find difficult to answer. In addition, if the taxpayer is absent from the meeting, the professional can defer answers on some questions until after he has had a chance to confer with the taxpayer. Ask your representative to debrief you after his meeting with the Assessor so that you will know the results of the meeting, and whether additional information and/or meetings have been requested.

It may be necessary to take your case to a higher level if the Assessor does not agree to lower the value. Your representative should ask the Assessor what additional information would have to be presented to convince him to lower the value. The Assessor may need to have the information be verified. The Assessor may state that he will not lower the value no matter what evidence is presented. This may or may not be indicative of the likelihood of success at a higher level. In some jurisdictions, it is commonplace to take every case to at least the next level. Whether this is the right step for your property depends on the costs and benefits of taking the case to a higher level. Your representative should be able to assist you in making this decision.

In sum, there are some common procedural and valuation methods to be used in protesting the property tax value of a hospitality property. An appraiser or other representative experienced in property tax valuations can be invaluable both in assisting a taxpayer in the determination of whether the Assessor's value is accurate and in the presentation of evidence to the Assessor.
If you would like more information on HVS's property tax services, please e-mail the authors at rwilliams@hvsinternational.com.

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