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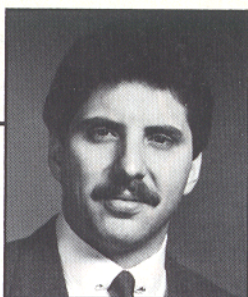
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RUSHMORE AND ARASI



An allocation of a hotel's value between land, improvements and personal property is sometimes required to establish depreciable tax basis, property tax appeals, and for other similar reasons occasioned by the sale or continuing operation of the property. Allocation of the hotel's personal property, that is the furniture and equipment, has extraordinary implications because such property comprises a relatively significant portion of total value. In fact, 15 to 25% of the cost of a new lodging facility goes into furniture and equipment, assets which typically have a short useful life.

The shorter useful life of personal property, generally lasting five to ten years, means greater depreciation tax benefits from an equity investment viewpoint, but requires a reserve for replacement to provide periodic upgrading. The personal property allocation is frequently the subject of discussion, posing complex appraisal questions.

As a hotel ages, the improvements — building, furniture and equipment — are subjected to various forms of obsolescence. Personal property depreciates fastest, in terms of both book and real value. However, the value in use of that personal property may differ significantly from the value in exchange. In general terms, value in exchange means the price one could sell a hotel's used furniture separately from the hotel property itself. Use value is the value of specific property under a specific use, as

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VALUE IN USE VERSUS VALUE IN EXCHANGE

indicated by the productivity of that economic good. The use value of a property considers the contributory value to the ongoing enterprise. In layman's terms, this is the value to the ongoing hotel operation of the existing, used furniture in producing a profit stream.

As shown in our article which appeared in the December 1985 issue of *Lodging Hospitality Magazine*, "Hotel Development Costs," personal property ranges from 15 to 25 percent of hotel development costs. Accordingly, it is logical to translate that range into the assumption that 15 to 25 percent of the hotel's income is produced by the personal property assets in use. This, indeed, is the case, but, as the analysis in Chart A shows, the nature of the rapidly declining exchange value of a hotel's personal property causes that identical 15/25 relationship to change. In the example, the newly developed hotel with a \$40 million original value has approximately \$6 million of personal property (.15 × \$40,000,000). This personal property exhibits obsolescence at various rates depending on the characteristics of the asset.

The economic life with value in exchange category shows how long the personal property will continue to have resale value. Our experience with numerous lodging transactions, development scenarios and acquisition studies shows that the exchange value of the personal property three years hence would be significantly lower. In this hypothetical illustration, the remaining

exchange value is \$1,870,000. Because the hotel has generated a positive income stream, the total property has appreciated five percent per annum to an overall property value of \$46,305,000. Accordingly, the personal property value in exchange is now only four percent of overall property value.

This understates the actual value in use of the furniture and equipment to the overall property value because the hotel is generating a positive cash flow by employing all of its physical assets. Clearly, the personal property contributes its share, as the furniture and equipment creates the hotel's image, style and class. Because the economic life in use of the personal property is far longer than the economic life in exchange, value in use obsolescence is significantly lower; thus, the value in use is higher. In order to quantify this relationship, we must perform a calculation to determine obsolescence of the personal property after three years, based on the weighted average economic life in use of 9.96 years:

Physical age:	3 years
Economic Life In Use (Say)	10 years
Accumulated Value In Use Obsolescence Percentage	$\frac{3}{10} = 30\%$
Original Cost	\$6,000,000
Accumulated Depreciation %	.30
Accumulated Value In Use Depreciation	\$1,800,000
Personal Property Value In Use After 3 Years:	6,000,000 - 1,800,000 \$4,200,000

The \$4,200,000 personal property value in use equates to approximately

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nine percent of the year-three overall property value of \$46,305,000, much higher than the \$1,870,000 personal property value in exchange.

The \$4,200,000 figure is closer, in practical terms, to the contributory value of the personal property to the overall hotel value. The nine percent personal property value in use component is still substantially below the 15 percent personal property portion of original value, reflecting the high depreciation characterizing hotel furniture and equipment.

As the original furniture and equipment approaches the end of its useful economic life, this nine percent relationship will decline a bit more until

the time is reached when all original personal property has been replaced by new furniture and equipment. At such time, the personal property component value in use will again approach 15 percent.

Value in exchange differs from value in use, especially for properties such as lodging facilities which contain a significant value of personal property. In attempting to estimate true economic value of personal property, real estate and lodging professionals should consider the value in use versus value in exchange techniques outlined herein. Such techniques will provide a more equitable basis for allocating assets for tax, legal and assessment purposes. **H**

Chart A

Hypothetical Standard Class Hotel
Furniture and Equipment Matrix
(\$15,000 per room × 400 rooms = \$6,000,000 Total Cost)

Furniture and Equipment Items	Original Cost	Economic Life in Exchange	Economic Life In Use	Exchange Value Three Years After Purchase	Comments
Bed Mattresses	\$ 300,000	1	8	\$ 0	Often no secondary market due to health codes.
Carpeting	1,500,000	3	7	0	Installed to fit, difficult to resell.
Kitchen Equipment	1,000,000	8	15	625,000	Strong resale potential to restaurant and institutional feeding operations.
Soft goods	250,000	3	6	0	Limited resale.
Linen, china glass, silver	500,000	4	6	125,000	Moderate resale potential.
Case goods	1,400,000	6	12	700,000	Strong resale potential to salvage operations.
Other assorted	1,050,000	5	10	420,000	Varies.
Total original Furniture & Equipment cost	6,000,000	—	—	1,870,000	F & E exchange value declines rapidly.
Total hotel value	40,000,000	—	—	46,305,000	Overall property value appreciates due to positive cash flow.
Weighted Average Life		4.87	9.96		Average Economic Life in Use is 105%. Longer than Average Economic Life with Exchange Value.



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Hi- I'm Steve Rushmore and I would like to tell you about my online course- "**How to Value a Hotel.**" It teaches how to perform a hotel valuation using my **Modern Hotel Valuation Methodology**. Designed for experienced appraisers looking to specialize in valuing hotels or new valuers starting their careers, this course provides all the knowledge and tools needed to evaluate hotel markets, forecast income and expense, and value all types of hotels. For the final project, students value an actual hotel.

You will be working with the latest version (6.0) of my **Hotel Market Analysis and Valuation Software**-three powerful software models that have become the hotel industry standard for hotel valuations and investment analysis throughout the world. By the end of the course, you will be able to perform your own hotel market analysis and valuation plus many other applications.

The course consists of video lectures, readings, hands-on software case studies, quizzes, and a final project valuing an actual hotel. It should take about 20-35 hours to complete.

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Hotel Valuation Software- For Performing Hotel Market Analyses, Financial Projections and Valuations

Hotel Market Analysis & Valuation Software was developed by Steve Rushmore for his firm- HVS. It was then enhanced by Professor Jan deRoos of the Cornell Hotel School. This software has been the most downloaded product on the Cornell website and is used by thousands of hotel professionals around the world. It consists of three models:

- Hotel Market Analysis and ADR Forecasting Model
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This software package also provides answers to a wide range of key hotel investment questions such as How much is my hotel worth? What can I do to maximize value? What is the likely impact of new competition? How much value will a refurbishment add? Is my market strong enough to support adding more hotel rooms? What is the impact of my brand adding another hotel to the market?

If your role includes responsibility for performing hotel valuations and associated financial analyses- you need to include this software in your business toolbox.

Hotel Market Analysis & Valuation Software v. 6.0 is written as Microsoft Excel files (which runs on both Windows and Apple OS X operating systems) and comes with a detailed users' guide and case study. Version 6.0 contains significant enhancements over Version 5.0 which is no longer distributed.

HOTEL VALUATION SOFTWARE



Steve Rushmore is the Founder of HVS and the **Creator of the Hotel Valuation Methodology**. He has authored eight textbooks on hotel valuation and investing, along with over 350 articles on similar topics. In addition, Steve has taught thousands of industry professionals around the world. His online course- "**How to Value a Hotel**" is used by the leading hotel schools and consulting organizations. Contact Steve at steve@steverushmore.com or visit his website www.steверushmore.com

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