What's the Deal By Daniel Lesser

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Sales price versus market value

(The views and opinions expressed in this blog are strictly those of the author.)

The Appraisal Foundation, which sets the U.S. Congressional authorized standards and qualifications for real estate appraisers, defines market value as:

"The most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby,

• Buyer and seller are typically motivated;

• Both parties are well informed or well advised, and each acting in what he or she considers his/her own best interest;

• A reasonable time is allowed for exposure in the open market;

• Payment is made in terms of cash in U.S. dollars or in terms of financial arrangements comparable thereto; and

• The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale."

Merriam-Webster defines price this way: "the quantity of one thing that is exchanged or demanded in barter or sale for another" and "the amount of money given or set as consideration for the sale of a specified thing."

Daily leasing of hotel guestrooms, coupled with re-pricing of room nights that change by the nanosecond, result in lodging profits and hence market values that are volatile, particularly when compared with other forms of commercial real estate that are occupied with blue chip, long-term creditworthy tenancies.

My hotel valuation and advisory practice requires that I routinely keep a finger on the pulse of a very fluid and complex lodging investment market, and I therefore continuously communicate with active lodging market participants including sales and capital markets intermediaries (aka brokers), owners, operators, buyers, sellers and lenders.

I note the following observations relative to market value and sales price:

• Although many perceive the definition of market value to be the "highest" price, in fact it is the most "probable" price. Clearly there is a difference in the meaning of probable (likely to occur) and highest (exceeding the common degree or measure). In other words, market value is not predicated on an amount that a single or very select few are willing to pay, but rather what is a most likely sum of money a typical investor would pay given current market conditions. This notion is supported by the principle of substitution, which considers that a buyer will not pay more for a property than the cost of an equally desirable alternative asset.

• A hotel trade facilitated by a sophisticated intermediary who has widely marketed an asset for sale generally results in a price that reflects market value.

• With this said, a specific sales price of a lodging facility can be equal to, greater than, or less than the property’s market value. Oftentimes hotel acquisition prices are competitively bid up to a point whereby actual trades occur at levels above market value, while frequently, shrewd investors are able to secure properties at prices that represent below market value.

• A single or select few buyers’ willingness to pay the most for a particular asset usually results in a sales price above market value.

• A sales transaction that includes favorable below market financing commonly results in an asset price above its market value.

Determination of both a hotel’s price and its market value is far from an exact science and includes a bit of art. Caveat emptor! Only those that are fully and unremittingly immersed within a forever-changing hotel investment market are able to accurately comprehend the difference, if any, between sales price and market value.

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