

Business Enterprise Approach theory is unsubstantiated

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What's the Deal By Daniel Lesser

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

A recent article on hotelsmag.com, "[Valuation strategies for the new normal](#)," describes the Florida Fifth District Court of Appeal case (No. 5D18-2927) Rick Singh, As Property Appraiser vs. Walt Disney Parks and Resorts US, Inc., et al. involving a real estate tax appeal of the 2015 assessment of the Disney Yacht & Beach Club Resort in Orlando, Florida.

Real estate taxes are one of the primary revenue sources used by municipalities to obtain funds for public expenditures such as parks, highways, interest on bonds and other government services. Based on the concept that the tax burden should be distributed in proportion to the value of all properties within a taxing jurisdiction, a system of assessments is established by a local assessor.

Theoretically, the assessed value placed on each parcel bears a relationship to its market value. Therefore, properties of equal market values should have similar assessments. Depending upon the taxing policy of a municipality, property taxes can be based on the value of only real property (i.e., real estate tax) and in many cases also on the value of personal property.



During the past several decades, an unsubstantiated theory referred to as “business enterprise approach” (BEA), also known as “total assets of the business” (TAB) has been created by a small but vocal group of property tax professionals. | Getty Images

While the exact way in which property taxes are levied varies considerably, there are two commonalities among all tax jurisdictions. First, property taxes are always an ad valorem tax, meaning the actual tax liability for any given property in any given period is always based on the property’s value relative to other properties in the taxing jurisdiction, and is always calculated by multiplying the tax rate by the property’s assessed value.

Second, all property assessments feature some relationship to “market value” as of a certain date. Different tax jurisdictions may have other nomenclature for market value including: “fair cash value,” “fair market value” or “fair value.” The underlying definitions, however, are largely identical to the concept of market value as defined by agencies that regulate federally insured financial institutions in the United States, and is taken from the Uniform Standards of Professional Appraisal Practice (USPAP).

What is BEA?

During the past several decades, an unsubstantiated theory referred to as the “business enterprise approach” (BEA), also known as “total assets of the business” (TAB), has been created by a small but vocal group of property tax professionals. With a focus on challenging real estate assessments, the BEA/TAB concept is an attempt to change, not the market, but instead the actions of appraisers whose mandate it is to reflect the market.

The BEA/TAB hypothesis was originally formulated for application to hotel assets; subsequently, the philosophy and methodology was expanded to include commercial property including: regional shopping centers and malls, convenience stores, senior housing, congregate care and retirement facilities, golf courses and country clubs, restaurants, theme parks, race tracks, recreational vehicle parks, marinas and billboards.

Essentially, the notion of BEA/TAB is that real estate must be valued as a residual of a business, by first concluding to an opinion of the market value of the total assets of the business. TAB is a concept that has never been substantiated by “the market,” and is not an accepted principle or methodology used by knowledgeable hotel investment market participants. The BEA/TAB hypothesis is merely a contrived hypothetical construct, without any market foundation, that has been fabricated and developed with the sole intent to obtain reduced hotel property tax burdens.

Analysis of the actions of hotel investors proves that the purchase of a transient lodging facility reflects the acquisition of real and personal property only. Hotel investors account for income attributable to the business through the deduction of management and franchise fee expenses. An investor purchasing a hotel “unencumbered” by a management agreement will not pay for a seller’s assembled workforce, business name, patents, copyrights, working capital and cash, operating procedures, manuals, etc. A passive investment in a first-class hotel “encumbered” by a long-term hotel management agreement is riskier, but no different than a passive investment in a Class A office building occupied by a long-term credit-worthy tenant. Either passive investment yields a risk adjusted return on property and not on a business.

No one disputes that hotels are unique forms of real estate; they inherently contain significant business and personal property components. Problems occur, however, when one considers transient lodging facilities in the same breath as other real estate properties that contain one or both components. Hotels cannot be considered as just another “business enterprise.” The positing of theories and methodologies relative to valuation issues of lodging facilities which is unsupported by market evidence is fraught with danger.

The only arena in which the BEA/TAB methodology has been used is in real estate tax assessment appeal matters. In cases that have been litigated, it has been soundly and overwhelmingly rejected by the courts as clearly illustrated in paragraphs 40 and 41 of the following decision: State of Maine South Portland Board of Review Findings Of Facts And Conclusions Of Law On Petitions For Tax Abatement GGP – MAINE MALL, LLC v. CITY OF SOUTH PORTLAND (August 17, 2011)

Hotel owners should beware in any attempt to reduce their property assessments. While no proprietor should pay more than their fair share of taxes, given the clear rejection by courts, an uphill battle exists for those who engage legal counsel, property tax consultants or valuation experts who utilize the novel “BEA/TAB” methodology in an effort to decrease

property values for ad valorem tax assessment purposes. Hotel owners should carefully consider the ramifications of, in addition to most likely losing such a challenge, establishing a market value of their property that has the potential of reducing their mortgage asset security value that lenders rely upon when making new loans or providing refinancing proceeds.

At any given point in time, there can only be one market value of a hotel property irrespective of the purpose for which such conclusion is being sought. A free market and the courts have proven time and again that the sale of an open and operating hotel reflects the transfer of real and personal property only. The manufactured terminology and theory of BEA/TAB is a foreign concept to well-informed market participants within the lodging real estate investment arena.

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