

FAIR+EQUITABLE

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What's a hotel worth?

Many private appraisers erroneously use a 'going concern' premise, causing differences in value estimates between opposing appraisers

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A red wooden arrow pointing upwards, resting on a stack of US dollar bills. The background is a blurred blue sky. The text is overlaid on the right side of the image.

MYTH VS. REALITY

**'going concern'
hotel valuations**

five realities versus five myths ...

The overwhelming market evidence on this topic stands in contrast to a barrage of faulty theories and assumptions put forth by appraisers engaged by hotel property owners in assessment litigation.

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In the recent past, many appraisers retained by lodging property owners in connection with tax assessment appeals have erroneously used a “going concern” premise to valuation, resulting in wide differences in hotel property value estimates between opposing appraisers.

Important definitions include:

- ▶ **Going concern** – An established and operating business having an indefinite future life.
- ▶ **Going concern premise** – An outdated label for the market value of all the tangible and intangible assets of an established and operating business with an indefinite life, as if sold in aggregate; more accurately termed the market value of the going

concern or market value of the total assets of the business.

▶ **Market value of a going concern** – The market value of an established and operating business, including the real property, personal property, financial assets, and the intangible assets of the business.

These definitions come from The Dictionary of Real Estate Appraisal, Sixth Edition, published by the Appraisal Institute in 2015.

In the textbook The Appraisal of Real Estate, 15th Edition, published by the Appraisal Institute in 2020, examples of language used to refer to the concept include:

“Market value of a going concern, including the fee simple interest in real property along with tangible and intangible personal property.”

“Market value of a going concern, including the leasehold interest in real property along with tangible and intangible personal property.”

The purpose of this article is (1) to consider whether or not hotel transactions involve the sale of going concerns, referred to by some as Total Assets of the Business (TAB) and (2) to base the conclusions on market behavior and not on unfounded theories that are inconsistent with the reality of how the hotel transaction market operates.



Market Reality No. 1

Comparable hotel sale transactions do not reflect the purchase of “going concerns,” which in addition to real estate and personal property (FF&E) assets also include intangible business assets.

Verifications of numerous individual hotel transactions (comparable hotel sales) reveal similar facts regarding intangibles; that is, there are no business intangibles are included in the sale prices of typical hotel purchases.

What sells is real property (fee simple ownership of land and improvements) and usually the FF&E (furniture, fixtures, and equipment), although on occasion, the FF&E is transferred in a separate private transaction between the seller and buyer.

Collectively, the authors, their staff, and other colleagues they worked with during their careers have verified hundreds of hotel comparable sales with

the same findings regarding the lack of intangible assets in the purchase prices of hotels.

This reality is readily supported by real estate transaction market behavior.

The opposing point of view that hotel transactions reflect going concerns is a myth based on unfounded theories.



Market Reality No. 2

Comparable hotel sales do not include the value of the business start up costs; assembled workforce; regulatory compliance; accounting and other business systems, preopening marketing, and initial operating losses; or the hotel brand name, licenses, contracts, etc.

Some appraisers contend that the definition of “Going Concern” as “an established and operating business with an indefinite future life” implies ownership of the real property, FF&E, and all business components in the operation of hotels.

When hotel properties sell, the reality is that what sells is the fee simple ownership interest in the real estate

and the FF&E.

The business component of operating a hotel usually is carried out by a third-party-owned hotel management company, and that business operation is not part of the sale.

Typically, the seller does not own this business entity and, thus, cannot sell it along with the real estate and the FF&E.

The hotel management company either continues to manage the business under a long-term agreement or is replaced by a different hotel management company chosen by the buyer.

In either case, the hotel manage-

ment company is paid by the hotel owner through management/franchise fees.

The owner pays these fees from the hotel’s revenue and deducted as an expense before net operation income (NOI) is calculated.

Thus, to assert that the hotel business is a part of the sale transaction is yet another myth usually put forth by appraisers engaged by property owners in assessment appeal litigations.

This misguided and faulty myth is repudiated by practicing appraisers who understand how the hotel transaction sale market operates.



Market Reality No. 3

Capitalization rates for hotels quoted in published real estate investor surveys do not reflect going-concern sale prices.

Capitalization rates for hotels quoted in real estate investor surveys reflect likely transactions for land, improvements, and usually FF&E, but do not include intangible assets.

The cap rates do not represent the sale of going concerns.

This is supported by personal knowledge and discussions by the authors with contacts at major investor survey publications, including PwC Real Estate Investor Survey (formerly the Korpacz Real Estate Investor Survey®), SITUS RERC™

Real Estate Report, and compilations of various national appraisal and brokerage firms, including Cushman & Wakefield and Newmark.

Hence, market reality No. 3 reflects market behavior, and the opposing point of view that published cap rates in real estate investor surveys reflect going-concern transactions is a myth.

Market Reality No. 4



Real Estate Investment Trusts (REITs) acquire hotel properties that consist of real estate assets (land and improvements) and FF&E (often characterized as personal property) and typically (1) do not include intangible assets in the negotiated sale prices and (2) do not reflect going-concern transactions.

The assets traded are what are owned by the seller and transferred to the buyer.

The acquisitions typically do not include intangible assets owned by the management companies that is either retained by the buyer to continue managing the hotel or removed from the hotel management role and replaced by a new operator.

Some assets referred to as intangible assets are included in financial statements after the real estate closing and are based on the interpretation of accounting and IRS rules and guidelines.

This position is supported by hotel acquisitions reported in numerous Security and Exchange Commission (SEC) documents of publicly owned hotel REITs, specifically 10-Q (quarterly financial reports) and 10-K (annual financial reports).

A study of public hotel companies from 2015 through early 2021 completed by the authors found the following:

▶ From 2015 to the first quarter of 2021, a total of 54 hotel property transactions were researched with findings summarized in the exhibit at the end of this article.

▶ The sale price allocation for 41 hotels consisted of land, improvements, and FF&E only; there was no allocation for identifiable intangibles.

These 41 hotels represent 76% (41 of 54) of the total number of hotel sales.

▶ Thirteen of the hotel acquisitions contained real estate (land and improvements) FF&E, with a small percentage of the price representing intangible assets. The intangibles were not part of the acquisition pricing and negotiations between seller and buyer but were price allocations in financial statements and IRS filings of the buyer for that quarter or year compiled by accountants consistent with accounting rules and guidelines. The intangibles included adjustments for favorable ground leases and above- and below-market rents and contracts, advance bookings, and loan costs, etc.

▶ On a percentage basis, 94.55% of the total reported transaction prices represent real estate (land and improvements), 5.46% represent FF&E, and 0.14% represent intangible assets.

▶ The terms “going concern” and “Total Assets of the Business (TAB)” are not stated in any of price allocation content in the various SEC documents researched, wherein the price allocations are listed. Also, there is no mention of allocation of sale prices to start-up costs, assembled workforce, preopening marketing, initial operating losses, brand name, licenses, contracts, and the like.

Hence, market reality No. 4 reflects market behavior, and the opposing point of view that hotel purchases by public hotel REITs are going-concern sales that include business intangibles is a myth.

Market Reality No. 5



Appraisers who perform work for lenders, pension funds, government agencies, and eminent domain condemnation and assessment appeal clients, among others, do not value hotel property on the basis of their going-concern value.

The USPAP requirement for the appraiser to “analyze the effect on value of such non-real property items” when “intangibles are included in the appraisal” is misinterpreted to support the unfounded assumption that a “going concern” is the basis for a hotel sale transaction and thus intangibles must be included.

This may be true if the seller owns not only the fee simple estate in the real estate but also owns and sells the hotel management business as well. In that case, there may be a business intangible reflected in the sale price.

But hotel transactions do not normally include the transfer and value of the hotel management business, which remains owned by the hotel management company and is not part of the transaction.

The opposing point of view is not reflective of market behavior and is just another myth.

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EXHIBIT

HOTEL REIT PURCHASES⁽¹⁾ 2015 -2021

Hotel REIT Name	Sale No.	Date/ Period Ending	Property Name/Location	Sale Price Allocation			Accounting Entries		SEC Recorded Sale Price
				Real and Personal Property			Intangible Assets ⁽²⁾	Net Other Assets & Liabilities	
				Real Estate ⁽²⁾	FF&E	Total			
Ashford Hospitality Trust, Inc.	1	2/6/2015	Lakeway Resort & Spa/Austin, TX	\$29,244,000	\$4,237,000	\$33,481,000	\$0	\$0	\$33,500,000
	2	4/29/2015	Hampton Inn & Suites/Gainesville, FL	\$22,697,000	\$1,139,000	\$23,836,000	\$1,412,000	-\$150,000	\$25,200,000
	3	6/3/2015	Le Pavilion Hotel/New Orleans, LA	\$57,694,000	\$4,788,000	\$62,482,000	\$0	\$486,000	\$62,500,000
	4-12	6/17/2015	The Rockbridge 9 Hotel Portfolio	\$209,503,000	\$15,451,000	\$224,954,000	\$0	-\$298,000	\$225,000,000
	13	2/25/2015	Memphis Marriott East Hotel/Memphis, TN	\$39,144,000	\$4,350,000	\$43,494,000	\$0	\$34,000	\$43,500,000
	14	7/1/2015	W Atlanta Downtown/Atlanta, GA	\$54,111,000	\$2,626,000	\$56,737,000	\$0	\$1,358,000	\$56,800,000
	15	7/23/2015	Le Meridian Minneapolis Hotel/Minneapolis, MN	\$14,335,000	\$665,000	\$15,000,000	\$0	\$215,000	\$15,000,000
	16	8/5/2015	Hilton Garden Inn/Wisconsin Dells, WI	\$14,784,000	\$401,000	\$15,185,000	\$0	-\$39,000	\$15,200,000
	17	11/10/2015	W Minneapolis-The Foshay/Minneapolis, MN	\$84,272,000	\$3,868,000	\$88,140,000	\$0	\$1,937,000	\$88,100,000
	18	10/15/2016	Hotel Indigo/Atlanta, GA	\$25,365,000	\$1,576,000	\$26,941,000	\$0	\$425,000	\$26,900,000
	19	6/29/2018	Hilton Alexandria Old Town/ Alexandria, VA	\$108,994,000	\$2,479,000	\$111,473,000	\$0	\$194,000	\$111,000,000
	20	10/31/2018	La Posada de Santa Fe, Santa Fe, New Mexico	\$49,316,000	\$835,000	\$50,151,000	\$0	\$366,000	\$50,000,000
	21	1/22/2019	Embassy Suites New York Midtown Manhattan/New York, NY	\$191,666,000	\$8,626,000	\$200,292,000	\$0	\$1,559,000	\$195,000,000
	22	2/26/2019	Hilton Santa Cruz/Scotts Valley/Santa Cruz, CA	\$43,642,000	\$3,852,000	\$47,494,000	\$0	\$727	\$47,500,000
Chatham Lodging Trust	23	2/25/2015	Residence Inn, Gaslamp, San Diego, CA	\$89,040,000	\$960,000	\$90,000,000	\$0	\$158,000	\$90,000,000
	24	7/17/2015	Residence Inn, Dedham, MA	\$21,534,000	\$466,000	\$22,000,000	\$0	\$42,000	\$22,000,000
	25	8/17/2015	Residence Inn, Ft. Lauderdale	\$33,248,000	\$252,000	\$33,500,000	\$0	-\$205,000	\$33,500,000
	26	9/17/2015	Hilton Garden Inn, Marina del Rey	\$43,210,000	\$1,340,000	\$44,550,000	\$0	\$1,984,000	\$45,100,000
	27	9/20/2017	Hilton Garden Inn/Portsmouth, NH	\$41,230,000	\$2,120,000	\$43,350,000	\$0	\$25,000	\$43,400,000
	28	12/31/2017	Embassy Suites by Hilton/Springfield, VA	\$68,507,000	\$1,490,000	\$70,000,000	\$0	\$29,000	\$68,000,000
	29	11/15/2017	Courtyard Charleston/Summerville, SC	\$19,423,000	\$730,000	\$20,153,000	\$0	\$81,000	\$20,200,000
Diamond Rock Hospitality Co.	30	8/3/2014	Inn at Key West, Fort Lauderdale, FL	\$46,259,000	\$1,241,000	\$47,500,000	\$0	\$326,000	\$47,500,000
	31	9/1/2014	Hilton Garden Inn/Times Square Central	\$149,196,000	\$6,204,000	\$155,400,000	\$0	\$370,000	\$154,100,000
	32	12/3/2014	Westin Fort Lauderdale, FL	\$137,520,000	\$11,480,000	\$149,000,000	\$0	\$12,000	\$149,000,000
	33	2/6/2015	Shorebreak Hotel/Huntington Beach, CA	\$57,433,000	\$1,338,000	\$58,771,000	\$0	\$52,000	\$58,800,000
	34	6/30/2015	Sheraton Suites/Key West, FL	\$92,550,000	\$1,378,000	\$93,928,000	\$0	\$500,000	\$94,400,000
	35	3/1/2018	Landing Resort & Spa/South Lake Tahoe, CA	\$39,167,000	\$3,346,000	\$42,513,000	\$0	-\$685,000	\$42,000,000
Hersha Hospitality Trust	36	6/16/2015	St. Gregory Hotel/Washington, DC	\$56,769,000	\$3,240,000	\$60,009,000	\$45,000	\$978,000	\$61,032,000
	37	12/29/2015	Ritz Carlton/Georgetown, DC	\$46,730,000	\$3,270,000	\$50,000,000	\$0	\$0	\$50,000,000
	38	1/28/2016	Sanctuary Beach Resort/Marina, CA	\$37,107,000	\$2,369,000	\$39,476,000	\$0	\$198,000	\$39,674,000
	39	3/9/2016	Hilton Garden Inn/Washington, DC	\$96,102,000	\$9,621,000	\$105,723,000	\$874,000	\$0	\$106,597,000
	40	7/21/2016	Envoy Hotel/Boston, MA	\$101,243,000	\$11,251,000	\$112,494,000	\$131,000	\$0	\$112,625,000
	41	10/20/2016	Courtyard Sunnyside, CA	\$70,966,000	\$4,034,000	\$75,000,000	\$150,000	\$537,000	\$75,150,000
	42	1/3/2017	Mystic Hotel & Spa/Groton, CT	\$41,860,000	\$7,240,000	\$49,100,000	\$899,000	\$0	\$49,999,000
	43	2/1/2017	The Ritz Carlton/Cocoanut Grove, FL	\$35,927,000	\$1,064,000	\$36,991,000	-\$291,000	\$0	\$36,700,000
	44	2/21/2017	The Pan Pacific Hotel/Seattle, WA	\$72,335,000	\$6,665,000	\$79,000,000	\$0	\$0	\$79,000,000
	45	6/29/2017	The Westin/Philadelphia, PA	\$122,605,000	\$12,028,000	\$134,633,000	\$367,000	\$0	\$135,000,000
	46	3/28/2018	Annapolis Waterfront Hotel/Annapolis, MD	\$43,260,000	\$1,802,000	\$45,062,000	-\$3,199,000	\$0	\$41,863,000
Pebblebrook Hotel Trust	47	3/31/2011	Westin San Diego, San Diego	\$107,186,000	\$2,814,000	\$110,000,000	\$0	\$0	\$110,000,000
	48	6/11/2015	The Tuscan (Hotel Zoe)/San Francisco, CA	\$119,448,000	\$2,500,000	\$121,948,000	\$0	\$0	\$122,000,000
Xenia Hotels & Resorts, Inc.	49	5/1/2017	Hyatt Regency Grand Cypress/Orlando, FL	\$183,673,000	\$17,656,000	\$201,329,000	\$4,171,000	\$0	\$205,500,000
	50-52	7/1/2015	3 Hotels (Canary/Santa Barbara, CA; Hotel Palomar/Philadelphia, PA; and River Place Hotel/Portland, OR)	\$222,671,000	\$21,907,000	\$244,578,000	\$422,000	\$0	\$245,000,000
	53-54	10/3/2017	Hyatt Regency Scottsdale, AZ and Royal Palms Resort, Phoenix, AZ	\$300,928,000	\$4,072,000	\$305,000,000	\$0	\$0	\$305,000,000
				\$3,439,894,000	\$198,771,000	\$3,638,665,000	\$4,981,000	\$10,489,727	\$3,638,340,000
			Ratio to Recorded SEC Sale Price	94.55%	5.46%	100.01%	0.14%	0.29%	

⁽¹⁾ Information was taken from 10-Ks and/or 10-Qs.

⁽²⁾ Real estate is a combination of land and building improvements.

⁽³⁾ Intangible assets reflect accounting adjustments made by accountants in financial statements and IRS filings consistent with accounting and IRS rules and regulations. They primarily consisted of adjustments for above and below market rents, rents on leases, contracts and ground rent, advance bookings and loan costs.

Source: Research by Korpacz Realty Advisors, Inc.

Conclusions

First, the market evidence (consisting of verifiable facts from comparable sale verifications; public hotel REIT acquisition information; published real estate investor surveys; real estate appraisers who provide services for lenders, pension funds, property owners, and eminent domain condemnation and assessment appeal litigants) that comparable hotel sale transactions do not reflect the prices/values of going concerns is overwhelming.

That is a supportable, factual market reality.

And second, the contention that individual hotel transactions reflect the price/value of going-concerns values has no identifiable market support and is a myth, inconsistent with market behavior and not credible.

However, the overwhelming market evidence on this topic stands in contrast to a barrage of faulty theories and assumptions put forth by appraisers engaged by hotel property owners in assessment litigation.

These unproven myths need to be constantly challenged with the unsailable market realities.

We hope this article provides timely market-based guidance to help in this important task.



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