



*Expertise that Works*

# 2014 Hospitality Summit

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**Hotel Valuation and the Appraisal Institute**

**Presented by: David Lennhoff, SC&H Group & Jeff Shaney, SC&H Group**



# Introduction

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- Provide background of evolution of hotel valuation methodology in Appraisal Institute
- Discuss current treatment of hotel valuation methodology in Appraisal Institute courses and publications

# Background

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- Very little of substance offered to members prior to 2001
- Both textbooks and educational offerings recognized the issue after a curriculum committee white paper on it in late 1990s revealed inconsistency and lack of direction.
  - Led to: Debate at 1999 National Meeting in Orlando and
  - Development of Course 800, which premiered in Washington, DC in 2001

## Textbooks

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- Prior to the 12<sup>th</sup> edition of *The Appraisal of Real Estate* (2001), very little on topic appeared in this text
- With the 12<sup>th</sup> and continuing through current 14<sup>th</sup> ed., much more included. Current edition as full chapter devoted to topic
- Much back and forth, however, in *Appraisal Journal* articles prior to 12<sup>th</sup> edition
- *A Business Enterprise Value Anthology*, 1<sup>st</sup> and 2<sup>nd</sup> editions both provide wide coverage of issues relating to separating the various components of a hotel going concern. 1<sup>st</sup> ed. included ten articles on the topic while 2<sup>nd</sup> ed. carried nine more.

## Textbooks (cont.)

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- Hotel textbooks written by Stephen Rushmore date to 1978, with the most recent 2012. For the most part they present a consistent method for removing the intangibles, which involves simply deducting a management fee.
- The most recent domestic edition, 2001, specifically avoids discussing methodology for allocation or separation, as does the 2012 international hotel volume.

## Courses and Seminars

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- There are currently only one course and one seminar from the Appraisal Institute dealing with the topic.
  - Course 833
    - *Fundamentals of Separating Real Property, Personal Property, and Intangible Business Assets*
  - Small Hotel/Motel Valuation: Appraising the Limited-Service Lodging Facility

# Textbook Content

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- *The Appraisal of Real Estate*
  - Prior to 2001 very little content on topic.
    - 12<sup>th</sup> edition carried expanded discussion consistent with content of Course 800 (predecessor to Course 833), included in a chapter entitled “Appraisal Specialties and Emerging Issues.”

## Textbook (cont.)

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- 14<sup>th</sup> ed. Includes a full chapter of discussion of various approaches to separating the assets, though not specific to hotels
  
- Addresses specifically three techniques:
  - Management Fee method
  - Market Participant Survey approach
  - Parsing the Income method

## Management Fee Method

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- For various reasons this method is still used frequently, probably because it is easy and because it really does not remove any business value, thereby assisting in obtaining large loans
- Text does not rebut the method other than to say critics point out it does not account for a return on the business asset

## Market Participant Survey Approach

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- Relies on anecdotal evidence and such sources as filings of property owner's allocations with the Securities and Exchange Commission
- Critics of this method say buyers and sellers may have no need or motivation to allocate the value or have reasons for allocating in a certain way that may have no relationship to actual contributions of various assets
- Proponents say it is the method most closely aligned with the market

## Parsing The Income Method

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- This method is the one introduced in the courses by the Institute.
- Biggest complaint of it from critics seems to be that it can be difficult and if not done properly will result in wrong answer.

## Rushmore Textbooks

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- Early editions focused on management fee method as basis for removing business value
- 1983 version also included a proxy rent model, in which 16% of the total asset revenue was attributable to real estate rent. This method did not show up in subsequent editions
- Beginning with 2001 issue the topic was dropped from discussion. In its place was the statement, “Methodologies associated with the separation of business value from total property value have been evolving over time, and many theories exist. For further information about the separation of business value, the reader is directed to recent Appraisal Institute publications.” (Presumably Course 833)

## Rushmore Textbooks (cont.)

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- It is interesting to note, however, that while the text is dealing with valuing the total assets (no separation), a deduction is made in the income statement for a management fee, a franchise fee and a replacement allowance.
- This would more than imply deducting these items clearly not a method for their removal, rather they simply represent operating expenses.

## Educational Content *Course 833*

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- This 2011 course, which was an update to the 2001 800 course, deals extensively with the topic albeit not specifically in context of hotels. (Course 800 had a lengthy hotel case study as its centerpiece, which utilized a proxy rent model for removing intangibles)
- Using an elaborate case study, “Cave World,” the course illustrates weaknesses in the management fee method, relief from royalties method and 25% rule
- The case solution reveals a significant difference in amount allocated to intangibles between the parsing the income method—upon which the conclusion is based—and the other techniques

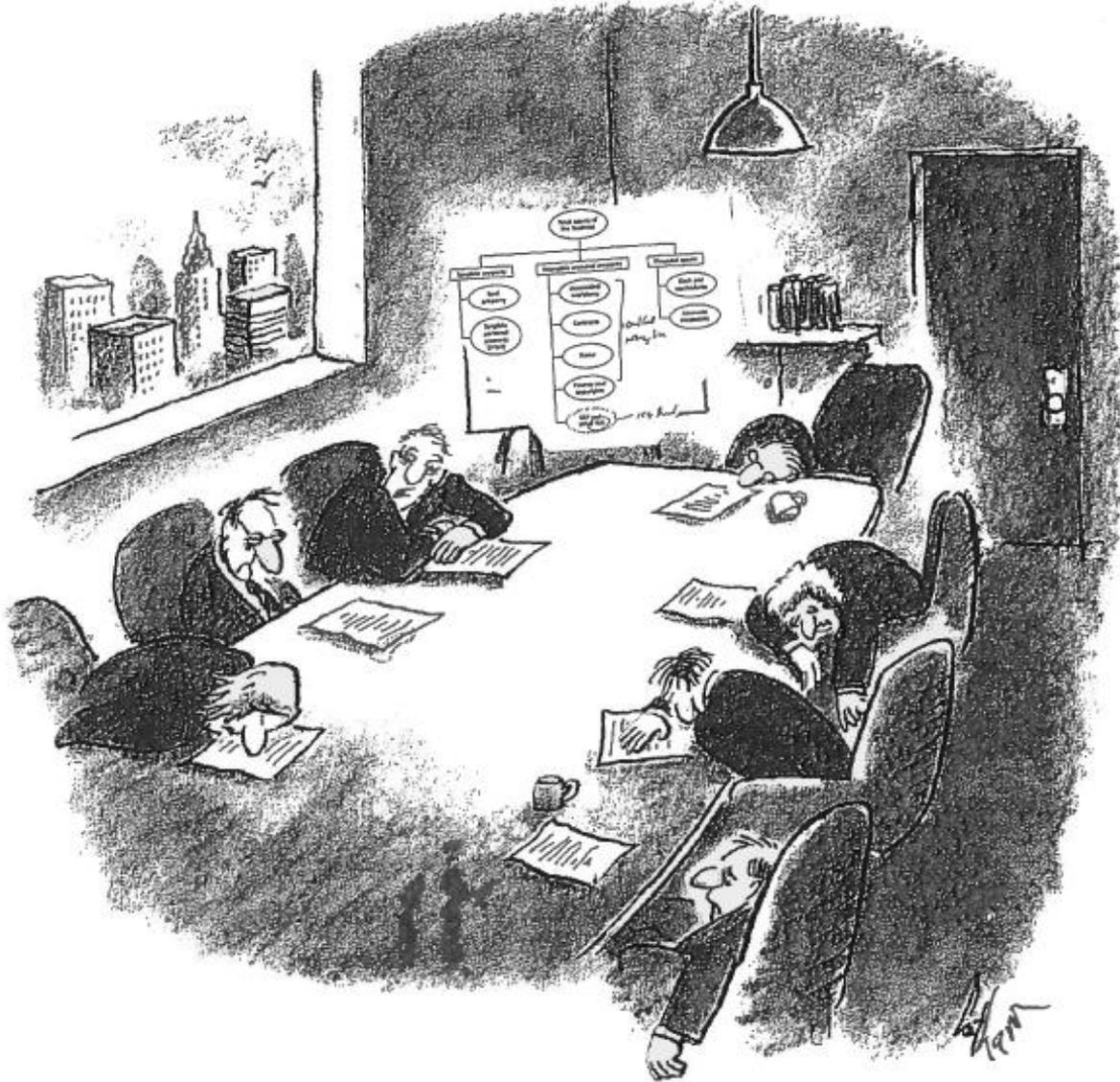
## Educational Content *Small Hotel/Motel Valuation Seminar*

- This seminar has been offered by the Institute since 2001. These days, however, it is mostly presented online
- Although the seminar does not specifically get into examples of separating the assets, it does thoroughly address the topic in Part 5, *Allocating the Assets*. Here it cautions, “the concept that deducting a management fee and franchise fee removes the business component” should be avoided, as “in truth, this method removes none of the business value because management and franchise fees are operating expenses.”

## Conclusions

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- Disappointing Appraisal Institute has not taken more of lead with this issue
- Encouraging that effort has been and is continuing to be expended to move the thinking on the topic
- In the words of Baltimore born 20<sup>th</sup> Century American author (and unsuccessful politician), Upton Sinclair, “It is difficult to get a man to understand something, when his salary depends on his not understanding it.”



*"We've been at it for the better part of an hour and still no solution."*

# Contact Information

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