



H&LA

HOTEL & LEISURE ADVISORS

30th Annual Ohio Business Tax Conference & Virtual Institute

Best Practices and Strategies for Determining Value for Hospitality Properties

Presented by:
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The COVID Impact

January 2020 vs 2021 Impact on Valuations

- As of January 2020, COVID was not known or expected
- As of January 2021, hotels have been severely impacted by COVID pandemic with value declines on a nationwide basis ranging between 10% and 50% from pre-pandemic levels
- Occupancy, ADR, net income have declined at nearly all hotels throughout the United States
- Urban hotels are affected more than resort and rural properties due to the collapse of the group market and major decline in the commercial transient demand



Pre-COVID Performance

Overall U.S. Lodging Performance

	Occupancy	% Change	ADR	% Change	RevPAR	% Change
2015	65.5%	1.7%	\$120.01	4.5%	\$78.63	8.1%
2016	65.4%	-0.2%	\$124.13	3.4%	\$81.15	3.2%
2017	65.9%	0.8%	\$126.72	2.1%	\$83.57	3.0%
2018	66.2%	0.5%	\$129.83	2.4%	\$85.96	2.9%
2019	66.1%	-0.2%	\$131.21	1.0%	\$86.76	0.9%

Source: STR

2020 vs 2019 Performance

U.S. Hotel Performance by Regions - Year-To-Date

November 2020 vs. November 2019

	Occupancy			ADR			RevPAR		
	2019	2020	% Change	2019	2020	% Change	2019	2020	% Change
New England	66.1%	39.4%	-40.3%	\$163.11	\$124.94	-23.4%	\$107.81	\$49.28	-54.3%
Middle Atlantic	69.9%	42.2%	-39.6%	\$164.65	\$116.44	-29.3%	\$115.05	\$49.14	-57.3%
South Atlantic	68.5%	46.2%	-32.5%	\$128.60	\$108.65	-15.5%	\$88.05	\$50.20	-43.0%
East North Central	62.5%	39.9%	-36.1%	\$113.55	\$87.54	-22.9%	\$70.94	\$34.96	-50.7%
East South Central	63.7%	46.2%	-27.4%	\$104.29	\$86.15	-17.4%	\$66.39	\$39.81	-40.0%
West North Central	59.6%	39.9%	-33.1%	\$99.86	\$84.21	-15.7%	\$59.56	\$33.58	-43.6%
West South Central	63.7%	45.4%	-28.6%	\$102.53	\$83.48	-18.6%	\$65.27	\$37.94	-41.9%
Mountain	68.1%	47.5%	-30.2%	\$122.16	\$106.18	-13.1%	\$83.16	\$50.48	-39.3%
Pacific	74.7%	48.1%	-35.5%	\$172.18	\$131.13	-23.8%	\$128.56	\$63.10	-50.9%
Total U.S.	67.1%	44.7%	-33.3%	\$131.56	\$104.10	-20.9%	\$88.31	\$46.57	-47.3%

Source: STR Hotel Review

The COVID Impact

2020-2021 Industry Forecasts

	STR		CBRE		HVS	
	2020	2021	2020	2021	2020	2021
Occupancy Change	-36.0%	23.6%	-40.3%	31.3%	-36.8%	31.3%
ADR Change	-21.0%	5.3%	-20.4%	7.5%	-20.4%	7.5%
RevPAR Change	-49.5%	30.3%	-52.5%	41.1%	-49.6%	40.9%
Occupancy	42.2%	52.2%	39.8%	52.3%	41.8%	54.8%
ADR	\$103.65	\$109.21	\$104.10	\$111.89	\$105.00	\$112.00
RevPAR	\$43.76	\$57.03	\$41.43	\$58.52	\$44.00	\$62.00

Source: STR/Tourism Economics (November 2020), CBRE (September 2020), HVS (November 2020)

- Major declines have occurred in occupancy, ADR, and overall performance of hotels in 2020
- Improvement expected in 2021, but not nearly to the level of previous years
- It will take until 2023/24 to get back to levels similar to 2019



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The Hotel Appraisal Process

Unique Challenges of Hotel and Leisure Property Valuation

- Going concerns
- Hotels, casinos, waterparks, amusement parks, FECs, restaurants have intangible components
- Very management intensive
- New customers every single day
- Franchises and management companies



The Hotel Appraisal Process

Market Analysis

- A thorough market analysis of the local hospitality market is essential
- The value conclusion will depend heavily upon this data
- Market research encompasses a wide range of data:
 - Population trends
 - Household income
 - Major employers
 - Transportation
 - Comparative property data
 - Occupancy, ADR, and usage level
 - Demand trends
 - Fill days

The Hotel Appraisal Process

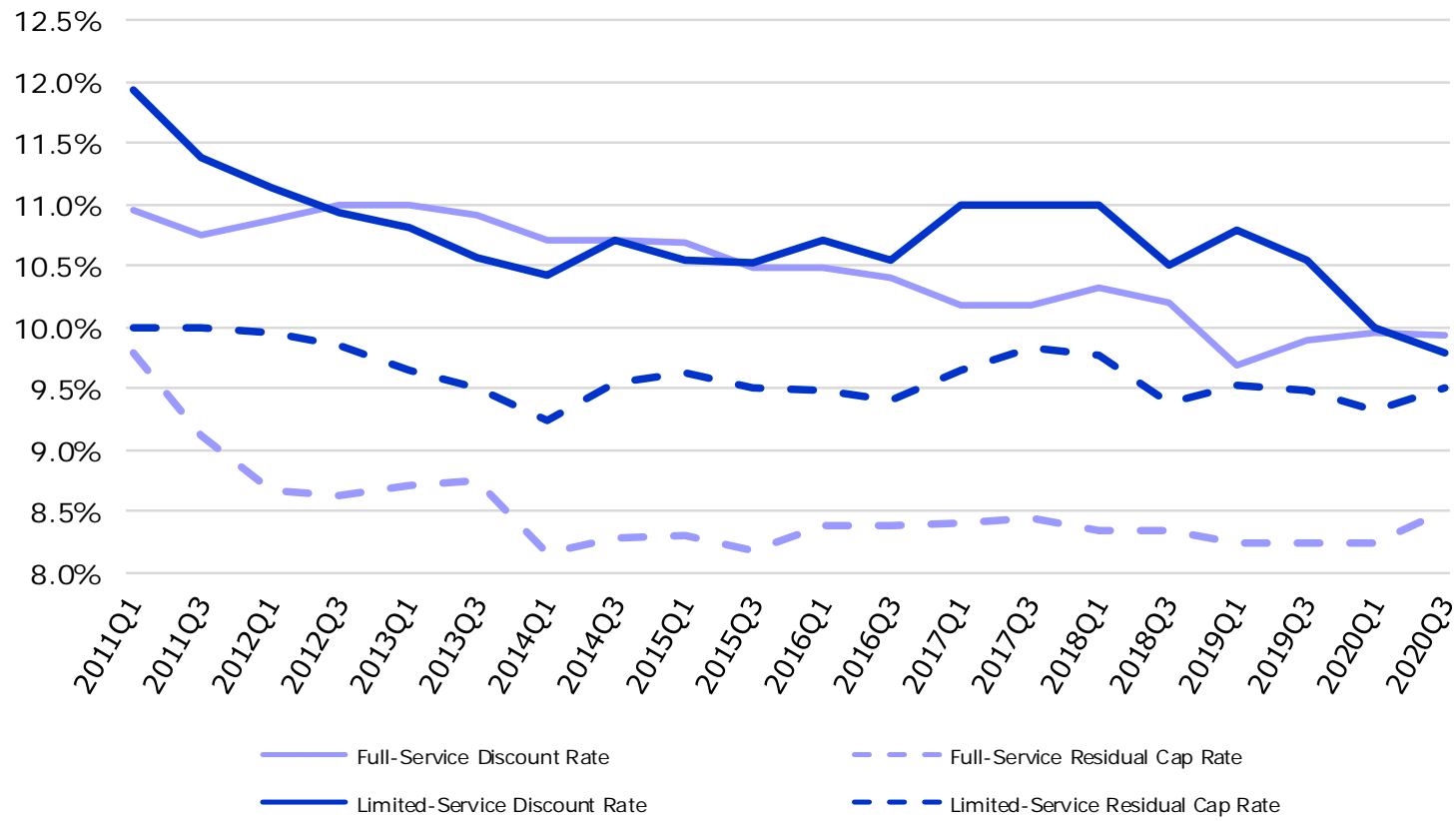
The Valuation Process: Income Capitalization Approach

- The direct capitalization approach or discounted cash flow (DCF) analysis are most appropriate for hospitality properties. DCF may be more appropriate for the near future
- Financial data: Interview management and obtain historical financial statements
- Collect historical performance data: market segmentation reports, occupancy and ADR figures, comparable financial statements, and other performance statistics
- Analyze and estimate various revenue and expense departments in determining the projected net operating income for projection



Cap Rates History

10-Year Lodging Discount and Residual Capitalization Rate History



Source: PwC Investor Surveys

The Hotel Appraisal Process

The Valuation Process: Income Capitalization Approach

- Hotel management fee and franchise fee
- Real estate tax additor
- Reserve for replacement
- Capitalization and discount rates (only small changes in 2020)
- Going concern value



The Hotel Appraisal Process

The Valuation Process: Sales Comparison Approach

- Analyze sales of comparable quality and ensure that the sale price is of comparable value (going concern, not real estate only)
- Need information on sale price, condition of asset, historical performance, ADR, renovation cost information, amenity offerings of the property, and special circumstances concerning each sale.
- Adjust sales to account for differences in location, size of the property, occupancy, ADR, and net income performance, time, circumstances of the sale, etc.

The Hotel Appraisal Process

The Valuation Process: Cost Approach

- The cost to replace the improvements is estimated and a deduction is made for any depreciation.
- The result is then combined with the estimated value of the underlying land.
- Most appropriate when appraising a proposed development where development budgets and land cost are available.
- Less appropriate for an older hotels due to the difficulty in estimating depreciation though can be helpful in determining amount of business value

The Hotel Appraisal Process

Allocation of the Going Concern Value

- Personal Property
- Real Estate
- Business Value



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Removing Business Value from Real Property

- Many theories on removing business value exist among appraisers with dozens of articles having been published in the Appraisal Journal (for which I am a reviewer) and other publications over the past two decades
- Walt Disney Parks & Resorts, U.S., Inc. vs Rick Singh, Orange County Property Appraiser is a recent case that is going through appeals
- In performing the income capitalization approach, the appraiser should adjust revenue and expense categories to reflect competent management, not extraordinary management that could be currently occurring at the property
- Appraiser should determine the depreciated value of the personal property

Removing Business Value from Real Property

- The removal of the management fee, franchise fee, and a reserve for replacement accounts for the bulk of the business value for most hotels
- An appraiser should perform a formal or informal cost approach and if the value from the income approach after these deductions is higher than the cost approach, then the difference could equal additional business value
- The hotel appraisal should also consider whether the property has historically been operating with above average performance levels and intangible value should be allocated.

The Hotel Appraisal Process

Conclusion

- Nearly all hotels and leisure properties will have a negative value change in 2020 due to the dramatic drop in demand
- Appraiser should consider historical and projected performance levels and not only the 2020 pandemic year in determining valuation conclusion
- The lack of sale transactions of hotels and leisure properties in 2020 limits the amount of market support for value conclusions
- Valuation of intangibles will continue to be controversial



Questions



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