



**Assessment and Taxation Department • Service de l'évaluation et des taxes**

## **VALUATION OF HOTELS**

**2010 General Assessment**

City of Winnipeg  
Assessment and Taxation Department  
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## ***Introduction***

This document outlines the process used by the City of Winnipeg Assessment and Taxation Department to determine the assessed values of hotels in Winnipeg for the 2010 realty assessment roll. The assessed value is the full market value of the fee simple interest as of the reference date of April 1, 2008.

Currently, there are 102 hotels in Winnipeg. Roughly half of these are beverage hotels—hotels that derive most of their revenue from the sale of alcoholic beverages rather than from room sales.

## ***Data Collection***

### *Physical Characteristics*

The Assessment and Taxation Department maintains a database containing physical descriptions of all land and improvements in Winnipeg. These data are updated with periodic field inspections and supplemented with information from returned questionnaires as well as information filed in connection with revisions/appeals.

### *Sales*

The provincial land titles office is the source of basic details of transfers of land. Going concern sale prices—which include the value of furniture, fixtures, equipment (FF&E) and goodwill—are usually reported to the Assessment and Taxation Department by one of the parties to the transfer. Below are the hotel sale counts for the time period from January 1, 2004 to April 1, 2008:

<u>Hotel type</u>	<u>Number of sales</u>
Hotels	5
Beverage hotels	18
Total	23

Sales of hotels are investigated to determine if they were bona fide arms-length transfers and if they were subject to any unusual financing arrangements. Questionnaires mailed to the purchasers assist in this verification process.

### *Revenues and Expenses*

For the most part, average daily room rates (ADRs), occupancy rates, revenue per available room (RevPAR), other revenue, and expenses come from responses to questionnaires mailed to hotel owners. Completed 2007 questionnaires were returned for 73% of the total hotel inventory. In addition, revenue and expense data published in various reports are considered, as is information filed in connection with revisions/appeals.

## Valuation

The *income approach* is generally used to estimate the value of hotel properties because the primary consideration for a purchaser of a hotel is its income-producing capability. This approach involves the direct capitalization of net operating income. The basic equation for direct capitalization is as follows:

$$\text{Market Value} = \frac{\text{Net Operating Income}}{\text{Capitalization Rate}}$$

Perhaps more than any other income-producing property, the value of hotel real estate relates to its actual performance. Therefore, actual revenue and expenses are the starting point in the valuation process. This data is then compared with similar hotels in order to establish typical performance and appropriate assessed values.

### Net Operating Income (NOI)

The annual net operating income (NOI) is calculated using stabilized revenues and expenses laid out according to the Uniform System of Accounts for the Lodging Industry. A major benefit of organizing and presenting information on a uniform basis is the ability to compare the performance of one hotel with others.

A stabilized income stream starts with actual revenue and expense amounts for the year prior to the reference date (April 1, 2008). The actual amounts are then adjusted, if necessary, to reflect a typical operation. Adjustments are made after examination of the income streams from preceding years as well as data from comparable properties. Where actual revenues and expenses are not available, a stabilized income stream is estimated using data from comparable properties.

### Revenues

Average rates for the major revenue categories are shown in the table below:

Category	Hotels	Beverage hotels
Average daily rate (ADR) (\$)	93.89	-
Occupancy rate	69%	-
Revenue per available room (RevPAR) (\$)	64.78	11.85
Food & beverage per licensed seat (\$)	2,770	2,030
Net VLT income per machine (\$)	15,900	13,700

## Expenses

Average rates for the major expense categories are shown in the tables below:

### *Departmental Expenses*

<u>Category</u>	<u>Hotels</u>	<u>Beverage hotels</u>
Rooms (% of room revenue)	27.0	42.9
Food & beverage costs (% of F&B revenue)	40.6	41.0
Food & beverage wages (% of F&B revenue)	37.0	26.6

### *Undistributed Expenses*

<u>Category</u>	<u>Hotels</u>	<u>Beverage hotels</u>
Administration & General (% of total revenue <sup>1</sup> )	11.9	14.8
Marketing (% of total revenue)	4.5	2.6
Energy & water (% of total revenue)	5.4	6.2
Repair & maintenance (% of total revenue)	5.4	5.6
Management fees (% of total revenue <sup>2</sup> )	4.0	4.0
FF&E reserve (% of total revenue)	3.0	3.0

### *Fixed Expenses*

<u>Category</u>	<u>Hotels</u>	<u>Beverage hotels</u>
Business tax (% of total revenue)	1.2	1.2
Property tax (% of total revenue)	4.7	4.2
Insurance (% of total revenue)	0.8	2.5

## **Income Attributable to Management**

A *management fee* expense equal to four percent of total revenue is deducted for all hotels. For hotels with revenue from video lottery terminals (VLTs), the net VLT revenue, not the gross, is included in total revenue. For hotels with beer vendor revenue, the cost of vendor sales is deducted from the total revenue before the four percent is

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<sup>1</sup> Total revenue excludes VLT revenue and is reduced by an amount equal to the cost of vendor sales, if applicable.

<sup>2</sup> For the management fee calculation, total revenue includes net VLT income and is reduced by an amount equal to the cost of vendor sales, if applicable.

applied. The management fee expense is considered to account for the income attributable to the business.

### **Furniture, Fixtures, and Equipment (FF&E)**

The value of *non-assessable furniture, fixtures, and equipment (FF&E)* is removed in two components. First, the return *of* the investment in FF&E is removed from the income stream in the form of a reserve for FF&E replacement equal to three percent of total revenue. For this calculation, total revenue excludes VLT revenue entirely and is reduced by an amount equal to the cost of vendor sales, if applicable. Second, the current value of the FF&E is removed by reducing the hotel's capitalized value by the following percentages:

<u>Hotel type</u>	<u>FF&amp;E deduction</u>
Hotels	15%
Beverage hotels	10%

This lump sum adjustment is analogous to removing the return *on* the investment in FF&E from the income stream.

### **Capitalization Rates**

Capitalization rates, which convert the stabilized net operating income into a market value estimate, are derived from an analysis of hotels that sold prior to the reference date. Stabilized net operating incomes for sold properties are calculated in a manner consistent with that used for valuation (described above) and then divided by the going concern sale price to yield the capitalization rate. For the most part, hotel capitalization rates range as follows:

<u>Hotel type</u>	<u>Cap rate range</u>
Hotels	9% to 11%
Beverage hotels	13% to 16%

### **Conclusion**

The number of variables that affect the values of hotels is greater than for other property types. For this reason, each hotel property is analyzed individually. The most weight is placed on actual performance but industry norms are also considered. The goal is to achieve accurate estimates of market value that are, at the same time, fair and equitable.

**Example of a Hotel Income Valuation (all figures are fictional)**

Available room nights	63,875	63,875	63,875	63,875
Occupied room nights	45,990	48,545	47,268	47,268
Average daily rate (ADR)	100.00	105.00	110.00	110.00
Occupancy rate	72.00%	76.00%	74.00%	74.00%
RevPAR	72.00	79.80	81.40	81.40

<b>Year end Dec. 31</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>Stabilized</b>	<b>%</b>
<b>Revenue</b>					
Rooms	4,599,000	5,097,225	5,199,425	5,199,425	75.4
Food & beverage	1,380,000	1,490,000	1,600,000	1,600,000	23.2
Telephone	35,000	32,000	29,000	29,000	0.4
Parking	25,000	27,000	30,000	30,000	0.4
Other	42,000	45,000	35,000	35,000	0.5
	6,081,000	6,691,225	6,893,425	6,893,425	100.0
<b>Departmental Expenses</b>					
Rooms	1,330,000	1,480,000	1,500,000	1,500,000	28.8
Food & beverage cost	500,000	550,000	592,000	592,000	37.0
Food & beverage wages	550,000	595,000	640,000	640,000	40.0
Telephone	32,000	29,000	27,000	27,000	93.1
Parking	12,500	13,500	15,000	15,000	50.0
Other	8,000	9,000	7,000	7,000	20.0
	2,432,500	2,676,500	2,781,000	2,781,000	40.3
<b>Undistributed Expenses</b>					
Administration & General	250,000	270,000	285,000	285,000	4.1
A&G management wages	-	-	-	-	0.0
A&G wages & benefits	240,000	265,000	275,000	275,000	4.0
Marketing	210,000	240,000	245,000	245,000	3.6
Energy & water	270,000	295,000	300,000	300,000	4.4
Repair & maintenance	280,000	320,000	310,000	310,000	4.5
Management fees	182,000	200,000	210,000	275,737	4.0
Franchise fees	230,000	255,000	260,000	260,000	3.8
FF&E reserve	-	-	-	206,803	3.0
	1,662,000	1,845,000	1,885,000	2,157,540	31.3
<b>Fixed Expenses</b>					
Business tax	62,000	67,000	69,000	69,000	1.0
Property tax	280,000	300,000	310,000	310,000	4.5
Insurance	30,500	33,000	34,000	34,000	0.5
Other	-	-	-	-	0.0
	372,500	400,000	413,000	413,000	6.0
<b>Net Operating Income</b>	<b>1,614,000</b>	<b>1,769,725</b>	<b>1,814,425</b>	<b>1,541,885</b>	<b>22.4</b>

Capitalized value	<b>9.0%</b>	17,132,058
FF&E deduction	<b>15.0%</b>	(2,569,809)
Adjustment		
<b>Final value</b>		<b>14,562,250</b>

**Example of a Beverage Hotel Income Valuation (all figures are fictional)**

<b>Year end Dec. 31</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>	<b>Stabilized</b>	<b>%</b>	
<b>Revenue</b>						
Rooms	120,000	115,000	135,000	135,000	3.0	
Food	310,000	305,000	300,000	300,000	6.7	
Beverage	1,040,000	1,080,000	1,150,000	1,150,000	25.6	
Vendor	2,000,000	2,100,000	2,200,000	2,200,000	49.1	
Other	195,000	205,000	200,000	200,000	4.5	
	3,665,000	3,805,000	3,985,000	3,985,000	88.9	
<b>Departmental Expenses</b>						
Rooms	48,000	50,000	55,000	55,000	40.7	
Food cost	153,000	151,000	150,000	150,000	50.0	
Food wages	225,000	250,000	230,000	230,000	76.7	
Beverage cost	421,000	433,000	445,000	445,000	38.7	
Beverage wages	166,000	165,000	150,000	150,000	13.0	
Entertainment	158,000	160,000	170,000	170,000	14.8	
Vendor cost	1,680,000	1,750,000	1,844,000	1,844,000	83.8	
Vendor wages	68,000	71,000	75,000	75,000	3.4	
Other	90,000	95,000	90,000	90,000	45.0	
	3,009,000	3,125,000	3,209,000	3,209,000	80.5	
<b>Undistributed Expenses</b>						
Administration & General	110,000	100,000	120,000	120,000	5.6	12.6%
A&G management wages	70,000	75,000	80,000	80,000	3.7	
A&G wages & benefits	70,000	65,000	70,000	70,000	3.3	
Marketing	85,000	65,000	52,000	52,000	2.4	
Energy & water	112,000	122,000	120,000	120,000	5.6	
Repair & maintenance	80,000	150,000	110,000	110,000	5.1	
Management fees	-	-	-	105,640	4.0	
Franchise fees	-	-	-	-	0.0	
FF&E reserve	-	-	-	64,230	3.0	
	527,000	577,000	552,000	721,870	33.7	
<b>Fixed Expenses</b>						
Business tax	29,000	27,000	22,000	22,000	1.0	
Property tax	115,000	95,000	90,000	90,000	4.2	
Insurance	44,000	40,000	37,000	37,000	1.7	
Other	-	-	-	-	0.0	
	188,000	162,000	149,000	149,000	7.0	
NOI before VLT	(59,000)	(59,000)	75,000	(94,870)	-2.1	
Net VLT income	470,000	490,000	500,000	500,000	11.1	
<b>NOI</b>	<b>411,000</b>	<b>431,000</b>	<b>575,000</b>	<b>405,130</b>	<b>9.0</b>	
Capitalized value	<b>13.0%</b>			3,116,385		
FF&E deduction	<b>10.0%</b>			(311,638)		
Adjustment				-		
<b>Final value</b>				<b>2,804,746</b>		