How the Income Approach Works

The Income Approach aims to obtain values for a range of hotels and motels with typical features and conditions.

The income approach methodology used in Saskatchewan for hotels/motels will be the "direct capitalization". Direct capitalization converts the expected level of current net earnings to indicate the estimated value of the property.

Only income and operating expenses necessary to operate the hotel/motel property will be used for the Income Approach.

Confidentiality of Information

The assessment jurisdiction recognizes information required may be personal, confidential or sensitive. Steps have been taken to ensure information is kept secure and confidential in accordance with confidentiality provisions in legislation.

When will the Income Approach be implemented in Saskatchewan?

The Income Approach will be used for the 2009 revaluation. The time until then is needed to:

- organize and carry out research,
- gather physical, as well as income and expense, data on properties,
- recruit and educate appraisers,
- ready computer systems to store, analyze and determine values.

Overall Capitalization Rate

For further information please contact

SAMA
Saskatchewan Assessment Management Agency

Revaluation Unit
306-924-6626 or 866-828-2133
www.sama.sk.ca

or

City of Regina
306-777-7240
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City of Saskatoon
306-975-3227
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City of Prince Albert
306-953-4320
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City of Swift Current
306-778-2777

City of North Battleford
306-445-1781

SAMA
Saskatchewan Assessment Management Agency

Hotels and Motels

Property Assessment through the Income Approach

Market Value

= Net Operatin

Income ÷ Overall Cap

Hotels and Motels

Hotels and motels are properties typically purchased for investment purposes. They return revenue to their owners in the form of income. The ability to earn income is fundamental to the value of hotels and motels. Other income value factors include economic conditions, location, and competition.

What is the Income Approach?

The Income Approach is one of three methods used by appraisers to estimate a property's assessed value. This valuation method is based on the assumption that the value of a property is directly related to the income it will generate over its economic lifetime. The Income Approach valuation method is used widely throughout North America when appraising income-producing properties such as hotels and motels.

Hotel Values Rely On Actual Performance

Perhaps more than any other income-producing property, the value of hotel real estate relates to its actual performance. There are many hotels of similar nature, but they rarely have the same features such as: room mix, room finishes, restaurants, franchise affiliations, or labour arrangements. With the income approach, actual income and expenses related to the real estate form the starting point. Actual data will then be compared to the performance of similar hotels to establish the appropriate assessment values.

Hotel Values are Sensitive to Market Change

The value of a hotel is sensitive to changes in the marketplace. Unlike other income-producing properties, revenue generated from a hotel relies on short-term stays. A reduction or increase in occupancy directly links to income. The hotel industry is cyclical in nature and values will rise and fall over time.

To even out short-term fluctuations and strengthen the assessment system, stabilized income and expenses are used to value hotels and motels.

Segregation of the Hotel Real Estate Component

The generation of gross income by hotels from a number of sources including room rentals, food and beverage sales, and other sources, supports the value of the entire enterprise. Income is generated through tangible assets such as land, buildings, and personal property, and intangible assets such as hotel management. Assessing the value of a hotel means separating the real estate portion from the value of other components.

Notes: Components are referred to as:

- *land and buildings;*
- *business interests, management, labour and operational expertise, licenses, trademarks; and*
- *furniture, fixtures and equipment (FF&E) such as beds, carpets and televisions.*

Income from the hotel/motel operation results partly from all these components. Since assessment reflects the <u>value of the real estate</u>, the valuation must differentiate between the real estate value and other components.

Application of the Income Approach to Hotels and Motels.

The Income Approach can be applied to the following hotels and motels:

- **Motel** - properties with limited amenities, generally catering to drive-by-traffic.
- **Limited Service** - properties with only some of the amenities found in full service properties.
- **Full Service** - hotels that provide a wide variety of facilities and amenities including food and beverage service, recreational facilities and meeting rooms.
- **Suite** - hotels that have separate (not necessarily physically divided) sleeping and living areas.
- **Resort** - hotels, usually in non-urban locations with recreational facilities.
- **Gallonage houses or tavern hotels**- hotels where room rentals are a minor component of the operation. They tend to have been constructed before 1940.

Due to declining populations and/or economies in some areas of rural Saskatchewan, hotels and motel establishments located in less viable communities may have to be valued by other appraisal approaches.

Bed and Breakfasts and Home-Based Inns

Bed and breakfast and/or home-based inns will not be included as part of the income approach.

Gallonage Houses or Tavern Hotels

If available income and expense data are unsuitable for the analysis of gallonage houses or tavern hotels, it may be possible to value these properties by the Sales Comparison Approach.

A sale is generally a good indicator of value, but the price paid for a hotel/motel reflects the value of the entire enterprise including real estate, business, management, and personal property. If sales data is limited, it is difficult to compare properties due to location, amenities, and condition.

Units of comparison between properties could include the value per (bar) seat, the value per volume of alcohol, or the value per square foot.