

Hotel/Motel Methodology

2021 Assessment Year

ASSESSMENT DEPARTMENT
March 2022

Scope Statement

This document is intended to be an introduction to the valuation process used to determine assessed values for hotel and motel properties in the City of Medicine Hat. For more detail regarding to a specific property, the property owner may contact an assessor with the City of Medicine Hat at 403-529-8114. Alternatively, the property owner can visit the website, www.medicinehat.ca/assessmentforms to complete an MGA s.299 or 300 request for more information and/or a Letter of Authorization form.

Property assessments in the City of Medicine Hat reflect the market value of the fee simple estate for property as of July 1, 2021 (reflecting the condition and characteristics of the property as of December 31, 2021) as required by the *Municipal Government Act* as enacted by the Government of Alberta.

For this purpose, market value is defined by the *Municipal Government Act*:

1(n) "market value" means the amount that a property, as defined in section 284(1)(r), might be expected to realize if it is sold on the open market by a willing seller to a willing buyer;

Market value, as defined by the Appraisal Institute of Canada and as detailed in the Canadian Uniform Standards of Professional Appraisal Practice as:

The most probable price, as of a specified date, in terms of cash, or in terms equivalent to cash, or in other precisely revealed terms, for which the specified property rights should sell after reasonable exposure in a competitive market under all conditions requisite to a fair sale, with the buyer and seller each acting prudently, knowledgeably, and for self-interest, and assuming that neither is under undue duress.¹

Market value, is also defined by the International Association of Assessing Officers (IAAO) as:

The most probable price (in terms of money) which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus. Implicit in this definition is the consummation of a sale as of a specified date and the passing of title from seller to buyer under conditions whereby: The buyer and seller are typically motivated. Both parties are well informed or well advised, and acting in what they consider their best interests. A reasonable time is allowed for exposure in the open market. Payment is made in terms of cash or in terms of financial arrangements comparable thereto. The price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.²

¹ AI Canada, Appraisal Journal. Winter 2020

² IAAO. *Glossary for Property Appraisal and Assessment*. Page 101.
http://www.iaao.org/media/Pubs/IAAO_GLOSSARY.pdf.

The fee simple ownership is the most complete form of ownership. The Courts and the IAAO define it as:

*Fee simple title indicates ownership that is absolute and subject to no limitation other than eminent domain, police power, escheat, and taxation.*³

The Appraisal Institute of Canada has similar definitions.

Hotel and motel properties in the city are primarily valued using the income approach to value. This valuation approach capitalizes a property's stabilized, market typical, net operating income into estimate of market value. The valuation formula for properties assessed using the income approach is:

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

³ IAAO. *Glossary for Property Appraisal and Assessment*. Page 67.
http://www.iaao.org/media/Pubs/IAAO_GLOSSARY.pdf.

Mass Appraisal

Primarily, property assessment establishes a base for the fair and equitable distribution of the tax burden. Individual assessments determine each property's share of the property tax base.

The Alberta assessment and taxation system is based on the laws outlined in the *Municipal Government Act*, RSA 2000, Chapter M-26 [MGA], and all associated regulations, including, *Matters Relating to Assessment and Taxation Regulation*, Alberta Regulation 203/2017 [MRAT].

Valuation procedures have been developed to enable assessors to prepare *market value* assessments, reflecting typical market conditions and bearing equitable relationships between similar properties. These procedures are encompassed in the practice of *mass appraisal*. The *Municipal Government Act* directs assessors to apply the valuation standards in a fair and equitable manner; the *Matters Relating to Assessment and Taxation Regulation* states that property assessments are to be prepared using *mass appraisal* to predict accurate and equitable market values.

A property assessment is:

- An estimate of the property's market value on July 1, of the assessment year;
- Prepared using mass appraisal;
- An estimate of the value of the fee simple estate in the property;
- A reflection of the property's physical characteristics and condition on December 31, of the assessment year;
- Prepared assuming typical market conditions, reasonable market exposure, a willing and knowledgeable seller to a willing and knowledgeable buyer.

Mass appraisal requires:

- Properties be stratified into groups of comparable properties.
- Common property data be identified and analyzed for the properties in each group.
- A uniform valuation method utilizing market information determined for each group will be applied to the characteristics of each property.
- Statistical testing is performed to confirm quality control.

Hotel/Motel Stratification

Hotels and motels can range from small, old, lower quality construction, one-storey buildings with dated décor and fixtures to luxurious properties with high-quality construction, modern décor and, extensive amenities. Services range from minimal services to various amenities including gyms, pools, spa, hair salons, dining rooms and restaurants. The level of services would affect the earning potential and overall costs of the operation. The expertise demanded of management and staff may vary from the family operated properties to the full multi-faceted operations.

- Full Service - Full Service hotels provide a variety of guest unit styles, meeting rooms, spacious public areas, and a wide variety of facilities including restaurants, lounges, fitness centres, pools, spas, business centres, shops and parking.
- Limited Service - Limited Service hotels are usually multi-storey establishments with interior entrances but containing fewer rooms than full service hotels. A variety of guest unit styles are offered, however, public areas including food and beverage facilities, pools and spas are usually limited.
- Motels – Motels are usually one to three storey buildings with inside or outside entrances to the units which provide easy access to parking. The standard guest units usually include a sleeping room and bathroom and are similar in decor and design throughout. Public areas are limited in the size and the variety of facilities provided. Motels range from the “mom and pop” type operations to chain affiliations where the higher end product is analogous to a hotel. It is common to have third party providers for food and beverage facilities that may be present.

Alberta Assessors' Association, Hotel/Motel Valuation Guide, page 10-11

Income Quality

The City of Medicine Hat Assessment Department bases the quality of a property on the level of productivity measured by stabilized Average Daily Rate (ADR), stabilized Occupancy rate, and stabilized Revenue per Available Room (RevPar). The income productivity of hotels and motels is typically affected by two major factors: location and physical characteristics.

Location

- Exposure and Visibility -- Properties with high traffic exposure and visibility from the major roadways tend to command a better income stream.
- Access – Properties allowing for ease of vehicular ingress and egress are of higher quality than properties that do not due to their ability to command a better income stream.

Inherent in the access and exposure/visibility equation is the question of appropriate parking. A site with adequate parking may be higher in quality compared to a property with insufficient parking based on the ability to command a better income stream. Hotel/Motel clients often have trailers that require more space to manoeuvre and park, than simply passenger vehicle clientele. Buses and tractor trailers need extra-large parking and turn around areas. Properties with insufficient parking often offer reduced rates to attract nightly clientele.

Physical Characteristics

In addition to location, the income stream may also be effected by a number of physical elements. Along with the income stream these characteristics assist the Assessor in determining the quality of a particular property.

- Building Design - The functionality of a building and individual room layout and design will influence quality by commanding a better income stream. Buildings designed to contribute to the overall comfort and care of the clients tend to be of higher in quality.
- Visual Appeal – Properties with excellent visual appeal catching the attention of prospective clients are generally regarded as a better quality and able to command a better income stream.

- Exterior Material Treatment and Finish – The exterior of the building having superior and/or modern materials and ornamentation are generally regarded as a better quality because these properties typically command a better income stream.
- Interior Finish and Décor – Interior finishing and décor vary greatly in quality depending upon materials, style, and workmanship, potentially affecting the income stream.
- Age – The effective age of a property may contribute to the quality. An older building may not be as desirable as a newer building would be. If a property (land and building) has been continuously well maintained and repaired, it is likely to continue to provide an appropriate income stream into the future.
- Condition/Maintenance – Newer and/or well-maintained buildings are generally higher quality than those with visible wear and tear as they usually produce a better income stream.

Please Note: -- “Star” ratings are not used as a classification factor due to the arbitrary application of these rating by individuals and/or travel companies. Often, individual properties will assign their own star ratings without any external unbiased input. This is merely a marketing tool and does not reflect how the property should be ranked in relation to its competitors for the purpose of property assessment.

Quality Groupings

The quality grouping mainly considers the income stream reflecting a combination of location, size, overall design, interior/exterior finishing, renovation, the quality and condition of the Furniture, Fixtures, and Equipment (FF&E).

Quality Grouping	Class	Quality Grouping	Class
Hotel	A	Motel	E
Hotel	B	Motel	F
Hotel	C		

Hotel/Motel Valuation

Three Approaches to Value

There are three approaches to determine market value: **direct comparison, income, and cost approach.**

In the **direct comparison approach**, typical market value is determined based on recent sales of comparable properties in the market. This approach requires sufficient sales of similar or identical properties in the market.

In the **income approach**, market value is indicated by typical income productivity of comparable properties. This approach considers the typical transactions between buyers and sellers by analyzing income and expense in similar properties.

In the **cost approach**, market value is determined by combining the cost of reproducing or replacing the improvements, less depreciated value and the estimated value of land.

Income Approach

Hotels and motels generate rental income which investors consider as part of the decision-making process in purchasing a property and determining the price that investors are willing to pay in exchange. The income productivity that a property generates is to be utilized to calculate the market value of a hotel or motel. The income approach given market conditions such as vacancy and expenses, captures the value of the property based on its current income-generation and potential. As such, the income approach is the most widely recognized and utilized approach in valuing hotels and motels for both appraisal and assessment purposes. The City of Medicine Hat uses the income approach to estimate typical market value of hotels and motels.

Capitalization (Cap) Rate Model

The indicated capitalization rates for sold properties are established using the following formula:

$$\text{Overall Capitalization Rate} = \frac{\text{Net Operating Income}}{\text{Adjusted Sale Price}}$$

Capitalization rates are a tool used in appraisal theory used to convert income into expression of value. According to appraisal theory, capitalization rates fundamentally reflect the following factors:

- The degree of perceived risk
- Market expectations regarding future inflation
- The prospective rates of return for alternative investments
- The rate of return and the rate on return earned by comparable properties in the past
- The prevailing tax law (not tax loaded)

The direct capitalization method is the valuation technique most commonly used by appraisal practitioners across Canada for valuing hotels and motels, as well as many other property types. Hotels and motels are bought, sold, and developed based on current and expected income, the income approach to value reflects how the market views these properties.

Direct capitalization converts or capitalizes the expected level of typical net earnings into an estimate of market value using a capitalization rate. The capitalization rate reflects all the investor's relative and comparative feelings and aspirations about the property in light of the investment characteristics offered by the asset and in comparison, to other investment opportunities in the market.

In its most basic form, the direct capitalization method is a mathematical ratio involving the estimation of typical net operating income (NOI), which is capitalized to produce an estimate of market value. The overall capitalization rate should capture the return **on** and the return **of** the investment.

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

Data Collection

The City of Medicine Hat annually requests detailed property and business information from owners to prepare market value assessments. The requested information is the following:

- Physical Characteristics such as room count, public facilities, amenities, etc.
- Occupancy/ADR/RevPar
- Quality Rating Guide
- Parking Details
- Detailed Income and Expenses or Income Statements ending June 30
- Commercial Tenant Roll

Furthermore, the City of Medicine Hat requests detailed information on any hotel/motel sales.

If a property owner fails to complete and submit the requested information, the City of Medicine Hat equates its typical income and expenses based on the obtained financial figures from similar properties.

Data Analysis

Hotels and Motels are been grouped separately and broken into separate classes within the respective group for analysis purposes.

Each returned Assessment Request for Information has been analyzed and verified as much as possible, with the operator/owner to ensure accurate data is used in the valuation. The number of rooms, the number of available rooms per year, and occupancy rates are used to obtain the Average Daily Rate (ADR) per occupied room and Revenue per Available Room (RevPar) are calculated using the reported room revenue.

Three years of revenue and expense information are obtained, analyzed, stabilized and normalized (according to the PAAH – Provincial Assessors Association Handbook) to account for the ‘typical’ revenues and expenses. The City of Medicine Hat uses a 50%-30%-20% weighting of three years of revenue and expenses, giving to the greater weights on the recent financial information.

20%	30%	50%
Income Statement for year ending June 30, 2019	Income Statement for year ending June 30, 2020	Income Statement for year ending June 30, 2021

For the 2021 assessment, the total revenue includes the subsidies such as Canada Emergency Wage Subsidy (CEWS), Canada Emergency Rent Subsidy (CERS), etc.

The City of Medicine Hat applies allowance for Furniture, Fixtures and Equipment (FF&E) within each quality groupings: 15% FF&E for Quality A and 10% FF&E allowance for Quality B, C, E, and F properties. Also, 2% for Reserves for Replacement costs have been applied to hotels and motels.

Other leasable space, including restaurant, coffee shop, etc. are extracted and valued separately. Refer to Non-Residential Methodology.

Land Valuation

Land in the City of Medicine Hat is valued according to the direct sales comparison approach to value. Qualified sales of vacant parcels from July 1, 2018 through June 30, 2021 are used. Refer to the Non-Residential Methodology.