By Joel R. Marcus

New Methodology Hits Hotels with High Taxes

The Department of Finance does an abrupt about face by dramatically ratcheting up the new 2007/08 property tax assessments after issuing generally lower ones last year. This represents one of the largest leaps ever in hotel assessments.

The Finance Department raised the tentative hotel assessments citywide by an average of 35%. However, the increases were even more pronounced for some of the City's premier hotels. For example, the Marriott Marquis saw an increase from $162.5 million to $227.2 million (an 80% change), the Grand Hyatt went from $75.1 million to $135.4 million, and there were over 40% jumps at The Pierre, Sheraton Manhattan, Le Parker Meridian, Waldorf, and Roosevelt Hotels. The outer boroughs were not spared either, as Brooklyn hotels' assessments increased by 74%. Queens hotels' assessments jumped by 34%, while Staten Island saw a 19% increase and the Bronx only experienced a 6% jump.

Some city newspapers speculated that industry leaders and consultants met with the City last year and convinced them to change the method of arriving at the assessed value for hotels. This new method may have contributed to the modest assessments for the 2006/07 tax year because the Finance Department was using only out-of-date 2004 filings, which covered a period when hotels were not doing as well as they are now. This year, by using current 2006 figures, the new methodology dramatically increased assessments.

For over 75 years, hotel assessments took into consideration the fact that a hotel comprised both a piece of real estate and an operating business. Numerous court cases pointed out that using business income and expenses for assessing hotel buildings was incorrect. The courts reminded assessors that business income could not be used to assess real estate. Instead, some method of allocation or extraction had to be employed to remove the income related to furniture, fixtures and equipment and franchise and business value.

In New York City, assessors accepted this premise but chose different approaches over the years to accomplish the job. In some years, they deducted a factor for business value when using sales to value hotels. In recent years, since sales no longer form the basis for assessing most commercial properties, income capitalization has become the primary valuation method. Hotels were sometimes assessed by applying higher capitalization rates, sometimes by deducting business income and sometimes by applying an expense ratio of 75% to room revenues before capitalization. All these approaches have now been abandoned.

Under the new method, assessments are based on a unique gross income multiplier formula where room revenues are converted into market value. The record indicates that this formula is not used anywhere else in the country.

The first step in the new formula calls for estimating room revenue by taking the latest income statement and adjusting it upward to account for normal occupancy, alterations and so on. A percentage of food, beverage, conference and exhibit revenue is then added to this room revenue number. The total gross income thus derived is divided by 365 and then multiplied by 960 for luxury hotels. According to the Finance Department, this calculation provides a fair market value for the hotel's real estate. Should the hotel also contain apartments, retail, office, garage, signage/billboard, telephone or other income, the net income from these categories is then capitalized and added to the prior calculation. To determine the assessment value, the assessor multiplies by 45% the final number derived from these steps.

To illustrate how the new formula works, consider a hotel with a room income range of $295 to $371. The new formula puts the hotel's income at $475, with an estimated market value of $456,000 per room, an assessment of $205,200 per room, and property taxes of $22,572 per room. These calculations give no effect whatsoever to the age and condition of the property, its franchise, its advertising budgets or whether it is a union or nonunion operation.

The unfairness and inaccuracies of this new method of valuing hotels are overwhelming, so much so that the assessors have already spoken out decrying this methodology and claiming it was a contrived deal made by a consultant and the industry leaders. *The Chief* reported in a May 2006 article that David Moog, the assessor's union leader, claimed the method violated good assessing practices and was an improper way to determine fair market value. —RENY

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