STATE OF MICHIGAN
DEPARTMENT OF LICENSING & REGULATORY AFFAIRS
MICHIGAN ADMINISTRATIVE HEARING SYSTEM
MICHIGAN TAX TRIBUNAL

Grand Haven Investment, LLC,

Petitioner,

v

MTT Docket No. 364917

Spring Lake Township,

Tribunal Judge Presiding
Paul V. McCord

Respondent.

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FINAL OPINION AND JUDGMENT

H. Adam Cohen (P47202), and Jason C. Long (P59244), for Petitioner.
Bradley J. Fisher (P64608), for Respondent.

I. INTRODUCTION

This property tax valuation appeal comes before the Tribunal for decision following a hearing on May 14, 2012, in Lansing, Michigan. Petitioner, Grand Haven Investment, LLC, commenced this action in 2009 by appealing the ad valorem property tax assessment levied by Respondent, Spring Lake Township, against its 123 room hotel (the "Subject"). Only the real property is at issue in this case. After timely motions to amend, this matter extends over three tax years, 2009, 2010, and 2011. The parties' true cash value contentions of the Subject as stated in their respective valuation disclosures are as follows:

	P's TCV	R's TCV	TCV in Dispute
2009	$2,030,000	$4,850,000	$2,173,200
2010	$1,880,000	$3,709,400	$1,829,400
2011	$1,980,000	$3,241,000	$1,261,000

The only issue we are asked to decide is the true cash or market value of Petitioner's hotel property as of each of the three tax years at issue.

II. JUDGMENT

We hold that the Subject's true cash value (TCV), state equalized value (SEV), and taxable value (TV) for each of the tax years at issue are as follows:

Year	Parcel Number	TCV	SEV	TV
2009	70-03-16-475-004	$2,505,200	$1,252,600	$1,252,600
2010	70-03-16-475-004	$2,489,600	$1,244,800	$1,244,800
2011	70-03-16-475-004	$2,650,900	$1,325,450	$1,265,962

III. FINDINGS OF FACT AND CONCLUSIONS OF LAW

After hearing and observing the witnesses who testified at the evidentiary hearing, allowing for the Tribunal to assess credibility, and having further considered the exhibits submitted by the parties, the arguments presented by counsel, and applying the governing legal principles, the Tribunal makes the following independent findings of fact and conclusions of law[1] set forth below in memorandum form. See MCL 205.751(1) ("A decision and opinion of the tribunal . . . shall be in writing or stated in the record, and shall include a concise statement of facts and conclusions of law, stated separately . . ."); see also MCL 24.285.

IV. FINDINGS OF FACT

This section presents a "concise, separate, statement of facts" within the meaning of MCL 205.751(1), and, unless stated otherwise, the matters stated or summarized are "findings of fact" within the meaning of MCL 24.285. The findings of fact are set forth in narrative form based on the Tribunal's conclusion that it is the most expeditious manner of proceeding where there are few disputes about facts and the main focus of the controversy are the legal issues.

1. Assessment

The Subject is comprised of one real property parcel identified on Respondent's assessment roll by Parcel No. 70-03-16-475-004 ("Subject"). For the tax years at issue, Respondent assessed the Subject as follows:

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[1] To the extent that a finding of fact is more properly a conclusion of law, and to the extent that a conclusion of law is more properly a finding of fact, it should be so construed.

Year	TCV	SEV	TV
2009	$4,203,200	$2,101,600	$2,101,600
2010	$3,709,400	$1,854,700	$1,854,700
2011	$3,241,000	$1,620,500	$1,620,500

2. The Subject

The Subject is a full service hotel with, as of the relevant dates of value, 123 guest rooms and operated as the Holiday Inn Grand Haven-Spring Lake in West Michigan. Amenities include a full service restaurant and lounge, banquet space, fitness room, business center, and indoor and outdoor pools. The Subject is located on a peninsula where Spring Lake meets the Grand River, about two miles from the eastern shore of Lake Michigan, and situated on a 4.73-acre site that lies south of West Savidge Street, and east of US 31, at 940 West Savidge Street in the Township of Spring Lake.

Petitioner purchased the property for $4,100,000 on May 1, 2000. The Subject's original date of construction was in 1969 with a restaurant addition in 1983. The structure is of Class C commercial construction and is of average quality. The subject is four stories and the exterior walls are clad in painted brick and siding. The guest rooms are accessed through interior corridors. The Subject has been reasonably well maintained, recently undergoing a required remodel and refurbishment (after the relevant valuation dates) in late 2010 and early 2011. The Subject's updates include new exterior and canopy, new lobby and front desk area, and complete renovation of the guest rooms.

Demand for hotel accommodations in the Subject's general area is driven by tourism in the lake community and proximity to Lake Michigan. As a result, there is strong seasonal demand for the Subject's amenities during the spring and summer months, with much less demand in the fall and winter. The economy in West Michigan and the demand for hotel space was negatively impacted by the state and National recession occurring during the relevant time period. Occupancy at the Subject decreased during the period 2008 through 2010 from 49.5 percent in 2008 to 46.1 percent in 2009 and then rising to 4.73 percent in 2010.

3. Experts

a. Petitioner's appraiser

Petitioner's expert, Jeffrey G. Pelegrin, MAI, FRICS, opined in his appraisal that the market value of the Subject Property was $2,030,000 as of December 31, 2008. Mr. Pelegrin is a certified general licensed real estate appraiser and a member of the Appraisal Institute. He has appraised a wide array of properties including office buildings, shopping centers, hotels and motels, and industrial buildings.

Mr. Pelegrin testified that he inspected the property and reviewed the income and expense history for the hotel. Mr. Pelegrin considered the cost approach; however, this approach was not developed because there were insufficient waterfront land sales to estimate the land value and the age of the facility made calculating depreciation difficult. Mr. Pelegrin offered that the cost approach would not be relevant to an investor considering purchasing the property. The Sales Comparison and Income Approaches to value are developed in his appraisal report.

In his sales comparison approach, Mr. Pelegrin analyzed eleven sales between 2008 and 2011 in the Midwest. He calculated the sales price per room and examined the price per room for the comparable hotel sales located in Michigan to derive his opinion of value for the Subject. Mr. Pelegrin found that the Crown Plaza in Grand Rapids was most similar due to its geographical location, age, and that it was a full service hotel which sold for $13,438 per room. Thus, he utilized $15,000 per room for 2009, $13,500 per room for 2010, and $15,000 per room for 2011.

In developing his income approach as his primary valuation method, Petitioner's expert found that the most appropriate method was the direct capitalization approach, which analyzes the income and expenses of the subject property. First, Mr. Pelegrin analyzed the room revenue by examining occupancy rates and average daily rates (ADR) for competitive hotels as well as the actual rates for the Subject. Mr. Pelegrin obtained the comparable property data from Smith Travel Research. He found that the appropriate stabilized occupancy conclusion was 50 percent and the ADR was $105. Petitioner's expert testified that the same rates were utilized by Respondent. Using this data, Mr. Pelegrin found that approximately 54 percent of the gross income for the Subject comes from the rental of rooms, which is lower than the comparable properties. Next Mr. Pelegrin examined the food and beverage revenue, which he found to be stabilized at $1.95 million, and which he found to be higher than the comparables. Finally, the other sources of income were concluded to be stabilized at $20,000. Petitioner's expert then evaluated the expenses and concluded that the expense ratio for rooms was 28 percent and food and beverage was 80 percent. Other expenses were expressed as a percentage of general revenue and include general expenses 10 percent, marketing expenses 7 percent, franchise fees 4.5 percent, maintenance expense 6 percent, utilities 7 percent, management fee 3 percent, and insurance 0.9 percent. Mr. Pelegrin also calculated a reserve, which is for replacement of building components, as a 3 percent line item expense. Petitioner's expert concluded that the Subject has a stabilized net operating income (NOI) of 6.9 percent. This was found to be on the low end of the comparables due to the Subject's dependency upon food and beverage for revenue.

The capitalization rate was determined by looking at other hotel properties, a review of investor surveys, and the band of investment approach. For tax year 2009, Petitioner's expert concluded that the cap rate was 10 percent, but adjusted the rate to 12.82 percent for the effective tax factor, which resulted in the TCV of $2.31 million. For tax year 2010, Mr. Pelegrin found that the cap rate was 10.5 percent and adjusted to 13.31 percent for the effective tax rate. Further, he found that the property was below a stabilized level in this tax year and thus deducted the present value of revenue loss to arrive at the TCV of $2.16 million. Similarly for tax year 2011, Petitioner's expert concluded that the cap rate was 10 percent, adjusted to 12.81 percent for the effective tax rate and a revenue loss calculation was used to arrive at the TCV of $2.26 million.

In reconciling the values, Petitioner's expert opined that the most reliable method was the income approach. Mr. Pelegrin then found that the value of the furniture, fixtures, and equipment was $230,000 and should be deducted from the value of the subject as a going concern. In addition, the value of the liquor license was determined to be $50,000 and was also deducted as an intangible value to determine the value of the Subject's real estate only. Thus, Petitioner's expert's final opinion of value for the tax years at issue were $2,030,000 for the 2009 tax year, $1,180,000 for the 2010 tax year, and $1,980,000 for the 2011 tax year.

b. Respondent's appraiser

Respondent offered its assessment records (R-2), a self-contained appraisal (R-1), and the testimony of its expert, Jeffrey G. Genzink, MAI, in support of its theory of value. Respondent's expert is a certified general licensed real estate appraiser and a member of the Appraisal Institute. He specializes in the valuation of commercial, industrial, and investment real estate.

Respondent's assessment records were developed from a cost-less-depreciation method prescribed by the State Tax Commission. Mr. Genzink testified that the value conclusions in his appraisal are based upon the Subject as a going concern, meaning that the market value of the tangible and intangible assets of the established business sold in aggregate. Respondent's expert considered all three approaches to value. He did not find the cost approach particularly relevant in valuing the Subject.

Mr. Genzink developed a sales comparison analysis. In his sales comparison approach, Mr. Genzink analyzed five sales all located in western Michigan. For each of the comparables, he calculated the sales price per room and adjusted for economic conditions. After adjustments, the values ranged from $18,678 to $57, 355. Thus, it was concluded that the Subject's price per room for tax year 2009 was $35,000, which resulted in a TCV of $4,300,000. In his final reconciliation of value, Respondent's expert opined that his "sales comparison approach is given less emphasis due to significant variances in the RevPar between the subject and comparable properties." (Ex R-1 at 42.)

Respondent's expert testified that the preferred method for valuating properties like the Subject is the income capitalization approach. (Tr 120.) In developing this approach, Mr. Genzink testified that he examined Petitioner's 2006 through 2008 financial statements and compared this information to the Smith Travel Research hotel operating statistics to estimate the income and expenses. Respondent's income capitalization methodology yielded a value conclusion for the Subject as a going concern of $2,980,000. Respondent's expert examined both the capitalization rate and gross revenue multiplier methods of the income approach, finding that the gross revenue multiplier (GRM) was the most reliable because there was minimal information available to Respondent's expert regarding the net income ratio. To calculate the GRM, Mr. Genzink utilized four comparables and determined the applicable GRM was 1.2. This was utilized to calculate $5.24 million as the value of the going concern for tax year 2009.

Respondent's expert reconciled the values derived from the sales comparison approach and the income approach to arrive at his final conclusion of $4,850,000 TCV for tax year 2009.

V. CONCLUSIONS OF LAW

1. Value

A property's "true cash value" is defined as the property's "usual selling price" or "fair market value" under MCL 211.27(1). See also *CAF Investment Co v State Tax Commission*, 392 Mich 442, 450; 221 NW2d 588, 592 (1974). Petitioner has the burden of proving the assessment of the Subject is excessive by establishing the true cash value of the Subject. MCL 205.737(3); *President Inn Props LLC v Grand Rapids*, 291 Mich App 625; 806 NW2d 342, 347 (2011). In considering what the "usual selling price" may be for the property under appeal, we consider the three traditional approaches to valuation (income, sales, and cost) in order to arrive at our own conclusion of value. *Jones & Laughlin Steel Corp v City of Warren,* 193 Mich App 348, 353; 483 NW2d 416 (1992). While we prefer to use at least two valuation approaches, we may place greater or lesser emphasis on a particular method or methods of valuation. See *Meadowlanes Ltd Dividend Housing Ass'n v City of Holland,* 437 Mich 473, 485-486; 473 NW2d 636 (1991). All three methods were developed by one or the other party and applied in the present case.

Valuation of commercial real property is a factual question of such technicality as to require expert testimony. See *Edward Rose Bldg Co v Independence Twp*, 436 Mich 620, 638; 462 NW2d 325 (1990). We have wide discretion when it comes to accepting valuation testimony and appraisal evidence. See *President Inn Props,* 806 NW2d at 348. Sometimes, it will help us decide a case; other times, it will not. The Tribunal is under no obligation to accept the valuation figures or the approach to valuation advanced by either party. *Id.* at 351, citing *Teledyne Continental Motors v Muskegon Twp*, 145 Mich App 749, 754; 378 NW2d 590 (1985). We may accept or reject a party's valuation theory in total, or we may pick and choose the portions which we choose to adopt. *Meadowlanes, supra* at 485-486.

In evaluating expert testimony as to value, the Tribunal acts as the trier of fact and accepts or rejects given conclusions of an expert in whole or in part based on the persuasiveness of the expert's reasoning and the factual support the expert cites for the opinions asserted. See *President Inn Props,* 806 NW2d at 352. Thus, in order for any approach, method, or adjustment to have persuasive force in a factual finding of value, it should rest on solid reasoning and be founded on reliable data. Regardless of the valuation approach we employ, the final value determination must represent the usual price for which the subject property would sell. *Meadowlanes, supra* at 485-486. We are not, however, required to quantify every possible factor affecting value. See *Southfield Western, Inc v Southfield*, 146 Mich App 585, 590; 382 NW2d 187 (1985).

2. Approaches to Value

In their testimony, Mr. Pelegrin and Mr. Gensink discussed the three valuation approaches that they considered and referenced their appraisal reports. (*See generally* Ex P-1; Ex R-2.) Both experts cited reservations regarding the data in their respective sales or market approaches. Neither expert placed significant emphasis on this approach. The experts were also in agreement that the cost approach, while providing an indication of value, is not the primary approach used by market participants, and not considered applicable. We agree, and find, under the circumstances of this case, that the application of the cost approach is not particularly relevant. See *Great Lakes Div of Nat'l Steel Corp*, 227 Mich App 370, 403; 576 NW2d 667 (1998) ("If buyers and sellers do not use a technique, estimates of value derived therefrom have little bearing on the market price of the property").

Both experts were in agreement, however, that for properties like the Subject – a hotel – the income approach reflected the thought process of buyers and sellers. The Tribunal agrees. See *CAF Investment Co v Saginaw Twp*, 410 Mich 428, 476; 302 NW2d 164 (1981) (LEVIN, J., concurring). In this respect, the income approach would yield a value conclusion most reflective of the Subject's usual selling price. See *Antisdale v City of Galesburg*, 420 Mich 265, 277; 362 NW2d 632 (1984). After a careful review and weighing of the testimony and exhibits presented by both parties and after considering the credibility of the witnesses, we conclude that the income approach yields the most reliable indication of the Subject's "usual selling price" for each of the tax years at issue.

The largest disagreement in this case appears to lie not in the application of or emphasis on the income approach with respect to this hotel property (although they do share a difference of opinion regarding the treatment of replacement reserves), but in their respective conclusions from the data that they each utilized. Seemingly small differences between the two experts' conclusions as to net operating income ($112,928) and capitalization rate (0.99 percent) produce a $1,254,756 effect on value. Although the methods and analysis employed by both experts have both theoretical and empirical support, in other words, they are made for stated reasons, and they rest on particular data, we find Mr. Pelegrin's analysis, on the whole, more persuasive, as the data set he used was more relevant in time than that employed by Respondent's expert.[2]

3. Hotel Valuation Problem

From a valuation perspective, hotels consist of four components: land, improvements (building), furniture, fixtures and equipment (or FF&E), and business. The business component consists of various intangibles like specialized management expertise, brand affiliation and reputation. For property tax assessment purposes, generally only the real property components that are the land and improvements are to be considered. See, e.g., *Michigan Bell Tel Co v Department of Treasury*, 445 Mich 470, 485-486; 518 NW2d 808 (1994) (although intangible value influencers may also be considered). This being the case, the income that the property owner receives is not income from the rental of the real estate, but rather the product of personal services through the assemblage of the land, buildings, labor, equipment, and the marketing operations. See Appraisal Institute, *The Appraisal of Real Estate*, (Chicago, 13th ed, 2008), pp 29, 30. Therefore, valuation of the fee simple interest in the real property component of a hotel by the income approach is a more complicated exercise as it requires the separation of the income attributable to the use of the realty out of the total income generated by the operation of the hotel business.

The employment of the income approach to appraise hotel property and the task of extracting the value of the real estate from total asset value of the hotel as a business has attracted considerable attention in appraisal literature and practice. This process is generally treated in the discussions of going concern value and business value or business enterprise value The Appraisal Institute, *The Appraisal of Real Estate* (Chicago, 13th ed, 2008), pp 29-31. The treatise notes that the value of a going concern refers to the total value of the property, including both the real and personal property attributed to business value (*Id*. at 30), together with an intangible enhancement to value elements (*Id*. at 29). It also points out that:

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[2] Respondent's income approach was developed from income, expense, and occupancy rates for years 2006 through 2008, but states that relevant data for the 2010 and 2011 tax years was not forth coming. Petitioner states that it was willing to offer such information but only through formal discovery.

> It may be difficult to separate the market value of land and the building from the total value of the business, bus such a division of realty and non-realty components of value may be required . . . *Id.* at 30.

Although the treatise identifies hotel operation as a business presenting this pattern, it does not discuss particular methods for the determination of realty income, either for hotel operations or generally.

In *Amway Grand Plaza Hotel v Grand Rapids*, 11 MTT 496 (2001), this Tribunal accepted, with some criticism, the methodology developed by Stephen Rushmore, MAI, CHA, concerning the particular adjustments necessary to extract non-realty income from total income so as to compute the income to be capitalized into real estate value. See also *Metropolitan Life v Delta Twp*, 6 MTT 484 (1990).[3] Both experts more-or-less applied the valuation methodology espoused by Mr. Rushmore, although neither expert specifically cited that they were applying the eponymous method.

4. Stabilized Income and Expenses

Before turning to the treatment of business and personal property adjustments and capitalization rate to be applied, we first turn to a discussion of the parties' stabilized income and expense computations. Both experts relied on the Subject's actual financial statements for year ending 2008 in order to develop their stabilized gross revenue for the Subject for the 2009 tax year, the first year at issue. Each of the experts computed a RevPar figure (Revenue per Available Room) by multiplying the Subject's projected ADR (average daily rate) by a stabilized occupancy rate to arrive at a room revenue figure of $2,299,500 and $2,356,988 by Petitioner and Respondent, respectively. (See Appendix 1.) Here we note that as of the relevant dates of value the Subject had a total of 123 available rooms. Mr. Pelegrin used a figured of 120 available rooms based on his inspection of the Subject following its renovation in 2011. Although Mr. Pelegrin stated that this discrepancy would have no material effect on his value

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[3] Rushmore is the author of *Hotels, Motels, and Restaurants: Valuations and Market Studies* (1983). He has established a national reputation in hotel valuation, and the procedure he employed is often described as the Rushmore method. The so-called Rushmore method has been employed by experts in other hotel valuation cases and cited in decisions in Michigan and other jurisdictions. See *US Can Hospitalities, LLP v City of Romulus*, 17 MTT 311 (2009); *Amway Grand Plaza Hotel v Grand Rapids*, 11 MTT 496 (2001); *Metropolitan Life v Delta Twp*, 6 MTT 484 (1990); see also *RRI Acquisition Company, Inc v Supervisor of Assessments*, memorandum order of the Maryland Tax Court, issued February 10, 2006 (Docket No. 03-RP-HO-0055); 2006 WL 925212 (Md.Tax); *Chesapeake Hotel, LP v Saddle Brook Twp*, 22 NJ Tax 525 (2005); *Marriott Corp v Bd of County Comm'rs of Johnson County*, 25 Kan App2d 840; 972 P2d 793 (1999).

conclusions, the Tribunal, in our analysis of the Subject's room revenue will utilize 123 available rooms. (See Appendix 2.)

The experts also each developed stabilized gross income figures for other categories based on the Subject's historical operating statement and by comparison to data published in Smith Travel Research's Hotel Operating Statistics ("HOST") report. In total, the parties were approximately $100,000 apart in their respective gross income conclusions (approximately 2 percent). We will use Petitioner's conclusion as to gross revenue in our analysis.

Both experts also determined various stabilized operating expense items in a similar manner, by comparison of the Subject's historical operating expenses to the HOST report. As a whole, there are only minor differences between the two experts in the various expense line items, save for "Administrative and General." With respect to this expense category, both experts relied on the Subject's actual financials, with Petitioner's expert relying on financial data for tax years 2008 through 2010 and Respondent's expert relying on historical data for the period 2006 through 2008. As Petitioner's data set was taken from years more relevant in time to the tax years at issue, the Tribunal finds Petitioner's evidence more persuasive.

The final expense items before discussion of business and personal property deductions is insurance expense. There is an approximate $36,000 difference between the parties in this expense category. The difference between the parties is again explained by the particular data set each expert relied on: Respondent utilizing historical data for the period 2006 to 2008 and Petitioner utilizing data for the period 2008 through 2010. We conclude that Petitioner's data is more reflective of the insurable risk and associated insurance premium charged during the tax years at issue.

5. *Management Fees*

According to the Rushmore method of hotel valuation all payments to the entity that manages and operates the hotel constitute business income generated by the exercise of management and entrepreneurship. Rushmore, *Why the "Rushmore Approach" is a Better Method for Valuing the Real Property Component of a Hotel,* 1 Journal of Property Tax Assessment and Administration 15, 18-19 (2005) (hereinafter "Rushmore"). These payments then are to be subtracted in the calculation of the net operating income to be capitalized. In this case, both Mr. Pelegrin and Mr. Genzink made subtractions for management fees and franchise fees. Both experts utilized an imputed management fee of 3 percent of gross revenue as being market. A 3 percent management fee is supported by the evidence presented by both parties. Again, the variance between the parties (there is an approximate $5,000 difference between the parties as to this item), lies in their individual computations of gross revenue. Having more confidence in Petitioner's conclusion as to gross revenue, the Tribunal utilizes Petitioner's management fee of $126,085 in our analysis.

6. *Franchise fees*

A facet of the going business component that must be accounted for are the benefits that accrue from an association with a recognized hotel company brand or "flag" through either a franchise or management contract affiliation. In this case the Subject operated under the Holiday Inn flag pursuant to a franchise agreement. In theory, flagged or chain hotels are generally thought to out-perform independents, and the added value created by this increased income is considered part of the business component. Mr. Ishbia, the managing member of Petitioner's ownership group, testified that Petitioner wanted to maintain the Holiday Inn flag, specifically for the value of the reservation system. (Tr at 23.) Under the Rushmore method, this component, i.e., the portion of the hotel's income stream attributed to the business component is measured by the franchise fee and other associated costs, including reservation expenses, frequent traveler programs, training, information technology, and so forth, which are paid to the franchiser. Again, both experts applied this methodology in their analysis of the Subject. The difference between the parties is again in the data set that they utilized, Respondent using historical data and Petitioner using current data. Petitioner's data, being more relevant in time to the tax years at issue, provides a more accurate quantification of this item and we shall utilize same.

7. *Personal Property Component*

Hotels, like the Subject, contain a significant investment in personal property consisting of furniture, fixtures, and equipment (or FF&E) that has a relatively short useful life and is subject to rapid depreciation and obsolescence. It is without question that a hotel cannot accommodate guests and generate income without offering substantial personal services and the provision of significant personal property and furnishings (from signage, to the appointment of the lobby, to the front desk, to the furnishings in the individual guest rooms) is a material income-producing factor of the enterprise. As a result, a portion of the overall income of the going concern is realized by the employment of FF&E.

As personal property in Michigan is taxed separately from real property and only the Subject's real property is at issue here, the personal property's contribution to the income of the business enterprise and the value of the personal property at the Subject must be isolated and excluded from the real property component of the Subject. Two calculations/adjustments are needed to remove the contribution of the personal property from the income flow of the business: (1) an adjustment to account for the periodic replacement of personal property, *i.e.*, the return *of* personal property, and (2) an adjustment for the yield on the investment in personal property – the return *on* personal property. See Rushmore, *supra* at 20.

8. Return of Personal Property – Replacement Reserve

It is almost without question that a hotel cannot accommodate guests and a generate income without offering certain services and the provision of various personal property and furnishings (from signage, to the appointment of the lobby, to the front desk, to the furnishings in the individual guest rooms) all of which impact the guest's experience and reflect on the particular hotel's brand or "Flag" and, correspondingly, the income potential of the enterprise. Accordingly, the income of the business enterprise attributed to contribution of personal property must be isolated. Further, in order to maintain the quality, image, and income corporate hotel brands, such as Holiday Inn, impose so-called "Product Improvement Plans," which are mandatory periodic renovations and updates to the property and its furnishings required of franchised owners. See e.g., *Catalyst Development Co, LLC v Kalamazoo*, ___ MTT ___; 2012 WL 1060072 (March 16, 2012). Accordingly, an adjustment for the economic return of personal property is necessary because FF&E has a relatively short useful life and must periodically be replaced.

The parties share a difference of opinion regarding whether an operating expense deduction for reserves and replacement is appropriate in arriving at net operating income. Respondent did not include an expense item for reserves and replacement citing the fact that neither the Subject nor the selected comparable properties historically deducted reserves for replacement. Although the replacement of FF&E is considered a capital expenditure from an accounting standpoint and, as a result, is not a line item ordinarily included on an income and expense statement, it nevertheless represents a reduction in cash flow and return on equity and has a negative effect on the Subject's market value. Both the Rushmore method and the Business enterprise approach consider a deduction for the reserve for replacement to be the "return of FF&E."

An expense deduction for a reserve for replacement is consistent with the behavior of market participants. Hotel companies account for the frequent replacement of FF&E by establishing an expense deduction or reserve for the replacement of FF&E and required upgrades. This fund, which reduces the hotel's cash flow in annual installments, is set at the amount necessary to replace all existing FF&E with new FF&E over an assumed useful life. The typical hotel buyer will deduct a reserve to prepare for inevitable need for periodic replacement of such items as hotel furnishings or PIP imposed by the Flag. Similar to market participants, a hotel appraiser should account for any foreseeable PIP, or deemed necessary by the appraiser for the asset to remain competitive.

In this case, Holiday Inn required periodic replacement and upgrades and Mr. Ishbia, the managing member of the Subject's ownership group, testified that the hotel, built in 1969, went through such a mandatory renovation in late 2010 and 2011. (Tr at 20-22.) When formulating cash flow projections, hotel investors account for a 3 percent to 5 percent annual reserve for replacement during the holding period. Mr. Pelegrin selected a replacement expense reserve of 3 percent of gross revenue and considered this to be typical by industry standards. We find that Mr. Pelegrin's deduction for and computation of a 3 percent replacement reserve has both theoretical and empirical support and we accept same.[4]

9. Capitalization Rate

Having determined a stabilized net operating income of the going concern of $355,980, the computed net operating income is capitalized by an overall capitalization rate loaded for property taxes to determine the Subject's going concern value. Mr. Pelegrin computed an overall capitalization rate of 10 percent before a 2.82 percent property tax rate. (Ex P-5 at 63.) Mr. Genzink computed an overall capitalization rate of 11 percent, before a 2.81 percent property tax

[4] We note that the replacement reserve accounts for necessary future purchases, not the present value of furniture in-place. Because FF&E is replaced all of the time, expenditures for this item are considered an operating expense in the aggregate, despite the fact that the individual items are capitalized rather than expensed. In order to account for the value of the furniture and fixtures at the subject, an adjustment for FF&E in-place, i.e., the return *on* personal property, is taken after capitalized income. We discuss this adjustment *infra*.

rate. Again, the difference between the parties with regard to the tax load factor is not in the method employed but in the data set each of their experts used. Mr. Pelegrin started with a tax rate of 56.4621 and explained in testimony that this was the 2009 millage rate. Mr. Genzink uses a millage rate of 56.1331. Because Mr. Genzink did not explain where or to what year his millage rate relates, the Tribunal accepts Mr. Pelegrin's 2.82 percent property tax rate.

Mr. Pelegrin selected a capitalization rate at just above the mid-range (9.33 percent) of the eight comparable sales he identified. All of the sales relied on by Mr. Pelegrin occurred within 2008 through 2010, all relevant in time to the assessment dates at issue when significant change in the capital markets occurred. (Ex P-5 at 60.) Only one of these sales, however, occurred in Michigan, the Residence Inn in Kalamazoo on October 1, 2009, with an OAR of 10.55 percent. After reviewing the *Korpacz Investor Survey* and the *Realty Rates Investor Survey,* Mr. Pelegrin concluded that the Subject would "likely be higher than the average" in part, because of the Subject's location, size and performance. (Ex P-5 at 61.) Finally, Mr. Pelegrin's mortgage equity computations produced overall capitalization rates of between 7.25 percent to a high of 10.93 percent.

Respondent's expert employed the same methods. In his direct capitalization method, he reviewed four sales, only two of which occurred in 2008, with the other two occurring in 2004 and 2006. Mr. Genzink also reviewed *Korpacz* and *Realty Rates* and also employed the band of investment method, finally concluding to an overall capitalization rate of 11 percent before load for taxes. In the end, however, Mr. Genzink ultimately casts his income capitalization analysis aside as unreliable because, (1) the Subject's net operating income "is significantly below the sale comparables and the industry standards from the 2009 Report by Smith Travel," (2) "the uncertainty of the subject property expenses," and (3) he was "unable to interview the property owner as to why the subject net operating income ratio is less than the Smith Travel ratios."

Respondent instead relies on a gross income multiplier (GIM) analysis. Although a GIM can be used to simulate investor motivations, we are not convinced that buyers and sellers of hotel properties typically purchase these types of complex properties in this basis. Further, Respondent's GIM was developed from the same sales evidence that Mr. Genzink discounted due to the significant variances in RevPAR. Since the probative value of valuation evidence must stand or fall upon the facts and reasoning offered in support of that opinion of value, the

Tribunal is not convinced by the appropriate standard of proof that Respondent's GIM approach yields an accurate conclusion as to the Subject's "usual selling price." Although we note that Respondent complains that its expert did not have the benefit of interviewing Petitioner's management, Mr. Pelegrin did, and both experts used similar methods and concluded to respective overall capitalization rates within more-or-less the same range of each other. Based on the foregoing, the undersigned is constrained to reject the GIM approach presented by Respondent.

After considering all the evidence, including the size, location, and seasonal nature of the Subject's occupancy, the Tribunal concludes that the overall capitalization rate for the 2009 tax year before property taxes is 10.50 percent. After loading this rate for property taxes, the rate applied for the 2009 tax year at issue is 13.32 percent. Accordingly, the Subject's going concern value for the 2009 tax year is $2,672,519. (See Appendix 2.)

10. Return on Personal Property

As mentioned *supra*, the return on personal property is the second calculation required to both isolate the value of the FF&E currently in the hotel and remove this non-realty element from going concern value. This calculation is based on the premise that a property component is entitled to an annual return equal to the cost of the capital that comprises that component. Rushmore, *supra* at 20. This adjustment is taken as a deduction from capitalized income for the value of the FF&E in-place. This procedure has theoretical support and both experts utilized this method. See, e.g., *US Can Hospitalities, LLP v City of Romulus*, 17 MTT 311 (2009); *Amway Grand Plaza Hotel v Grand Rapids*, 11 MTT 496 (2001); *Metropolitan Life v Delta Twp*, 6 MTT 484 (1990). Here again, the variance between the parties is explained by the data set each of the party's experts examined. Petitioner's expert estimated that the FF&E costs were $19,000 per room based on the Hotel Development Cost Survey or $2,280,000 ($190,000 X 120 rooms). Contrast Respondent's expert who referenced Petitioner's 2008 personal property statement, which indicated a total cost new of the personal property in place of $690,000. We find that Respondent's use of Petitioner's 2008 personal property statement more accurately reflects the cost new of the FF&E at the Subject.

Both experts were in agreement that FF&E once installed in a hotel property such as the Subject depreciates rapidly over a 10-year life. We are in agreement and the testimony and evidence supports this conclusion.[5] Mr. Pelegrin utilized a straight-line depreciation schedule whereas Respondent's expert provided an exponential depreciation schedule. We find Respondent's estimate of accumulated depreciation persuasive as more reflective of the depreciation experience of such assets in the market. Petitioner completely renovated the Subject's guest rooms in late 2010 through early 2011, therefore, we infer from this fact the personal property was fully depreciated as of this time period. This leads us to the conclusion, based on the evidence and testimony presented, that the depreciated value of the FF&E as of each of the relevant tax days was as follows: (1) $117,300 ($690,000(1-83%) as of December 31, 2008; (2) $75,900 ($690,000(1-89%) as of December 31, 2009; and (3) $41,400 ($690,000(1-94%) as of December 31, 2010.

11. Other Business Intangibles – Liquor License

Petitioner holds a "Class B, Hotel Resort" liquor license (Ex P-5 at 72.) There is little room to dispute that the liquor license, of itself, contributes to the total gross revenue of the business enterprise. Further, a liquor license is a separate business intangible. See, e.g., *Amway Grand Plaza Hotel v Grand Rapids*, 11 MTT 496 (2001). Petitioner's expert accounted for the market value of the liquor license, removing it from the value of the going concern to find the residual value of the underlying real property.[6] Respondent's appraiser did not address this item. Respondent's failure to account for this and similar business intangibles is flawed.

In placing a value on the license's contribution to the Subject's as a going concern value, the appropriate measure is the amount that a willing buyer would pay to separately acquire the license, i.e., its separate market value.[7] While Petitioner's estimate of the liquor license at cost

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[5] We note that the Internal Revenue Service depreciation guidelines categorize the life expectancy of hotel furnishings – which is considered property used for the production of personal services (asset class 57.0 – is assigned a 9-year class life and is considered 5 year property. See, e.g., Rev Proc 87-56 and Rev Proc 77-10.

[6] The Michigan Constitution (art 9, § 3) restricts GPTA assessments to real and tangible personal property. It does not permit taxation of intangible assets. See *Michigan Bell Tel Co v Department of* Treasury, 445 Mich 470, 485-486; 518 NW2d 808 (1994).

[7] The gross revenue derived from liquor sales is not a measure of the license's value of itself, since sales revenue is the product of the license's value influence. See, e.g., *Amway Grand Plaza Hotel v Grand Rapids*, 11 MTT 496 (2001); see also *Huron Ridge LP v Ypsilanti Twp*, 275 Mich App 23; 737 NW2d 187 (2007), the Court of Appeals said "the value of nontaxable intangible assets may be included in the assessment of real property or tangible business property if the intangibles 'are deemed to be directly related to the tangible property, but not [where they] are deemed to be related to the business in which the tangible property is used.'" *Id*. at 37-38, quoting Anno: *Inclusion of Intangible asset value in tangible property tax assessments*, 90 ALR5th 547, § 2(a), pp 562–563. Accord *Meadowlanes Ltd Dividend Housing Ass'n v Holland*, 437 Mich 473, 495-496; 473 NW2d 636 (1991) (recognizing that while intangibles are not generally taxable in and of themselves, they may be considered in the

of acquisition is weakly supported as a measure of market value, (Ex P-5 at 72), it is nevertheless sufficient in this case, and Petitioner's reasoning is sound. Therefore, Petitioner's deduction of $50,000 as the market value (or the net income equivalent) for Subject's liquor license as an element of business enterprise value, to be deducted from the going concern, is accepted as the better approach and correct methodology.

12. Tax Years 2010 and 2011

Respondent's expert did not opine as to the market value of the Subject for tax years 2010 and 2011. Instead, Respondent offered its assessment records, its property record cards, as evidence of the Subject's market value for these years. Respondent's assessment records are prepared on a modified cost-less-depreciation methodology prescribed by the Michigan State Tax Commission. While we recognize that Respondent is required to use this method as a guide in establishing the assessment, see MCL 2011.10e, both experts in this case were in agreement, that the cost approach is not particularly relevant in ascertaining the market value of the Subject. As we briefly touched on above, we agree.

As a result, we find that Petitioner's income approach using the direct capitalization method, with modification, yields a proper finding of the Subject's true cash value for 2010 and 2011. As discussed above, we take issue with Petitioner's calculation of the value of the personal property in place for each of these years and will apply our computation as discussed above in our independent analysis. Further, in reviewing the location, size, and condition, and that the Subject was coming due on a mandated renovation or PIP, a capitalization rate of 10.80 percent for 2010, and 10.37 percent for 2011 before loading for real estate taxes is supported from the evidence. Accordingly, we will apply these capitalization rates in our analysis. After loading the capitalization rate for taxes, the overall rate that the Tribunal applies is 13.61 percent for the 2010 tax year, and 13.18 percent for tax year 2011. After our modifications, it is our conclusion that the Subject's true cash value for tax years 2010 and 2011 is $2,489,700 (rounded) and $2,650,900 (rounded), respectfully. (See Appendix 2.)

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valuation of property where they affect its market value) citing *Antisdale v City of Galesburg*, 420 Mich 265, 285; 362 NW2d 632 (1985).

CONCLUSION

After careful consideration of the testimony and evidence, the Tribunal concludes that the best indicator of the Subject's "usual selling price" is that developed through the income approach. We have further found that Petitioner's valuation evidence more closely reflects the Rushmore methodology, which is market driven and tested. The Tribunal concludes that the Subject's true cash value as of December 31, 2008, 2009, and 2010 is $2,505,200, $2,489,700, and $2,650,900, respectively. We emphasize that this opinion is based upon the consideration of the reasoning and supporting data addressed in the record of this case. It should not be understood as a definitive pronouncement on valuation practices designed to extract real estate value from the assets of a hotel business. In reaching the holdings in this opinion, we have considered all arguments for contrary holdings, and have rejected all arguments not discussed as without merit or irrelevant. To reflect the foregoing,

IT IS ORDERED that the property's assessed and taxable values for the tax year at issue are MODIFIED as set forth in the Judgment section of this Final Opinion and Judgment.

IT IS FURTHER ORDERED that the officer charged with maintaining the assessment rolls for the tax years at issue shall correct or cause the assessment rolls to be corrected to reflect the property's true cash and taxable values as finally shown in this Final Opinion and Judgment within 90 days of the entry of the Final Opinion and Judgment, subject to the processes of equalization. See MCL 205.755. To the extent that the final level of assessment for a given year has not yet been determined and published, the assessment rolls shall be corrected once the final level is published or becomes known.

IT IS FURTHER ORDERED that the officer charged with collecting or refunding the affected taxes shall collect taxes and any applicable interest or issue a refund as required by this Order within 28 days of the entry of this Order. If a refund is warranted, it shall include a proportionate share of any property tax administration fees paid and of penalty and interest paid on delinquent taxes. The refund shall also separately indicate the amount of the taxes, fees, penalties, and interest being refunded. A sum determined by the Tribunal to have been unlawfully paid shall bear interest from the date of payment to the date of judgment and the judgment shall bear interest to the date of its payment. A sum determined by the Tribunal to have been underpaid shall not bear interest for any time period prior to 28 days after the issuance of the Tribunal's order. Pursuant to 1995 PA 232, interest shall accrue (i) after December 31, 2008, at the rate of 3.31% for calendar year 2009, (ii) after December 31, 2009, at the rate of 1.23% for calendar year 2010, (iii) after December 31, 2010 at the rate of 1.12% for calendar year 2011, (iv) after December 31, 2011, and prior to July 1, 2012, at the rate of 1.09% for calendar year 2012, and (v) after June 30, 2012 and prior to January 1, 2012, at the rate of 4.25%.

This Order resolves all pending claims in this matter and closes this case.

MICHIGAN TAX TRIBUNAL

Entered: October 31, 2012 By: Paul V. McCord

APPENDIX 1

Income Capitalization Comparison

	Petitioner	Respondent
Number of Rooms	120	123
Occupancy	50%	50%
Average Room Rate	$105.00	$105.00
RevPar (Revenue Per Available Room)	$52.50	$52.50
Gross Revenue		
Room Revenue	2,299,500	2,356,988
Food & Beverage Revenue	1,950,000	1,845,000
Other Food & Beverage		135,300
Telecommunications Revenue		615
Rental & Other Income	20,000	30,135
	4,269,500	4,368,038
Expenses:		
Departmental:		
Rooms	643,860	455,000
Food & Beverage	1,560,000	1,494,450
Other Food & Beverage		121,770
Telecommunications		18,450
Rental & Other		
	(2,203,860)	(2,089,670)
Undistributed:		
Administrative and General	426,950	602,700
Marketing	298,865	307,500
Property Operations & Maintenance (POM)	256,170	258,300
Utilities	298,865	295,200
	(1,280,850)	(1,463,700)
House Profit	784,790	814,668
Management and Franchise Fees		
Management	128,085	131,041
Franchise Fees	192,128	196,562
	(320,213)	(327,603)

Insurance and Fixed Expenses		
Real and Personal Property Taxes		
Insurance	40,000	75,645
Replacement of FF&E		
Replacement Reserves	128,085	
Net Operating Income (NOI)	296,492	411,420
Capitalization Rate	12.82%	13.81%
Concluded Going Concern Value	**2,310,000**	**2,980,000**
Value of Personal Property In Place	(230,000)	(150,000)
Other Business Intangibles		
Liquor License	(50,000)	
Indicated Value Real Estate	**2,030,000**	**2,830,000**

APPENDIX 2

	2009	2010	2011
Number of Rooms	123	123	123
Occupancy	50%	50%	50%
Average Room Rate	$105.00	105	$105.00
RevPar (Revenue Per Available Room)	$52.50	52.5	$52.50
Gross Revenue			
Room Revenue	2,356,988	2,356,988	2,356,988
Food & Beverage Revenue	1,950,000	1,950,000	1,950,000
Rental & Other Income	20,000	20,000	20,000
Total Revenue	4,326,988	4,326,988	4,326,988
Expenses:			
Departmental:			
Rooms	643,860	643,860	643,860
Food & Beverage	1,560,000	1,560,000	1,560,000
Total Departmental Expenses	(2,203,860)	(2,203,860)	(2,203,860)
Undistributed:			
Administrative and General	426,950	426,950	426,950
Marketing	298,865	298,865	298,865
Property Operations & Maintenance (POM)	256,170	256,170	256,170
Utilities	298,865	298,865	298,865
Total Undistributed Expenses	(1,280,850)	(1,280,850)	(1,280,850)
Gross House Profit	842,278	842,278	842,278
Fixed Expenses			
Real and Personal Property Taxes	-	-	-
Insurance	40,000	40,000	40,000
Total Fixed Expenses	(40,000)	(40,000)	(40,000)
Net Income Before Business and Personal Property Deductions	802,278	802,278	802,278
Less: Total Income Attributed to the Business			
Management	126,085	126,085	126,085

Franchise Fees	192,128	192,128	192,128
	484,065	484,065	484,065
Less: Total Income Attributed to Personal Property (Return of FF&E)			
Replacement Reserves	(128,085)	(128,085)	(128,085)
Income Attributed to Real Property and FFE in Place	355,980	355,980	355,980
Capitalization Rate (Loaded for RE Taxes)	13.32%	13.61%	13.18%
Capitalized Value (of Going Concern)	**2,672,519**	**2,615,573**	**2,700,907**
Other Business Intangibles			
Liquor License	(50,000)	(50,000)	(50,000)
Value of Personal Property In Place (Return on FF&E)	(117,300)	(75,900)	(41,400)
Value of Real Property	**2,505,219**	**2,489,673**	**2,650,907**
Value of Real Property (Rounded)	**2,505,200**	**2,489,600**	**2,650,900**