

FPC LIMITED PARTNERSHIP

\*

IN THE

\*

v.

MARYLAND TAX COURT

\*

SUPERVISOR OF ASSESSMENTS  
OF PRINCE GEORGE'S COUNTY

\*

No. 13-RP-PG -0805

No. 13 RP-PG- 0806

\*

## MEMORANDUM AND ORDER

This case arises from a dispute between the Supervisor of Assessments for Prince George's County ("Supervisor") and FPC Limited Partnership ("Taxpayer") regarding the valuation for tax years 2011 and 2012 of the Colony South Hotel and Conference Center ("Hotel"), a property titled to the Taxpayer. The Supervisor argues for a \$15 million valuation for both years, consistent with the valuation set by the Property Tax Assessment Appeal Board, while the Taxpayer argues for valuations of \$4.8 million and \$6.6 million for the two tax years, respectively. The dates of finality for the 2011 and 2012 tax years, upon which the focus is for valuation, are January 1, 2011 and January 1, 2012, respectively.

The Taxpayer offered testimony from the Hotel's Director of Finance, Korian George, and an expert in real estate valuation, Eric Baum. The Supervisor offered testimony from Kim Thomas, a commercial real estate valuation expert employed by the Supervisor. There was no dispute regarding the experts' credentials to offer an opinion regarding the valuation of the Hotel.

The Hotel was constructed in 1988 and has continually been operated as the Colony South Hotel and Conference Center since. It is located atop a hill at the intersection of Branch Avenue and Surrattsville Road and enjoys high visibility from

Branch Avenue, which is a heavily traveled six lane divided highway connecting Southern Washington, D.C. to Southern Prince George's County and Northern Charles County. The Hotel "stands out" with, as Mr. Baum noted, its "...very prominent location on a hill."

The Hotel was constructed as part of the Southern Maryland Hospital Campus, being connected to that hospital by an atrium. The Hospital includes a 262-bed full-service hospital and a 24-bed sub-acute unit. Various medical offices and 21 townhouses are within the Campus. A single person developed the entire campus, envisioning it, according to Ms. Thomas, as a "...self contained environment."

The Hotel has 195 rooms and is full service, offering an extensive array of amenities including an 8437 square foot conference facility; a 6247 square foot banquet facility; two outdoor tennis courts, a swimming pool and Jacuzzi; a fitness center; a racquet ball court; a coffee shop; a restaurant; and a bar/lounge. Ms. Thomas testified it is the "...only full service hotel in this immediate area," explaining in her report that area is the Branch Avenue corridor. Resp. Exh. 1, p. 4. In the broader area Mr. Baum considered, there was another full service hotel, which he described as an "inferior product " due to its smaller allotment of meeting space. He testified the subject Hotel was the only hotel in his broader area that could accommodate a "...meeting or conference of any substance" and the only "credible" full service hotel there. This comports with Ms. Thomas' characterization

of the Hotel as “...the only game in town” insofar as its full service offering. See Pet. Exh. 7, p. 22<sup>1</sup> & Resp. Exh. 1, pp. 4-5.

While realizing a profit in 2005 and 2006, the Hotel was operating at a loss from 2006 through both dates of finality. Pet. Exh. 7, pps. 71-73. While testimony indicated the Great Recession was a significant factor, mismanagement, generally reflected in a neglect of needed improvements, appears to be the primary cause of the continued operating loss. While Mr. Baum stressed the adverse impact of three new competitor hotels opening between March, 2007 and December 2008, the Court is not convinced that impact was the primary contributor to the revenue challenges, as those hotels were not full service hotels. Pet. Exh. 7, p. 57.

Mr. George testified he had prior experience in hotel management and was hired in September 2010 “..to turn the hotel around.” He noted significant capital investment, which had been neglected, was needed to get the Hotel “...in line with the market.” Evidence of prior mismanagement Ms. Thomas highlighted included a lack of an on-line reservation capability, a failure to properly price rooms, and the loss of certification for occupancy by Andrews Air Force Base personnel. While the Base-driven occupancy had “minimal” relevance to overall occupancy, prior management’s failure to even be aware of the certification’s loss is indicative of its inattention.

After Mr. George’s hire, the Hotel’s owner decided to implement an aggressive investment strategy in 2011, reflected in a \$1,008,741 appropriation for

---

<sup>1</sup> Mr. Baum provided separate reports for tax years 2011 and 2012, which are essentially the same. So, the Court will not cite the report for tax year 2012 unless there is a germane difference meriting a citation.

capital improvements that year. See Pet. Exh. 5. Mr. George testified that with those improvements implemented it “...was like day and night.” Mr. Baum indicated \$2.2 million was expended in total for improvements from January 2011 to year-end 2013. Pet. Exh. 7, p. 34. The Court finds this investment reflects the previously planned full implementation of the 2011 investment strategy.

Mr. Baum emphasized the need to “flag” the Hotel for it to be competitive. “To flag,” means to associate with a recognized national brand. Costs to flag are significant, being described as “humongous” by Mr. George. Mr. Baum testified an association with Wyndham Garden for flagging would be appropriate for the Hotel. Pet. Exh.7, p. 36. He also testified “..it is not often easy to get the franchise” with the applicant having to prove it would be a “good steward.”

Mr. Baum suggests the aggregate improvement costs, including specific costs to achieve a flagged status, are \$3,163,000. Pet. Exh. 7, p. 37. With the \$2.2 million investment to realize only the investment strategy, the Court concludes the capital cost to flag would be \$963,000. In addition, eight percent of room revenue would be assessed annually for the flag as a franchise fee. Pet. Exh. 7, p. 79.

The Court is not convinced the significant costs to flag would be an expenditure a willing buyer of the Hotel would determine justified. The hotel has unique characteristics, such as its location, integration with the Southern Maryland Hospital, and full service offerings, differentiating it from its flagged competition and facilitating the “induced demand” to which Mr. Baum referred. The Court believes the benefits Mr. Baum stressed of a flagged hotel’s on-line booking system would be negligible, accepting Ms. Thomas’ suggestion that the “cost conscious

traveler” to whom the hotel markets would be apt to use travel websites, offering rate comparisons.<sup>2</sup> Since its inception, the Hotel has enjoyed periodic profitability without ever being flagged. Management did not feel pursuit of a flag was justified, as the costs were not incorporated in its investment strategy and, as Mr. Baum testified, as of the dates of finality, there was “...nothing in the wind to change to a flag.” And, it appears that with the Hotel’s recent history of mismanagement, it would be a challenge to secure a flag. So, the Court will not consider the costs of flagging in its valuation analysis.

The Court will consider though the \$2.2 million envisioned for full implementation of management’s investment strategy in its valuation analysis. A willing buyer would be aware of the need to implement the investment strategy and would conclude this expenditure is immediately necessary. It would be factored-in to any offer. The Court does not accept the Supervisor’s suggestion that the cost should be amortized or depreciated over time.

The Court will rely on Mr. Baum’s stabilized income and expense analysis, with necessary adjustments to accommodate the Court’s determination that flagging will not be funded. Pet. Exh. 7 & 8, pps. 82 & 88 and 83 & 89, respectively. Ms. Thomas premised her expense analysis on a hypothecation of a percent of revenues expended. Resp. Exh. 1, pps. 10 & 11. This hypothecation considered “industry analysts” and actual experience of four hotels in the “competitive set” and of 80 hotels in Prince George’s County. Ms. Thomas conceded the referenced actual experience did not differentiate full service hotels. Mr. Baum’s analysis focused on

---

<sup>2</sup> Mr. George described the Hotel’s market as a “budget market.”

actual experience of five comparable full-service hotels. Pet. Exh. 7, pps. 74 & 75. The Court finds this focus on actual experience of comparable properties a more credible foundation for determining the Hotel's Net Operating Income (NOI).<sup>3</sup> In addition, the Court finds Mr. Baum's analysis more thorough with specific enumerations of revenue and expense categories, not reported in Ms. Thomas' analysis.

Before a valuation can be extracted from the NOI, the Court must determine the appropriate capitalization rate.<sup>4</sup> The capitalization rate suggested by Ms. Thomas was 8.5 percent for both tax years, while the rates suggested by Mr. Baum were 10.5 percent for tax year 2011 and 9.5 percent for tax year 2012. Mr. Baum testified the decrease reflected an improving real estate market driven by more capital being available. The real property rate to be added to the capitalization rate chosen by Mr. Baum was 1.431 percent and by Ms. Thomas was 1.43, which were essentially the same.

Both Mr. Baum and Ms. Thomas noted a robust market for hotel properties. "Hotel properties were being actively sought by investors as of the date[s] of value," observed Mr. Baum. Pet. Exh. 7 & 8, pps. 1. Ms. Thomas explains that within this

---

<sup>3</sup> The Rushmore method for hotel valuation upon which the parties relied requires that a hotel's personal property not be a valuation consideration. To accommodate this requirement Ms. Thomas deducted from the valuation the personal property's cost as reported by the Hotel with depreciation, while Mr. Baum deducted from the valuation the income determined to be attributed to the personal property. The Court concludes the deduction of the income is more consistent with the Rushmore methodology.

<sup>4</sup> While the experts did present comparable sales analysis, since they both testified that the income approach was the more appropriate valuation methodology the Court will only consider that approach.

robust market, "...the Washington DC Market [within which the Hotel is located] appears to have fared better than most," with it being "[r]anked number three by the 2011 Hotel Valuation Index with regard to sales value volume.." and with it having an above average price per room." Resp. Exh. 1, p. 6.

With this robust market, the Court finds the Hotel would have significant allure to investors as a turnaround opportunity, particularly with the many attributes distinguishing it from its competition.<sup>5</sup> The Hotel's potential is vividly illustrated by the average historic occupancy from 2005 to 2008 exceeding the 60 percent level Mr. Baum identified as necessary for profitability. Pet. Exh. 7, p. 65.

Mr. Baum's capitalization rates are interpolated from the findings of two reports of investor surveys and are premised on the hotel being an inferior 3<sup>rd</sup> tier property. He reports the 2<sup>nd</sup> and 3<sup>rd</sup> tier differentiated capitalization rates extracted from the RERC Real Estate Report. Pet. Exhibits 7 & 8, pps. 83 & 84, respectively. The Court believes this asserted 3<sup>rd</sup> tier status ignores many of the unique attributes described earlier, which distinguish the Hotel from its competition. Also, a review of the photographs included in Mr. Baum's reports, which, in part, reflect the improvements to the Hotel a knowledgeable investor would envision, convinces the Court the Hotel is at least as attractive and often more attractive than its competition. Pet. Exh. 7, pps. 28-36, 59-62. Hence, the Court concludes it would have been more appropriate for Mr. Baum to rely exclusively on the average capitalization rate of 9.5 percent for full-service hotels he reports from the

---

<sup>5</sup> An addition allure could be the above market food and beverage income, reflecting income potential from non-hotel guest patrons. Pet. Exh. 7, p. 79.

PriceWaterhouseCoopers Real Estate Investor Survey (“PwC Survey”) and to not consider the Hotel as a 3<sup>rd</sup> tier property.

Ms. Thomas also references the RERC Real Estate Report, focusing instead on 1<sup>st</sup> and 2<sup>nd</sup> tier properties, and a PwC report extract for the “National Full-Service Lodging Segment.” But, she ultimately relies on a report by HVS, the same company with whom Mr. Baum is associated, which is founded on hotel appraisals performed by HVS in determining hotel capitalization rates. Resp. Exh. 3, p. 6. From that report, Ms. Thomas extracts a reported base capitalization rate of 5.8 percent, which she adjusts to her suggested 8.5 percent capitalization rate, due to the Hotel’s location and age.

The Court will rely on the 9.5 percent capitalization rate reported in the PwC Survey for both tax years. Unlike the RERC Real Estate Report, the PwC Survey provides a specific valuation for full service hotels, which is the attribute the Court finds fundamental in distinguishing the Hotel from its competition. And, the PwC report extract and HVS report do not distinguish between full service and luxury hotels, as does the PwC Survey. The almost 50 percent adjustment Ms. Thomas makes to the 5.8 percent capitalization rate she extracts from the HVS report to reach her suggested 8.5 capitalization rate undermines the credibility of that suggested capitalization rate. While Hotel’s allure is a compelling consideration, the Court’s reliance on the higher 9.5 capitalization rate recognizes a risk factor for the anticipated turnaround.

In extrapolating the NOI’s from Mr. Baum’s analysis, the Court will add back for both tax years the \$313,000 expense deducted as the franchise fee to flag and



then apply to the resulting NOI's the 9.5 percent capitalization rate to determine a market value. Pet. Exh. 7, p. 8. From the market value there is deducted for tax year 2011, the \$2.2 million envisioned to implement management's investment strategy. For tax year 2012, that deduction is reduced to \$1,191,259, recognizing the implemented \$1,008,741 of the investment strategy. The resulting fair market values of the Hotel for tax years 2011 and 2012 are \$9,385,005<sup>6</sup> and \$10,485,989, respectively.

Accordingly, it is this 1<sup>st</sup> day of December, 2014, by the Maryland Tax Court **ORDERED** that the decision of the Property Tax Assessment Appeals Board for Prince George's County is reversed and that the fair market values for the subject property for tax years 2011 and 2012 are \$9,385,005 and \$10,485,989, respectively.<sup>7</sup>

**CERTIFIED TRUE COPY**  
**TEST:** John T. Hearn, Clerk

**NOTICE:** You have the right of appeal from the above Order to the Circuit Court of any County or Baltimore City, wherein the property or subject of the assessment may be situated. The Petition for Judicial Review **MUST** be filed in the proper Court within thirty (30) days from the date of the above Order of the Maryland Tax Court. Please refer to Rule 7-200 et seq. of the Maryland Rules of Court, which can be found in most public libraries.

cc: Michael A. Cain, Esq.  
William K. Hammond, Esq.  
Kent Finkelsen, Administrator

---

<sup>6</sup> It was necessary to also utilize the 9.5 percent capitalization rate in determining the return on personal property, which results in a lower deduction for tax year 2011 than reported by Mr. Baum.

<sup>7</sup> Issues raised and differences in the experts analysis not specifically addressed by the Court were deemed de minimis.