What are the Intangibles in an Operating Hotel Deal?

The price paid for every operating hotel includes money exchanging hands for the acquisition of intangible assets. Of course, it also includes money exchanging hands for the acquisition of real estate and tangible personal property – land, building, and FF&E. However, some renowned appraisers would have you think that that is it. The evidence for the fact that intangible assets are transacting is the terms of the Purchase and Sale Agreement (PSA).

The PSA will explicitly state that there are indeed intangible assets included in the transaction AND will explicitly state exactly what they are (i.e. all contracts, licenses, permits, and advance bookings). First and foremost among the contract category is either a management agreement and/or franchise agreement. The terms of the PSA will address whether the existing management agreement and/or franchise agreements are being assigned in the transaction, or being renegotiated. If they are to be renegotiated, it is often a condition precedent to closing. In other words, the buyer will have the approval of the management and/or franchise companies before closing, and whatever terms and conditions are required will be known.

Conceptually one might consider that a buyer of a franchised Marriott is not acquiring ownership of the flag. That is true, but the buyer is acquiring the rights to continue to use that flag and receive all the benefits associated with the use of that flag. By acquiring the existing franchise agreement or having the opportunity to negotiate a new franchise agreement with Marriott, either situation allowing the hotel to continue to operate as a Marriott, the buyer has essentially paid for that intangible asset (contract).

Other intangible assets that are transacting include rights to trade names, trademarks (if any), and a trained workforce. Even if the management agreement is terminated because the buyer wants to either manage the property themselves or hire a different third-party manager, all of the employees, except maybe the General Manager and Director of Marketing, remain in place. The consequence of the transaction is that the employees now work for someone else. Not that all the employees were fired and whole new staff hired.

For those that routinely work with hotel assets these concepts may seem elementary, but for tax assessors, it is this very lack of understanding that causes them to overlook the need to account for the intangible assets in a sale price and include that increment of value as real estate. Being able to explain exactly what the intangible assets are should help in arriving at a fair market value of the real estate. And, if the buyer has properly accounted for the portion of the price applicable to the intangible assets at closing by recording only that portion of the price applicable to the real estate on the deed, the information becomes clearer for the appraiser.

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