Real estate value, Vrbo & Airbnb - by John Rynne

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The Vrbo and Airbnb revolution has exploded on the scene especially for residential properties. I've appraised a number of properties that have been used for short-term occupancy, either daily or weekly. In the past they were typical month-to-month or annual traditional rentals. Most of the owners of these use as a guide to value the operation as Vrbo or Airbnb. The intended use of many of these appraisals have been for mortgage financing. The clients typically have been lenders. In every case the property owner has the expectation that because they're using Vrbo or Airbnb income that the values will be significantly more than traditional monthly or annual leases or as an owner occupant property. In many cases, they are right. However, generally the pure real estate value doesn't change.

Real estate value for most lenders is what is important. In many cases the regulators make it mandatory. There are some exceptions. The reason for the confusion is that once a property is dominated by Vrbo or Airbnb income, the property goes into a new tier of valuation; that being Total Assets of the Business (TAB). Hotels, assisted living, nursing home properties, etc. are classified this way. I have completed hundreds of these properties over the years. There are three important segments in TAB reports; that being A) real estate value, B) furniture, fixtures & equipment (FF&E) and C) business enterprise value (BEV). It's important for owners, lenders and appraisers to understand this. Of course real estate value commands relatively low interest rates, long amortization and terms because it's physical and economic life is longer since it is affixed and immobile. FF&E and BEV can be financed using chattel or short term notes at higher rates, much lower amortization and term. FF&E is attributed to free standing assets not affixed to the real estate such as beds, silverware, towels, sheets, tables, chairs, paintings, oven & ranges, refrigerators washer/dryers etc. Obviously, these assets are movable, have generally a much shorter physical & economic life and have substantially more risk than the immobile real estate segment.

There are some rare exceptions primarily due to economic obsolescence which goes to the adage that more buildings are torn down than fall down. I know of a recent example regarding a new restaurant which was demolished within six years due in part to a poor commercial location which was magnified by the COVID-19 crisis. The tables, chairs, kitchen utensils, free-standing appliances and other movables had salvage value and were sold to other users while the building had negative value because of the demolition costs. BEV can be even more risky because it is an intangible and difficult to measure in Vrbo and Airbnb properties. It's difficult to sell BEV in the marketplace without the real estate and FF&E.

When FF&E is a major part of a hotel, Vrbo,or Airbnb property, these assets have to be accounted for as an operating expense in the form of an annual chattel outlay. This can be done on a straight line basis or a sinking fund factor method depending upon the quality of the property. For an extreme less desirable or older property the straight line method may be most reflective. As an example, if the FF&E costs per unit is $10,000, a 20-unit property would have a total FF&E replacement cost new of $200,000 ($10,000 x 20 units). If the economic life of the FF&E is 12 years the allocated annual chattel expense to the operating expenses would be $16,666 ($200,000/12). However, generally for most Vrbo and Airbnb properties a sinking fund method is most appropriate.

When the $200,000 FF&E replacement cost new is based upon a 9% discount rate, the sinking fund for 12 years would be 4.965%. Thus, the annual chattel expense would be much lower at $9.930 (4.965% x $200,000). The BEV is based upon a percentage of gross profit or effective gross income. This typically is in addition to management salaries. So if the effective gross income is $250,000 and the BEV percentage is 3%, the BEV operational allocation is $7,500 annually. Thus, there is a minimum of $17,430 or $24,166 added annual expenses for FF&E and BEV depending upon whether the SL method or SFF is used. Also for the TAB method there is higher vacancy, cleaning, staff, etc. which further increase operating expenses. Therefore, in some cases the highest best use of the subject will be as a traditional income property not as a Vrbo or Airbnb model. However, generally the pure real estate value always will be equal.

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