Seattle Waterfront LID Assessment Hearing

Seattle LID Public Comment Hearing

February 19, 2020

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SEATTLE WATERFRONT LID ASSESSMENT HEARING

BEFORE

HEARING EXAMINER RYAN VANCIL

Taken at 700 Fifth Avenue, Suite 4000

Seattle, Washington

DATE TAKEN: FEBRUARY 19, 2020

REPORTED BY: CARISA KITSELMAN, RPR, CCR 2018

A P P E A R A N C E S

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EXHIBIT INDEX

SEATTLE, WASHINGTON; FEBRUARY 19, 2020
8:58 A.M.

HEARING EXAMINER VANCIL: Good morning. Call to order this February 19, 2020, continuance of the Seattle Waterfront LID Assessment Hearing.

Today we continue objections for, I believe it was -- I'm sorry. I don't have the number for the Thompson -- remind me of the case number. Mr. Gordon was going to speak a bit more, too.

MR. REUTER: Yes. Good morning. The Thompson is 168.

HEARING EXAMINER VANCIL: All right. So we're going to continue with 168. And then we also have 218, 219, and 220. We're going to hear from you about scheduling.

MR. REUTER: We're done with Thompson. What I have today is a witness I would like to put on now for 218, 219, and 220. I then have a witness for the Edgewater Hotel, No. 136, and then I will resume the testimony of Mr. Gordon, and he's going to make some points about the Edgewater, and perhaps one other. That's agreeable.

HEARING EXAMINER VANCIL: All right. So your two witnesses you will call for the morning. We'll try to make progress for those. And then

Mr. Gordon will be picked up after that.

MR. REUTER: Yes.

HEARING EXAMINER VANCIL: Complete his testimony, and then there will be an opportunity for cross.

MR. REUTER: Excellent.

HEARING EXAMINER VANCIL: Let's proceed then.

MR. REUTER: We call Katarina Kueber. Matters 218, 219, and 220.

HEARING EXAMINER VANCIL: Good morning. Please state your name and spell it for the record.

THE WITNESS: Good morning. Katarina Kueber, K-A-T-A-R-I-N-A, last name is K-U-E-B, as in boy, E-R.

* * * * * *

KATARINA HUBER, having been first duly sworn, was examined and testified as follows:

THE WITNESS: I do.

HEARING EXAMINER VANCIL: Thank you.

DIRECT EXAMINATION

BY MR. REUTER:

Q. Where do you work?

A. I work for CBRE, Downtown Seattle director.

Q. And how long have you been doing that?

A. I've been in commercial real estate for 25 years.

Q. Okay. And how long have you been at CBRE?

A. I've been at CRBE twice in my career. This most recent time, I've been there for a year and a half.

Q. Okay. And where were you before?

A. I was at Columbia Center for 15 years as the manager there.

Q. Of the building?

A. Yes.

Q. Okay. Do you consider yourself knowledgeable about downtown and the downtown real estate market?

A. Yes.

Q. And how have you gained that familiarity?

A. Mostly through my experience with Columbia Center for 15 years, involved in the DSA and the BOMA agencies. I was on the MID board for several years, and just connections through my commercial real estate industry.

Q. We're here today to talk about three properties. Those are 818 Stewart, which is Case 218. 1918 8th Avenue, which is Case 219. And 1800 9th Avenue, Case 220.

Are you familiar with those properties?

A. Yes.

Q. And tell us how?
A. So my client JPMorgan owns all three of those properties, and it's about 1.25 million square feet that we manage for the client.
Q. How are those buildings used?
A. They are pier commercial office buildings with light retail.
Q. Is there any residential?
A. No.
Q. What do you mean by "light retail"?
A. There's a coffee shop, Caffe Ladro at 1800 9th. There's a Dilettante coffee shop at 818 Stewart. And then at 1918 there is Specialty's. And there's CrossFit store and a little deli.
Q. Okay. And approximately how many tenants are in these buildings?
A. Employees, like occupied or --
Q. No. I mean the tenants.
A. There's two or four in 1918. In 818, there's about six. And at 1800 9th there are three or four.
Q. Okay. Can you describe the -- and I'm talking about the outside of the buildings.
A. Mm-hmm.
Q. What's the -- what's the condition of that -- that area? These buildings are near each other?

A. They are. They are within two blocks of each other.

Q. Okay.

A. So 1918 and 818 are fairly newer buildings built in the last eight to ten years. We've done some minor improvements around the exterior, some landscaping upgrades, trees, shrubs, oils over the last year and a half.

1800 9th is a newer building for JPMorgan, and our client just purchased it recently in December. They've had some minor improvements as well.

Q. Okay. And have you -- can you tell us how you characterize the area? Is it -- are the sidewalks broken down? Are there amenities out in the street? What's it like over there?

A. It's -- you know, it's that tech sector. Amazon is one of our larger tenants there for two of the buildings. The area is well maintained. There's a little dog park on the side of one of our properties which people get to enjoy. Other than that, the condition of the area is really good.

Q. Okay. Have you -- or your client, spent money improving the exterior area of the buildings?

A. Yes. So in 2018, they spent about $24,000 in sidewalk repairs at 1918. In early 2018, they did a landscape refresh for about 24- $25,000 at 1918. And in early 2019, we did a $13,000 landscaping upgrade for 818 Stewart.

Q. Okay. And the net effect of that is to make for pretty nice-looking outside areas.

A. Mm-hmm.

Q. Have you looked at the proposed improvements, the improvements proposed by the waterfront LID?

A. Yes, I have.

Q. And do you -- have you looked at what's proposed in the four -- in the Pike/Pine Corridor?

A. Yes, I have.

Q. Okay. How would you characterize those improve -- those proposed improvements?

A. Mostly I would characterize it as our area that we maintain, that we manage for our client is already nice in that -- in the very similar condition. I don't think those improvements will make an impact on our properties.

Q. So is there already exterior landscaping?

A. Yes.

Q. Is there lighting in the area?

A. Yes.

Q. Okay. Do you -- do you perceive any benefit to the value of the property in any way from the proposed Pike/Pine benefits?

A. Not -- not a marginal benefit whatsoever.
Q. And have you looked at what's proposed for the waterfront area?
A. Absolutely I have, yeah.
Q. Okay.
A. It's beautiful.
Q. Yeah. How far is that from the buildings that you're representing?
A. It's just shy of a mile. It's about a 20-minute walk down to the waterfront.
Q. Okay. Do you -- do you perceive the office workers in your three buildings getting a benefit from those?
A. I don't. I'm not sure what -- what would attract them down to the waterfront. It takes 20 minutes to walk down there. If you're going to go down there on your lunch hour, you're going to take 20 minutes to go down there. You're going to have basically five or ten minutes to eat your lunch, or walk along the waterfront, and then you have to hike back up there in 25 more minutes.
Q. Now what about you personally? Do you foresee yourself using the waterfront?
A. I enjoy the waterfront. I live in Magnolia. I bring my kids down there. We ride our bikes. Go on the -- we use the tourist attractions, go to the aquarium

there.

Q. And is Magnolia in the LID area?

A. It is not.

Q. Not yet?

A. It is not. Not yet.

Q. Okay. So you use the word "tourist." Do you see the proposed benefits particularly on the waterfront as tourist related?

A. Absolutely. Tourism and families.

Q. And is your -- are your buildings catering to tourists or families?

A. We are not.

Q. That's all I have.

MS. THOMPSON: No questions from the City.

HEARING EXAMINER VANCIL: Thank you.

THE WITNESS: Thank you.

HEARING EXAMINER VANCIL: Next witness.

MR. REUTER: Robert Peckenpaugh will testify regarding the Edgewater Hotel, Case 136.

HEARING EXAMINER VANCIL: Please state your name and spell it for the record.

THE WITNESS: Good morning. My name is Robert Peckenpaugh. R-O-B-E-R-T, last name Peckenpaugh, P-E-C-K-E-N-P-A-U-G-H.

MR. REUTER: Good morning.

THE WITNESS: Good morning.

* * * * * *

ROBERT PECKENPAUGH, having been first duly sworn, was examined and testified as follows:

THE WITNESS: I do.

HEARING EXAMINER VANCIL: Thank you.

DIRECT EXAMINATION

BY MR. REUTER:

Q. Where do you work, Mr. Peckenpaugh?

A. The Edgewater Hotel.

Q. What do you do there?

A. I'm the general manager.

Q. Which means what?

A. I oversee the entire operations of the property.

Q. Okay. And how long have you been working there?

A. Just shy of four years.

Q. And how long have you been in the hotel business?

A. About 35 years.

Q. Where is the Edgewater?

A. The Edgewater is on 2411 Alaskan Way. It sits on top of Pier 67.

Q. And have you seen the LID area map?

A. I have, yes.

Q. And the Edgewater is inside it.

A. It is. It's the last property on the north end of the waterfront that is included in the LID map.

Q. And so that's to say who's your neighbor to the -- to the north?

A. To the north next up is the Port of Seattle and Pier 69. And then Pier 70 houses a law firm, as well as the AQUA Restaurant, and a few other small restaurants.

Q. And they're not included?

A. They are not included. And they're right next door to the Sculpture Park.

Q. Okay. Are there hotels that are north of the Edgewater?

A. Not on the --

Q. I mean in Seattle Center, the Seattle Center area?

A. Up in the Seattle Center area there is, yes.

Q. And they are not in?

A. They are not, no.

Q. What about the property directly across Alaskan Way from you?

A. That is not included. It's not until you get down. I don't know the pier numbers. Where Anthony's is. The Marriott across the street is. I'm not sure if the World Trade Center is or not. But it's not until you get south of that, it goes across the street and starts working its way up.

Q. Okay. Do you know -- do you know whether the Edgewater was initially in the LID?

A. I'm not aware of that.

Q. Okay. Have you reviewed the slides or the depictions of the proposed improvements?

A. I have, yes.

Q. Are any of those improvements what you would think of as near the Edgewater?

A. Near in proximity, they're a quarter mile away. But they -- there seems to be an invisible area even today, prior to this work being done where the tourism that happens on the waterfront kind of stops around the Aquarium area.

Now, I say that, my guests still walk up and down that corridor, but you don't get many of the tourists that are coming down from the downtown corridor, walking all the way up to the Sculpture Park. Does that make sense?

Q. Yes. Where is the Sculpture Park?

A. The Sculpture Park is two piers north of us.

Q. Okay. And -- and so do you -- do you -- are you saying you have to go to the aquarium before you see a benefit from the LID?

A. I believe so, yes.

Q. How do people get typically -- if you're coming from

the airport, how do you get to the Edgewater?
A. Right now I use Waze for electronics, but I use Waze. And it typically shoots me up -- I don't have the numbers there. But eventually onto 99 North.
Q. Down by Burien or SeaTac?
A. Correct. Shoots you out that way. And then it dumps you off on Alaskan Way, and you take Alaskan Way and all the stoplights all the way down. You can come via I-5 as well. But it doesn't typically take you that way to exit Mercer just because of all the traffic that happens.
Q. And so is -- is -- is the Edgewater on a -- today, on a main street or a side street?
A. It's a -- it's the main street of Alaskan Way. And typically people will -- tourists at this point in time, if they're not on foot, and they're trying to find their way from the ferry, they'll come down Alaskan Way all the way to the end, hit Broad Street where the Sculpture Park is, and shoot up north to the Seattle Center area.
Q. All right. And you understand the LID improvements or the improvements resulting from the removal of the viaduct as changing your positioning on a main street to more of a side street?
A. There's been a series of changes, right? When the

viaduct came down, it made my guests come all the way up Alaskan Way and hit all the stoplights along the way, as opposed to you used to exit -- is that Western, and then one stoplight up, you shoot down to the Edgewater and you would be there in no time.

Now, it will be that series of stoplights still, but as you get to the aquarium, the road changes significantly. And as you're headed north on Alaskan Way, it will actually shoot you up to Elliott, making the Alaskan Way portion where we are a passed-over area, as far as the typical traffic patterns go.

Q. More of a side street?

A. That's a good way of describing it, I believe.

Q. And do you agree with the age-old principle that -- of a location, location, location --

A. Absolutely.

Q. -- for hotels?

A. Absolutely.

Q. Okay. And so do you perceive a benefit from the waterfront improvements, including this relegation of the Edgewater to a side street?

A. I don't. In fact, when I first moved back to Seattle four years ago, and I got involved in trying to understand what the LID was and what the waterfront improvements were, I tried to speak with everybody that I could along the way saying, you know, we have the Sculpture Park up here, we have the hotels, the cruise terminal. All of these things on the north side.

Why aren't we at least including part of that on the waterfront park. Why isn't this a waterfront that goes all the way up to the other activities that we have, and I couldn't get an answer. I think what I realized, in my opinion, is that the decisions had already been made, things had already been in motion by the time I started asking questions like that.

So I feel like it's just kind of a forgotten part of the waterfront, is my best description.

Q. As far as this LID improvement project?

A. Correct, correct.

Q. Do you pay attention to the rates, the average daily rate and occupancy at your hotel?

A. One of my primary functions, yes.

Q. I imagine.

If you are hit with an assessment for these improvements that are a quarter mile away from your property, how are you going to deal with that? Can you raise your rates to get -- to -- can you raise your room rates to help absorb that?

A. I don't think that the waterfront is a determining factor on whether we can raise our rates. There are many other economic factors, including demand -- supply and demand as far as hotels go. I just -- I don't see the waterfront park being primarily spring, summer, fall, and primarily summer in Seattle being a driver. Because right now those are the months that we're already fully occupied. Especially, the summertime, I should say.

So there's not going -- the increased demand that it may create isn't going to increase any occupancies for me. It's not going to necessarily be able to drive rates depending on what the other economic indicators that are going on in the City.

Q. Okay. Does the Edgewater own the property it sits on?

A. No, it does not.

Q. It leases that property?

A. Yes.

Q. And from whom does it lease the property?

A. The Department of Natural Resources.

Q. Is it your understanding that the DNR also owns the hotel's building?

A. That is my understanding of the lease. I'm not intimately involved in the lease portion of the business. But that's my understanding.

Q. Is that the lease?
A. Yes, it is.
MR. REUTER: I'd like to mark that.
HEARING EXAMINER VANCIL: You want the whole lease?
MR. REUTER: Yes.
HEARING EXAMINER VANCIL: Are you going to reference something in it?
MR. REUTER: Yes.
HEARING EXAMINER VANCIL: All right. We'll mark it as Exhibit 11.
(Exhibit No. 11 marked.)
BY MR. REUTER:
Q. Would you look at page 9 of the lease which is Section 7.
A. Yes.
Q. Do you see 7.1 defining what the existing improvements are?
A. Yes.
Q. And what do those -- do the existing improvements include the commercial structure used as a hotel?
A. Correct.
Q. And then in the second paragraph do you see the tenant acknowledging that the existing improvements are owned by the State?

A. Yes.
Q. All right.
MR. REUTER: That's all I have.
THE WITNESS: Thank you.
MS. THOMPSON: Just --
THE WITNESS: New to the process.
MS. THOMPSON: That's okay.

CROSS-EXAMINATION

BY MS. THOMPSON:
Q. So you mentioned that a part of -- a main part of your job is to review and consider the ADR for the hotel.
A. Correct.
Q. Do you know off the top of your head what the hotel's ADR was in 2019?
MR. REUTER: Objection. This is -- this is potentially confidential information. And I don't -- I don't know that Mr. Peckenpaugh is authorized to put that on the record.
MS. THOMPSON: Understanding that there may be a concern for confidentiality here, the issue of value and the importance of ADR in the value of the hotel has been raised. So the door has been opened in our mind.
HEARING EXAMINER VANCIL: To any

confidential information? What's the limit, Counsel? I've got to have something because right now you describe it as we get to do everything. So what's your limit?

MS. THOMPSON: Well, the limit would be the details about the average daily rate of the hotel in the preceding year.

MR. REUTER: We have put in the record aggregate ADR numbers and we have made clear throughout this that the actual ADR numbers for these hotels are confidential information. The value of the hotel has been testified to by the appraiser, Mr. Gordon.

And that valuation is the valuation that's at issue in the case. We have tried to shield the record from the actual ADR of these businesses and we've -- opened the door to the disclosure of information. We've been trying very hard to keep out of the public record.

HEARING EXAMINER VANCIL: So we've got the privacy issue too. I guess I had a question as to what in this witness's testimony spoke to ADR? I know I heard him speak to, in his direct, that he tracks occupancy. But I don't recall any testimony concerning rates.

MS. THOMPSON: He did mention that ADRs are an important aspect of his job in particular as the manager of the hotel.

HEARING EXAMINER VANCIL: I'll allow you to ask questions that are generalized and don't require the divulgements of specific privileged industry secrets essentially is what we're talking about here. He didn't go into it deep. So I don't know how much he can find for it as opposed to Gordon who has already testified well to it and speaking to it as an expert.

MS. THOMPSON: Okay. Thank you. Maybe we'll try it a different way.

HEARING EXAMINER VANCIL: Thank you.

BY MS. THOMPSON:

Q. Have you seen the Kidder Mathews appraisal of the Edgewater Hotel?

A. I have not.

Q. Well, I will represent to you that in the appraisal the Kidder Mathews report says that based on STAR reports --

A. Yes.

Q. -- the average daily rate in that market was 296 in 2019.

A. Okay.

Q. Can you confirm whether the actual ADR of the Edgewater was higher or lower than that number?
A. Yes. It was lower.
Q. It was lower.
And then the Kidder Mathews appraisal projects that the average daily room rate for the Edgewater in going forward, presumably in the next year, will be $258.
Is that higher or lower than you anticipate your ADRs being?
A. That appears to be about right. My apologies. I don't know the exact number.
Q. Were your 2019 actual ADRs higher or lower than 258?
A. I'm sorry. I don't remember that exactly right now.
Q. Were your actual ADR numbers provided to Kidder Mathews?
A. Yes, they were -- or I should say, I believe so. I don't know that answer. I'm sorry. I'm assuming that they were, yes.
Q. Did Kidder Mathews interview you as part of their appraisal?
A. No.
Q. So I mentioned that the projected ADR for the hotel is 258 in the appraisal.
In your experience in the last two years, let's

say, is that higher or lower than what the hotel has experienced?

A. That is lower. The impact of the new supply in hotels over the past two years has been significant. And our ADR has actually dropped significantly, as well as most hotels in the region.

MS. THOMPSON: No further questions. Thank you.

HEARING EXAMINER VANCIL: I just have one question for you.

You indicated that the current configuration of the street in front of the Edgewater has changed, it may be from a main thoroughfare to a secondary thoroughfare. Was that a result of the viaduct changing and the tunnel work, or is that related to the waterfront LID proposed changes?

THE WITNESS: Today it's still a main thoroughfare. After the LID changes down by where the aquarium will be now on both sides of the street, you will actually no longer go straight to the Sculpture Park on Alaskan Way. You'll be forced up onto Elliott. So it's after the LID improvements.

HEARING EXAMINER VANCIL: Thank you.

THE WITNESS: Okay. Is that all?

HEARING EXAMINER VANCIL: Anything on

redirect?

MR. REUTER: No. Thank you.

THE WITNESS: Thank you very much.

HEARING EXAMINER VANCIL: Back to Mr. Gordon?

MR. REUTER: Yes.

HEARING EXAMINER VANCIL: All right. Mr. Gordon, you remain under oath or affirmation from yesterday.

THE WITNESS: Understood.

DIRECT EXAMINATION (continued)

BY MR. REUTER:

Q. Mr. Gordon, I want to ask you about the Edgewater and this lease issue. We've heard some testimony about other properties that are leased or fractioned, you might say, between the land and the -- and the improvements.

How did you value in your -- in your appraisal of the Edgewater that we put in the objection, what's valued there?

A. What we valued is the leasehold interest. And what that means, it's the interest of the hotel operator who is paying rent to the State.

So the income -- when we capitalize the income for the leasehold interest in the property, we're

capitalizing the NLI that I discussed yesterday. It's the net operating income less the rent payments.
Q. And do you know how -- and what was -- what was your value conclusion?
A. Sorry. We concluded to an overall value of the leasehold interest in the Edgewater of 63,600,000 of which 61,400,000 was real estate. The remainder just being personal property.
Q. And then that's the -- that's the leasehold value.
A. Correct.
Q. As opposed to the fee value.
A. Right. The fee simple value would be calculated by capitalizing the net operating income rather than the net leasehold income. So that would assume that they didn't pay rent, is the simplest way to look at it.
Q. Okay. And have you calculated that value?
A. It doesn't appear in the appraisal. But I have done a calculation of that for this hearing.
Q. Okay. And what is that value?
A. The -- by -- well, I should say that as I discussed yesterday, though only briefly, the capitalization rate appropriate to a leasehold interest is generally higher than one for a fee simple interest.
So when we capitalize the net operating income -- I'm sorry, the net leasehold income in the appraisal,

I used a 7 percent cap rate. To cap the net operating income, I reduced that rate down to 6-and-a-half percent, which is what I think would be a reasonable depiction of the risk of investment if it was a fee simple ownership, if the buyer coming in didn't have to deal with the State. I -- their net operating income in our forecast was 6,160,692. That's unchanged. That's the figure from our appraisal.

I came up with an overall value of the fee interest of 94,780,000 if the property were fully stabilized. The Edgewater is really close to being stabilized. I addressed that previously as well.

But in the first year we do see a very slight shortfall in income as the hotels recover from the increase in supply.

So I'm deducting an additional 140,000. And that's the difference between my estimate of value as if stabilized today, and my estimate of how it's going to perform in the current year. So they're both in 2020 dollars, but there's a shortfall of 140,000 in the current year in my forecast.

Q. Okay. Will you give me that value number again of the fee?

A. Well, after the -- after the deduction?

Q. Yes.

A. The -- the overall fee value is 94,640,000. That includes real estate and personal property. If we deduct the same figure for personal property as was used in the appraisal, and there's no reason to change it, that was 2.2 million.

So take 2.2 million off of the overall fee value, you'll get 92,440,000. That would be my estimate of fee simple value for the real estate.

Q. And what is the ABS number?

A. I don't know -- oh, wait. I do have that.

Their estimate of current value is 117,444,000.

Q. And do you know what ABS is valuing?

A. I don't know if they're valuing the fee simple or the leasehold. They don't say.

Q. Okay. We -- we had testimony yesterday about the rack rate versus the ADR. And for some of the properties you knew what the -- what the ABS rack rate assumption was at least in 2018.

A. Right. We knew that for four of the five properties.

Q. Okay. Do you know that for the Edgewater?

A. No. We received a spreadsheet that had breakdowns for all of the hotels in downtown Seattle except the Edgewater. I don't know why.

Q. Okay. And do you have those spreadsheets?

A. I do. For the other four hotels. Not for the Edgewater.

Q. Yes.

A. There are copies available. So there's a set. There's one for the examiner, one for you. As you look at these packets, each hotel has two pages that are stapled together. The four hotels are paper-clipped together.

Q. Okay. And so what we have -- and I'm going to put these in the record. We have an exhibit for the Hotel Vintage which is Case 134.

HEARING EXAMINER VANCIL: Marked as Exhibit 12.

(Exhibit No. 12 marked.)

MR. REUTER: For the Hotel Monaco which is Case 133.

HEARING EXAMINER VANCIL: Marked as 13.

(Exhibit No. 13 marked.)

MR. REUTER: For the Hilton which is Case 353.

And for the Thompson which is 168.

HEARING EXAMINER VANCIL: Marked 14 and 15 respectfully.

(Exhibit Nos. 14-15 marked.)

HEARING EXAMINER VANCIL: Are these exhibits

12, 13, 14, and 15 the information that you were looking at when you testified yesterday about ABS's use of rack rates?

THE WITNESS: Yes.

BY MS. THOMPSON:

Q. Okay. Let's leave it at that. I think that testimony stands for itself. I just wanted to put these in the record.

Now, regarding back to the Edgewater, 136. You -- you have there in front of you the lease. When you were testifying, you said you took into value -- or into consideration the -- the fact that they have to -- that a buyer would have to deal with the State.

A. Right.

Q. Okay. I want to just touch on a couple provisions of that lease if you --

A. I don't have a copy in front of me.

Q. Oh, I'm sorry. Here is my copy. That speaker was the last witness that just spoke.

A. Oh, great. Thank you. What page are we on?

Q. 15, please.

A. Okay.

Q. I'm just directing your attention to the restrictions on assigning or subletting the property. Do you see

that?
A. Yes.
Q. Would that sort of restriction be something that might be included in the -- in the value accounting for having to deal with the State?
A. Yes. Anything that restricts the options available to the buyer, to the owner or operator of the hotel would -- would be something that would affect their perception.
Q. And would that include restrictions on taking a mortgage or deed of trust against the property?
A. Yes. I don't know that that exists. I have not read the lease.
Q. I understand.
A. Yeah. Okay. One example would be if the lease said that you had to operate a hotel on the site, that if you change the operation or tore down the building, that it went back to the State, that you lose the property. That would be a restrictive covenant. But I don't know that that exists in this lease.
Q. All right. Okay. Let's --
MR. REUTER: That's all I have.
HEARING EXAMINER VANCIL: I'm going to ask one question before we go to cross. It may inform cross, so rather than waiting until after.

Mr. Gordon, I want to understand you presented hotels as being valued uniquely as to -- as opposed to other properties. You've gone to great lengths to tell us how unique it is to appraise a hotel.

THE WITNESS: At least how difficult it is.

HEARING EXAMINER VANCIL: Yes. One question that I'm trying to understand through your presentation is in this unique valuation, it seems to be that your testimony has tied that valuation to the ability of a purchaser to maybe realize increased rates or an owner to increase -- realize increased rates in order to show that there's an actual value to them.

THE WITNESS: To the purchaser?

HEARING EXAMINER VANCIL: To either the owner or potential owner of the property?

THE WITNESS: The way that we value the hotel is to -- is to relate the income that the hotel is going to -- is expected to produce in the coming years to what people are willing to pay for hotels.

HEARING EXAMINER VANCIL: Okay. So the question that I have, though, is let's say -- let's say there's some hypothetical. I won't cite to the potential improvements from the waterfront LID. If you have a hotel property next to a condo property, which is a residential and there's an improvement made such that now they have waterfront views, mountain views that they never had before. In the residential situation, typically that just means that the value of the property goes up?

THE WITNESS: That the hotel would have better views?

HEARING EXAMINER VANCIL: No, I'm talking about the resident has a better view as a result of this improvement, this hypothetical improvement. You've got a condo property, and a hotel property for all practical purposes, that same side by side except one is a hotel, one is a condo, privately owned. Setting aside the potential for Airbnb and such with the condos, their property goes up. That's pretty standard. If it can see mountains and water, now you've got better value for that property. Is that not the case with a hotel then?

THE WITNESS: If the view allows them to earn more money, then, yes, their value will go up.

HEARING EXAMINER VANCIL: But even if -- but what you're saying, even if the market doesn't allow them to, though. What I heard you say is the market won't bear it even if you have a beautiful view now, the market bears X, if there's no increase in value.

Is that --

THE WITNESS: Well, yes and no. We do think that tourists are going to like the hotels. But there's a restriction right now on what you can do with rates because the market is so bad. If we look out several years, maybe they'll get some increase. But we don't -- we're not anticipating anything beyond that 2-and-a-half percent that I floated into the average rate.

HEARING EXAMINER VANCIL: So in the review for a hotel, there's no accounting for any increased value unless it's tied to the ability to increase rates.

THE WITNESS: Not just rates, but to increase income. So it could be occupancy. It could be average room rate, but yes.

HEARING EXAMINER VANCIL: So even though you break out the value of land from the structure and the business itself, I saw you do that in your appraisals, you broke out land as a separate line item. You don't increase the value of that land in any way? It's only the increase or ability to increase income?

THE WITNESS: We didn't have a breakout of land.

HEARING EXAMINER VANCIL: In all of your appraisals?

THE WITNESS: If you can point me to a page.

HEARING EXAMINER VANCIL: If I recall, you indicated property versus personal property.

THE WITNESS: Oh, no, that's not land. That's real estate, meaning land and building combined. We don't do a separate value for the land. But we do break out the real estate from the personal property.

HEARING EXAMINER VANCIL: And there's no increase in the value of that real estate, say, with a view or something, that you only account for increases relative to potential income?

THE WITNESS: Yeah. If the view adds to the income, if that's an expectation, then there will be an increase in value. If it has no impact --

HEARING EXAMINER VANCIL: Okay. And your testimony that that's standard practice for appraisals for -- anyone would look at this, this is how hotels are done. We don't look at any potential increase.

THE WITNESS: That's correct.

HEARING EXAMINER VANCIL: Okay. City.

CROSS-EXAMINATION

BY MS. THOMPSON:
Q. Good morning.
A. Good morning.
Q. So just because it's top of mind, I'm going to ask you about the Edgewater.
A. Okay.
Q. So you -- a couple of moments ago you were asked to look at the lease for the Edgewater property.
A. Yes.
Q. And you stated that you had never reviewed that lease?
A. I never read all the way through it. I was aware that it existed.
Q. Did you consider the lease terms in your appraisal?
A. No. We just considered the rent -- well, by lease terms, we -- we -- we considered how much rent they had to pay. And we did get that from the lease. So they pay 6 percent of room revenue, 3 percent of food and beverage revenue, 1 percent of other revenue. But I didn't consider other terms of the lease.
Q. Okay. So their rental -- sorry. Excuse me. Their lease payment is tied to revenue from rooms and other items?
A. All of the revenue.
Q. All of the revenue?

A. But in different ratios. That's not uncommon for hotels. There are very few leased hotels, first of all. But those that are leased, it's typically that rent is a percentage of room revenue and because the rooms tend to make most of the profits, the percentage applied against room revenue will be higher than the percentage applied against the restaurant because the restaurants are not as profitable typically.

Q. And so in your projection for the value of the Edgewater in your appraisal, were you basing the lease -- expected lease payment on your projected income?

A. Yes. Yes. So the lease -- the rent that we projected is calculated using those ratios against our forecast of revenue.

Q. So the value -- the overall appraised value of the property could go up or down depending on what the actual projected income is?

A. Correct.

Q. You mentioned also that terms within a lease such as restrictions on subleasing or transferring the property could impact the capitalization rate.

A. Yes. But I was just giving general examples. It wasn't anything specific to this lease.

Q. So -- but did you consider the terms of this lease in evaluating what capitalization rate you should apply?

MR. REUTER: Other than the rent. He's already testified that he included the rent.

THE WITNESS: Yeah. You're asking if I incorporated any additional risk factors. I took the cap rate up by half a point for the leasehold interest. But I didn't do a specific -- I didn't say here is a quarter point because of this, or here is a tenth of a point because of this.

BY MS. THOMPSON:

Q. Okay. So the other thing that you mentioned about the Edgewater is that you considered it to be almost stabilized --

A. Yes.

Q. -- is that right?

And because it was only almost stabilized, you did -- you would deduct $140,000 from the value of the property.

A. That -- that's right. And that's -- that's because the very first year of our forecast we have -- we're projecting an occupancy rate that's a point less than our stabilized occupancy. So we're -- I think we -- we include in our -- in our appraisal what our forecast is. We're not putting in the actual

performance. But we do have the forecast in here.
We're projecting that it will stabilize at 83 percent occupancy. For the first year, I'm projecting 82 percent.
Q. And you said that's because there are supply issues, new hotels coming in?
A. New hotels in the general market area. Their existing supply is stable. I mean, their comp set is stable. But all the new rooms that have come in downtown, I don't think the Edgewater has been as affected as some hotels. They might argue the point. But I think that they're generally insulated from what happened in downtown. However, their occupancy did go down last year. And so I'm letting -- I'm showing them recovery but taking two years to get there.
Q. Okay. Because in your appraisal you say that no changes in the primary market supply are anticipated in the near term.
A. That's correct.
Q. So I guess my question is if your forecasts in here are being derived from what's happening in the Edgewater's market, which is a subgroup of hotels that it considers to be its direct competitors?
A. Correct.

Q. Then why should it -- and you stated here that among those competitors there shouldn't be a supply issue for the Edgewater.

A. Right.

Q. So why -- why would you apply a discount for stabilization in that case?

A. For the first year?

Q. Yes.

A. Well, because they're below stabilized right now and they need to work their way back in. That's an increase in demand. That's not an increase in supply.

Q. So maybe -- maybe I'm not understanding what becoming stabilized means. What -- what does the hotel have to do to become stabilized?

A. That's -- in the way that I define it is that that's your typical level of performance for the long term. If the hotel is underperforming right now, then it needs to get up to a stabilized level. We assume at some point it will get up to a stabilized level. We expect that that will happen. But the number of years that that takes depends on how far below stabilization you are right now.

Some of the hotels got pretty hammered by the new supply and it's going to take them four or five years, in my view, to actually get up to a stabilized level of performance. The Edgewater, it's only taking one year. That's the shortest of any of the hotels that we looked at. And that's because there were only -- in the first year of our forecast, they're only a point below what we think is typical.

Q. Okay. So we'll set aside the Edgewater for now. I want to just ask you a couple of more general questions about your process for preparing these appraisals.

A. Sure.

Q. When were you retained by the property owners?

A. Well, Peter was retained, Peter Shorett was retained on behalf of our company. It was during January. But I don't know the exact dates.

Q. And so January about -- sometime in January?

A. Sometime in January, yeah.

Q. Was when you began your appraisal process?

A. That's correct.

Q. And did anyone assist you in preparing the appraisal?

A. I did -- I really did all the work on most of the appraisal. But Peter oversaw the work in that he had to approve and sign off on it. And Jesse Baker assisted us with the appraisal of the Sequel Apartments, so not one of the hotels, but part of the

Thompson case. He and I both have experience in apartments and hotels.

Q. Okay.

A. We ultimately included all three of our names on the appraisals, I believe, either as a signatory or being credited in the certification.

Q. So I wanted to ask you about that. Because I was looking at what's marked as Exhibit C to the Thompson Sequel objection, which is the restricted appraisal report for the Sequel Apartments?

A. For the Sequel?

Q. Mm-hmm.

A. Okay. I have it here.

Q. Okay. So on page 3, this is the certification that you -- you were referring to just a moment ago?

A. Yes.

Q. And I see here that it's signed by Mr. Shorett and Mr. Baker, but not by you. And I understand that from what you were saying earlier -- okay. I see here that it includes your name among the certifications.

But can you tell me whether the limiting conditions in this report also apply to your work in this appraisal?

A. Yes. They apply -- these are standard living conditions that go in all our appraisal. So, yeah, it would apply to this.

Q. Okay. And when you were retained to prepare these appraisal, what was your scope of work? How was it defined in your engagement agreements?

A. Just to estimate the -- the market value of the property. There was some discussions with the different clients, and so the way we moved forward evolved a little bit. We -- for example, the table that we presented earlier showing the impact of -- if you assume the ABS growth rate and applied that to the current value, what would our value be.

That was not something in the original scope of work. But it was something that we added in.

Q. And what information did you review to prepare your appraisal?

MR. REUTER: For which one?

MS. THOMPSON: Well, we can go through them one by one. Sure.

THE WITNESS: It's pretty uniform.

MS. THOMPSON: If it's uniform, I would just like to know what type of information you were reviewing.

THE WITNESS: The basic information that came from the clients were their STAR reports in the case of the hotels, and their annual operating statements. We requested and received either three or four operating statements from each property. Some of them gave us their 2016, '17, and '18 statements, and then followed up later with a 2019 statement when they got it finished. Remember, this was January. They were still working on their financials.

The STAR reports, we received at least three years for each hotel with the -- oh, you're not doing that -- yeah. There's a couple of hotels that opened during 2019, so we obviously didn't have three years' data for those. But that's not among this set of hotels.

Other than that, we used the same information that we would use for any hotel. We go through county records, looking at the physical aspects of the land and the building. We use the hotel websites and the AAA guide to identify the physical characteristics of the properties. We use census data to get general background on the economy. The same -- same approach that we take on all hotel appraisals. There are a couple of special cases.

In the case of the Edgewater, we did have access to the lease agreement. As I say, I didn't read it, but Peter did. And -- oh, and we also -- we also just had discussions with people with representatives of each hotel, either the owners or the managers.

In the case of the Edgewater, it was one of the owners, not the gentleman who just testified.

And I visited each of the hotels. Took a walk through and just to refresh myself. I had been to all these hotels before. But I wanted to see currently what kind of condition they're in.

BY MS. THOMPSON:

Q. Okay. So the STAR reports that you mentioned, all of the STAR reports that you reviewed for these hotels were provided to you by the owners or managers of the properties?

A. That's correct.

Q. And did you independently obtain any STAR reports?

A. Purchased a trend report, for example.

Q. A STAR report.

A. No. The only source of STAR reports is the owners and managers of the hotels. They're not released by STR and there's nobody else would have them, unless they're given them by the manners.

Q. Okay. So then the trend reports that you just mentioned and we talked about yesterday, did you

obtain any trend reports for your analysis of these appraisals?

A. No.

Q. And the STAR reports that you were provided by the hotel owners, those were limited to the -- were they limited to the hotel that you were reviewing, and then the hotels that that hotel thinks is its main competitor?

A. That's correct.

Q. Okay. So these appraisal reports that -- I don't know if appraisal report is the right term. Appraisal that you've prepared?

A. Restricted appraisal.

Q. Yes. So I was going to ask you about that.

What is -- or is it called a restricted appraisal?

A. What's restricted?

Q. Yeah. What does that mean?

A. That means it's restricted to certain users. That it's -- the intent in a restricted appraisal is to write a short -- a really short, in some cases, report. And you can make it short because the people who are going to use it already understand a lot about the property. They don't need you to write, you know, a five-page description of what the hotel is like because they work there. They don't need a big description of the site.

So restricted appraisal is intended only for the users that we name at the beginning of the appraisal. That's in the transmittal level. They're itemized there. It includes you guys, includes the examiner and includes counsel for the owner, and it includes Bob McCauley as well, because we assume that he'll be looking at these.

But what it doesn't confirm is anybody else. We don't want somebody to get a very short report like this, and then make decisions based on partial information that they don't have prior knowledge of the property.

So it's not intended for somebody on the street or a buyer of the hotel or anything like that.

Q. So these restricted appraisals contain limited information then?

A. Yes.

Q. And I see that you've provided, sounds like you've reviewed the actual financial provided by that hotel?

A. That's correct.

Q. And you used that information to project what their likely revenue will be and what -- correspondingly, what the property value would be.

A. Right. We use primarily the STAR reports to project what we think their room revenue will be. And we use their financial statements primarily to project all the other elements of their operation.
But we supplemented that with the performance of similar hotels and published industry averages. In general, we gave greatest weight to how they've been performing.
So our forecast -- leaving aside the issue of changes in occupancy, because for some of these hotels the occupancy is expected to change in the near term. Leaving that aside, their forecasts are pretty similar to how they've actually been performing.
Q. The underlying information about how they've actually been performing isn't part of your appraisal, is it?
A. No. We intentionally excluded that to maintain the confidentiality of it.
Q. And so you can confirm that that information hasn't been provided to the hearing examiner, for example?
A. That's correct. Well, you didn't do -- I mean, we did not provide it to anybody else. We didn't provide it to anybody. I mean, it was given to us. It's in our files. It's on my computer. But it's not in the reports and I haven't sent it to anybody.

Q. And one thing that's common among the appraisals that you performed are capitalization rates. And I just wanted to ask, are the capitalization rates in your appraisal, are those assumed rates?

A. We say selected.

Q. Selected?

A. We go through and say, well, what have cap rates been in other sales. And what cap rates are reported in industry surveys. And say, well, how does our hotel compare to a typical hotel or to these hotels that have sold in terms of perceived risk.

The question that you're asking when you select a cap rate is, here is my projection of operating income. How likely is it that I'm wrong? What's the chance that this property is going to tank when I say it's going to do well?

If it's a high risk, if you're making a very aggressive forecast, for example, you should counter that with a high cap rate to say that there's a pretty good chance that I'm going to be wrong if I'm assuming they're going to run 100 percent occupancy next year.

If the property is very stable, the cap rate should be relatively low. And the range of those rates is established by comp sales and by the surveys.

So for full-service hotels in a downtown urban location, the range is probably 6 to 8 percent. And the stable or really high end or really safe investments will be down toward the 6. We actually only use 6 for one hotel in this town.

And those that are more risky will be more than 8 percent those ranges shift by hotel type and by location. So limited-service hotels which we're not discussing here today, would have more of a range of 8 to 10 percent or 7-and-a-half to 9-and-a-half percent extended stay or select service would be somewhere in between.

Full-service hotels tend to have the lowest cap rates because ordinarily the risk of new competition is low. That it's hard to build a brand-new full-service hotel. And, of course, the experience in downtown Seattle is just putting to light all of that because all of a sudden we have all these hotels which nobody expected the scale.

So if somebody had been investing in downtown Seattle ten years ago, they would have assumed the risk is extremely low of new competition.

Now they would probably say, well, there is pretty significant risk of new hotels coming on board. Even so, certain hotels tend to be insulated from that. The Four Seasons would be an example where the extreme top of the market, nobody can duplicate what they're doing. And so they get the lowest cap rate because the risk of getting new competition there, the risk that they're going to fail is very low.

The Edgewater is somewhat similar to that. Very stable property, the only one on the market. So as long as we feel that our income forecast is realistic, they should have a pretty low cap rate. The other hotels we capped between 7 and 7 and a half.

Q. So it sounds like the capitalization that you select as part of an appraisal, it's -- it falls within a range of potentials -- potential capitalization rates based on what's going on in the market.

A. Yes. And it's a judgment call.

Q. Okay.

A. It's just us exercising our judgment.

Q. And the selected capitalization rate affects the overall projected value of the hotel, does it not?

A. Yes, it's very key to the value.

Q. So yesterday you provided a sample. It's called Hotel Analysis Sample Tables?

A. Yes.

Q. Was this something that you prepared for this hearing?

A. Yes.

Q. Have you used this before any other setting?

A. Well, some of these tables will be in the class that I teach next month. So I have them ready to go. But I have not prepared this sample packet for anyone else.

Q. Okay. I had a question because it looks to me like this sample packet includes some -- these hotels in Bellingham, and are these all what you would consider limited hotels?

A. I think it says in one of the columns there's -- there's sort of toward the right, it identifies them as limited, extended, or select.

Q. Okay. And then further on in the packet you -- and I believe it's the last page actually. You've provided a sample of how you can project the net operating income of a property. And does this calculation -- I understand, is this calculation just based on -- this is completely hypothetical?

A. Well, some of those numbers came -- those numbers came from a real hotel but this is how we would lay it out -- in a typical appraisal. And that's the same layout that we used in these appraisals.

Q. Okay. So this hypothetical hotel, was it -- it's not among the group of Bellingham?

A. It's not for Bellingham, no, no. It's from Portland.

Q. And the NOI, or net operating income, reflected here in this table, does that -- would that include revenue from just the room rentals, or other revenue as well?

A. No. It would be all the net income which is -- it's all the sources of revenue less all the operating expenses. So that's the net income from the entire operation of the property.

Q. Okay. And does net operating income, does that exclude mortgage operations?

A. Yes. That's before deducting debt.

Q. Okay. And I just wanted to turn to an example of one of the appraisals.

Do you have the Hotel Monaco appraisal?

A. Yep.

Q. So that would be Exhibit B to the Hotel Monaco objection.

A. You're speaking of the restricted appraisal?

Q. Yes. Thank you.

So on page 10 of that appraisal, the second section down from the top is called projected

performance. And in the last sentence there you say that for a future stabilized year, stated in current dollars, we are projecting an average room rate of $220, total revenue of 17.4 million, operating expenses of 12.8 million, and net operating income of 4.6 million.

A. Correct.

Q. So the -- to get to the net operating income of 4.6 million, I take it that you subtracted the operating expenses of 12.8 million from the total revenue of 17.4 million?

A. That's right.

Q. Okay. So is the total revenue of 17.4 million in this appraisal, does that include revenue from rooms only? Or are there other sources of revenue included in that number?

A. No. That includes the restaurant and the little ancillary sources they have, gift shops and whatever the Monaco -- they rent bikes. There's little sources. But it includes all sources of revenue.

The room revenue -- I can give you the room revenue total alone if you would like for that property.

Q. If you can.

A. Yeah. Because it's our estimate. It's not the actual.

Q. Okay. The estimate.

A. Yes. And so is the 17.4. That's our estimate. We're estimating room revenue at 12.7.

If you multiply the 189 rooms times the 84 percent, times 356 days, times 220, then that's how you get to 12.7 and change.

Q. Okay. And so did you compare your -- so this is a projection of what the NOI would be for this hotel?

A. Yeah. It's -- it's a point of confusion, not just here, but often in our appraisal because the method is to estimate how would it do in the current year if it was stable. And then project how it's going to do for ten years.

So the first year of our forecast isn't going to necessarily match. In fact, it will only match the stabilized estimate if the property is stabilized. And none of these hotels are. And hotels usually aren't stabilized. It's pretty unusual for them to be because they fluctuate up and down all the time.

Q. So is this net operating income, that's the projection for 2020; is that right?

A. This is the projection for 2020 if the hotel was stabilized.

Q. Was stabilized. Okay.

And so for the purposes of appraising the

property, you've assumed that it's stabilized or not?
A. No.
Q. You've adjusted the --
A. No. Our projection of NOI for the Monaco for the first -- for 2020 is 4.8 million for the NOI. We're saying on a stabilized basis, it would be 4.6. Because for this coming year, we're projecting that it's going to do a higher occupancy than we expected to do long term. The Monaco is doing well.
Q. This is the -- is the appraised value of the property based on the stabilized NOI or the 2020 projected NOI?
A. The answer is both.
Q. Both.
A. If you look at the sample table that I gave you. In the top section there's two methods of capitalization. I talked about this yesterday. Direct capitalization is you are just taking the net operating income, dividing it by a cap rate and your value pops out. But if the property is not stabilized, you need to make an adjustment for the near term variance. That's what that second line is.
So if you make that adjustment, then the value through direct capitalization should be similar to the value that you get through a DCF, through a yield

capitalization, which is the bulk of the table.

And in those numbers, those aren't stabilized numbers. Those are actual projection of NOI for the first ten years.

Q. Okay.

A. Eleven, technically. I like to do both methods because I feel like it serves as a little bit of a check on my own work, because we're picking the cap rate from within a range that we think is reasonable. We're picking the yield rate from within a reasonable range. But it's still subjective.

And if we were to come up with wildly different numbers here, then it would lead me to doubt the results and go back and look at them again. If you use two methods, that is -- that can be helpful.

HEARING EXAMINER VANCIL: We'll stop there and come back at 10:30.

(A break was taken from 10:13 a.m. to 10:29 p.m.)

HEARING EXAMINER VANCIL: Now we return to Mr. Gordon on cross.

CROSS-EXAMINATION

BY MS. THOMPSON:

Q. Hello, again.

A. Hello.

Q. Before the break we were talking about the net operating income, and specifically, we were looking at the Hotel Monaco appraisal as an example.

And my question is, what kind of information did you refer to in determining what the net operating income would be?

A. We -- we -- for the top line revenue -- net operating income is the difference between the revenue and the expenses. To do our revenue estimate for rooms, we relied on the STAR reports and our discussions with the property owner or manager, and our knowledge of what's going on in downtown Seattle.

We also included in our forecast for the market new rooms if we felt they would be direct competitors of each hotel. There were two proposals -- two new hotels that are expected to open within the next two to three years. Some of them -- for some of these hotels we felt they would be direct competitors. For others, we felt one or both would not.

So there was some variation in what we included in the market. But all of that went into our forecast of occupancy and room rate and room revenue. The rest of the forecast of NOI was based on the actual performance of the properties, the performance of similar hotels and published industry averages.

I think I mentioned the name of the publication that we were using, CBRE's Trends in the Hotel Industry; went through this yesterday.

Q. Okay. So the actual performance of the hotel, that would be determined by looking at the financial statements provided by the owners?

A. Yes. That's correct.

Q. But the projection here in the appraisal is just that it's a projection. It's not --

A. Those are my estimates.

Q. Those are your estimates?

A. Yes.

Q. Did you make those -- did you compare this estimate of net operating income to the historic net operating income of the hotel for 2019?

A. Well, we compared each line item to the historical amounts on each line item. The net operating income number may vary because the revenue varies; it jumps up and down.

But we really gave -- I'm hesitant to put a percentage on it, but at least 90 percent of the weight to the historical numbers. That's what formed the basis of our forecast and it's what would form the assumption of a buyer.

Q. And the projected net operating income in the

appraisal here, for example, the Hotel Monaco, is this higher or lower than the 2019 actual or NOI?

A. I don't actually have a comparison of NOI numbers. I have a comparison of operating profit. That's the line item before management fees and capital reserves. And that's because not all hotels deduct management fees and almost no hotels deduct capital reserves in their financial statements.

So in order to do an apples-to-apples comparison, I don't include those expenses, but we're uniformly assuming a 3 percent management fee and a 5 percent reserve allowance for all the properties.

So we can adjust the historical operating profit and take off 8 percent of revenue and come up with what the NOI would be. But I haven't done that for each of these hotels. But if I look at the operating profit for 2019, and compare it to my estimate, I am lower than what they did in 2019. That's because -- primarily because their occupancy rate in 2019 was higher than what I expect them to do long term because they're getting two new competitors.

Q. Okay. And so for the other hotels, can we look at those numbers as well?

A. It will -- yeah, it will vary for each hotel.

Q. So starting with the Hilton?

A. Well, keep in mind the Hilton was under renovation during 2019, so their 2019 numbers stank.
Q. So did you base your projection on 2018?
A. On 2018. Yeah.
Q. Okay. If you can look at the 2018 numbers then and let me know if they're higher or lower than what you've projected?
A. The operating profit that they achieved.
MR. REUTER: Without giving the numbers themselves.
BY MS. THOMPSON:
Q. Yeah.
A. Without giving the numbers.
Q. Just higher or lower?
A. Just higher or lower. We are quite a bit higher.
HEARING EXAMINER VANCIL: Please remember to frame either an objection or something along those lines. Interjecting is not allowed.
MS. THOMPSON: Sorry.
THE WITNESS: Our forecast of operating profit on a stabilized basis for the Hilton is considerably higher than what they actually achieved in 2018.
BY MS. THOMPSON:
Q. Did the renovation of the Hilton increase the number

of rooms?
A. Yes.
Q. So your projection for --
A. Is on the new number.
Q. Is on the new number. So would that explain why -- could that be an explanation of why there is --
A. It's certainly a contributing factor.
Q. Okay. Thank you. Let's look at the Edgewater next, please.
A. Well, here, our forecast for the Edgewater is higher than their 2019 operating profit and lower than their 2018 operating profit. They had a better year in 2018.
Q. Okay.
A. As did a lot of hotels.
Q. And then the Thompson.
MR. REUTER: Objection. It's not a question. I'd like a question, answer.
BY MS. THOMPSON:
Q. Okay. Could you please look at your appraisal for the Thompson Hotel, and let me know whether the projected income is higher or lower than the 2019 income -- actual income?
A. Yeah. Again, looking at the line for operating profit, our projection is really, really -- well,

they didn't give us the 2019 numbers because they weren't ready. The Thompson was one of the first hotels we started working on. So in early January, they didn't have -- they didn't have a full financial to give us on 2019. So we used the 2018 numbers.

Q. Is that reflected in your appraisal? Is that noted somewhere?

A. I -- I don't know. We say that we got several years of data. I'm not sure if we say which years we got. We -- we received a three -- we say that we received a three-year history, but we don't say what years they were. But, in fact, for the -- oh, I'm looking. Yeah. It's the same text. We're talking about the Thompson Hotel.

Q. Yes.

A. All right. I need to keep them separate. Yeah. We say that we received a three-year history in the text of the appraisal. The data that they gave us was 2016, 2017, 2018 on there.

And comparing their 2018 operating profit to our estimate for stabilized year, they're very, very close. Ours is higher, but just by a sliver.

Q. So if you would turn then to the Hotel Vintage appraisal on page 10 of Exhibit B.

A. Mm-hmm.

Q. Or that's directing for the hearing examiner. We're on page 10 of Exhibit B for the Vintage objection.
And could you tell me whether the projection of income in your appraisal is higher or lower than the actual income of the hotel?
A. Our projection is lower.
Q. And I just want to get back to you were explaining earlier about comparing apples to apples in terms of what expenses are included or not included in the NOI?
A. Right.
Q. And could you just explain that a little bit more. So some hotels include it?
A. Well, some hotels hire outside management. And so the fee that they pay to the outside manager is an expense. Other hotels are self-contained. The owner manages the place. Or their -- a branch of their firm manages the place and they don't record an expense.
So when I line up several hotels' operating statements and I want to compare them, I tried to compare them above the deduction of management fees, before management fees are deducted, so that way we're comparing the same level of income.
Net operating income is after a deduction for

management fees if they have them, and after a deduction for capital reserves if they were to report that. But since those items aren't consistently reported in the financial statements, I also look at the line above, which I call operating profit. So that's operating profit is net operating income before deducting management fees and reserves.

And the management fees typically around 3 percent, if they have one and the reserves are usually 5 to 5 percent. We're using five in this case for these fancy hotels. The reserve is not -- doesn't usually show up in the financials at all.

But from a buyer's perspective, they have to plan on, if not setting aside money, at least acknowledging that eventually they're going to have to replace a lot of the personal property. So they need to be setting aside, they need to make some provision to where they'll have the money when they need it. That's what the reserve allowance is. And that's an assumption that the appraiser makes.

We assume that a buyer coming in will set aside money. We also assume that they'll hire a management company because that's usually what happens, but not always. So that's why in all of our forecasts we're making those deductions as expenses, whether or not they appear in the financial statements.

In the case of these five hotels, they all do deduct management fees, so that really wasn't an issue. But the capital reserves are not shown.

Q. Okay. And so you were just testifying about some of the assumptions that appraisers make and that you made in preparing these appraisals. Are there any others that you haven't mentioned?

MR. REUTER: Objection. Vague.

BY MS. THOMPSON:

Q. Are there any other assumptions that you made in preparing the appraisals for these properties?

A. We assume that the information they give us is accurate when they send us their financial statements. We assume they're the real financial statements. We assume the STAR reports haven't been doctored somehow. But that information is legit.

We assume that whatever the manager tells us about the physical property is correct, and that the information in the county assessor's records are correct. Oh, and for survey data on cap rates or operating expenses, we assume that the data that was provided to the surveyor is correct, that they didn't just make stuff up.

Q. And turning back to the STAR reports that we were

talking about earlier. If a person -- so the STAR reports are only available to the owners or managers of the hotel.

A. That's correct.

Q. And -- but trend reports are something that you can pay -- like anybody could pay the fee and get a trend report. And is that report on a specific property?

A. No. It's a -- it's a report on a group of properties. And STR is very careful not to let you, for example, order two STAR -- two trend reports and leave one property out, so that you can compare the two and figure out how the extra property is performing. They're extremely careful not to let you do that. You have to order a set of at least four hotels that can't overlap too heavily in terms of ownership or management or brand.

And you can't -- if you have already ordered a set last year, you can't come back next year and order a slightly different set that might end up disclosing information. They keep track of what you have ordered. But anybody can buy one.

Q. And so are the -- is the information in the trend report the actual information about the hotel or is it a range or an estimate?

A. Their actual specific numbers for the groups of hotels. They'll tell you the total -- this is on a monthly basis. They tell you the total revenue, the available room nights, the occupied room nights, the market occupancy rate, the market ADR, and the market RevPAR.

All of that is provided for on a monthly basis for at least six years.

Q. Okay. If somebody were -- let's say a hotel owner wanted to order a STAR report for their hotel and a trend report that included their hotel, would the data between the STAR report and the trend report about that hotel be the same?

A. Yes.

Q. Okay.

A. Yeah. It's all the same data.

Q. So let's turn back to the Monaco appraisal. If you can turn to page 9.

So in the last section of the appraisal under "Market Demand."

A. The last paragraph of that page.

Q. Yes. Thank you.

The last sentence there says that you're projecting that the market ADR will increase by 2.5 percent annually through the forecast period?

A. That's correct.

Q. And I believe either today or yesterday, you mentioned that that assumption is applied in all of the appraisals that you prepared?

A. That's correct.

Q. And in that same section it says here that the STAR reports -- and these are the STAR reports of the market which are the competitors, correct?

A. For the Monaco, yeah.

Q. For the Monaco. The average daily room rate in 2019 for that market set was $226.

A. Correct.

Q. And then if we turn the page, page 10 under projected performance, you've projected an average room rate of $220?

A. Yes.

Q. So my question is, if you're assuming that there's a 2.5 percent increase in ADR each year and the market ADR was 226 for 2019, shouldn't the projected ADR be higher than 220?

A. No. Because the 220 is for the Monaco itself, not for the market.

Q. And so without giving a specific number as to the ADR of the Monaco in 2019, can you tell me if the Monaco's actual ADR in 2019 was higher or lower than the market ADR?

A. It was lower than the market. We're projecting a -- an ADR index is a room rate index of 95 percent, that our hotel would be 95 percent of the market in our forecast.

And that's in line with historical performance, not exact. I don't want to get exact. But it's close.

Q. And could you tell me whether -- so here in the Monaco example, we see that the projected ADR is lower than the market ADR for 2019?

A. Correct.

Q. Was that the case in the other four properties as well?

A. I don't remember.

Q. Okay. We can go and look at the appraisal, if you would like.

A. We can -- well, I need to look at, yeah, my little tables. Do you want to do that now?

Q. Sure. Yeah. So maybe let's start with the Hilton.

A. Remember, in each case we're comparing with their set, their comp set. Not with the whole city. So it will be different. The comp sets are different for each hotel.

Q. Right.

A. In the case of the Hilton, they were achieving higher average room rate than most of the market up until last year. And then they went under renovation. And it's really tough to look at 2019 for the Hilton. It was just an odd year.

I'm projecting that they'll come back up to 110 percent of the market ADR, which would put them pretty close to where they used to be. But I think it will take another year for them to get there.

Once you renovate a hotel, it takes a little while for the guests to figure out that it's nicer than it used to be. So that's why I give them an extra year.

HEARING EXAMINER VANCIL: And where are you looking in your report?

THE WITNESS: This isn't in the report. I'm looking at the individual data that I haven't disclosed.

HEARING EXAMINER VANCIL: Okay.

BY MS. THOMPSON:

Q. I believe we already discussed earlier the Edgewater. So next, let's look at the Thompson.

HEARING EXAMINER VANCIL: When you say "look," we're not looking at anything.

MS. THOMPSON: My apologies. Could we please look at the appraisal for the Thompson Hotel, which is Exhibit B to the Thompson objection. Page 9 of that appraisal.

THE WITNESS: What was the question?

BY MS. THOMPSON:

Q. The question is could you tell me what the 2019 market ADR was for -- listed in your appraisal?

A. $249.

Q. And on the next page you provide your projected ADR.

A. Of 255 for the subject.

Q. Okay. And can you tell me whether the hotel performed better or worse than the market?

A. It performed really close to the market.

Q. Close to the market. Okay.

Do you have -- so you have the STAR reports for each of the hotels?

A. Not on hand, but in my computer, yeah.

Q. Not on hand. And that's something you considered in rendering your opinions?

A. Yes.

Q. And could you tell me, understanding that you don't have them on hand, were the STAR report ADRs for each of the hotels higher or lower than what you've projected?

A. I'm not sure I understand the question. You're talking about the -- STAR reports are only historic numbers. They don't have a forecast in them. But what we've been going through here and talking about what was the market ADR, that's the STAR -- those are the STAR numbers.

Q. So but you said earlier that the STAR reports correspond to the specific property?

A. Well, they're both. They give you the specific property and they give you the aggregate for their competitors.

Q. Okay. So with respect to the specific properties ADR for 2019, let's say.

A. Okay.

Q. That's something -- that number is not listed in your appraisal?

A. Right.

Q. Because it's proprietary?

A. But it does appear in the STAR report.

Q. But it appears in the STAR report.

So, for example, for the Hotel Monica, the 2019-ADR in the STAR report for the Hotel Monaco, can you tell me whether that was higher or lower than your projected ADR for that hotel.

A. Yeah. I thought we did that. Maybe not.

Q. I think we've gone through what the market ADR is. But as you explained, the market is the ADR for a

group of hotels and not the specific hotel itself?
A. Okay. Yeah. My forecast for the coming year for the Monaco is higher than the actual number the Monaco did in 2019. Does that answer your question?
Q. It does. I'd like to go through each of them.
For the Hilton, I understand that it was under construction in 2019?
A. Yeah.
Q. So my question would be in the STAR report for the Hilton, the actual ADR for 2018, is that higher or lower than what you've projected in your appraisal report?
A. My projection -- well, my projection is lower for 2020 than how they did in 2018 in an average rate. But within a couple of years it comes back up to it.
Q. Okay.
A. Again, that's the delay in the renovation.
Q. And then in the Edgewater STAR report, the Edgewater is actual ADR for 2019. How does that compare in terms of high or low to your projection of ADR in the Edgewater appraisal?
A. Our projection is higher. Not dramatically so.
Q. And then for the Thompson Hotel, is the Thompson STAR report ADR for 2019, is that higher or lower than your projected ADR in the Thompson appraisal?

A. The 2019 historical is lower. Our projection is higher than the historical -- than the 2019. Our project -- our estimate for 2020 is higher than how they actually did in 2019.

Q. And then last, but not least, the Vintage.

Was the Vintage actual performance in terms of the 2019-ADR listed in the STAR report, was that higher or lower than your projected ADR?

A. The actual performance was lower than our projected ADR for 2020. The ADR had come down considerably in 2019 after all the new supply came in.

Q. So you've mentioned the new supply that has arrived in the market. And is there anticipated additional supply?

A. There are two that we feel will be directly competitive with these hotels, with some of these hotels. And that we think have a strong likelihood of being developed in the near term, meaning two to three years. There's -- across the street from where we're sitting is the F5 Tower. The bottom, I want to say eight floors of that building are built out as a hotel, but it's never opened. Because the -- I talked to the developer and he said he didn't want it -- he was thinking about selling the building, and he didn't want to sell it if the hotel was encumbered by a brand affiliation or a management fee. So he just didn't open it. And this is two years ago. Year and a half ago.

Now, the suspicion is that that hotel will open. I talked to somebody in the building who really would know, and he said, oh, yeah, everybody thinks it's going to open in June. Well, maybe it will. Maybe it will still be sitting there.

But I'm making the assumption that by the end of the year those rooms will open. So I'm adding the 184 rooms to the supply in most of these sets, most of these competitive sets. I don't add it for the Edgewater because I -- it's too far away, and I just don't think it will be competitive.

The other one is a 245-room hotel that's proposed on 5th Avenue between Pike and Union. It's an infill property. There's an old retail building there now that would be demolished and the new hotel would be built. They haven't done physically anything on the site. But they're through the permit process; they're through the public comment process.

And I think that that's -- of all the various proposals that are out there, I think that one is pretty likely to go ahead. So I'm assuming that it will open in 20 -- let me see. I include that in the market in 2023 as new supply, 245 rooms of new supply.

There are over a dozen proposals for new hotels in Seattle, even now, even after all the new ones that we've had. And it's a judgment call as to how many of these are most likely to get built and when they would open. So that's -- these are the two that I've included.

Q. So supply is a factor that you considered to limit the ability of the hotels just to raise room rates; is that right?

A. Well, it does both. It waters down the volume of demand so the guests -- there are some new guests that come in when a new hotel opens. But by and large, the occupancy percentage declines, and it adds to the competitive pressure on room rates.

Q. Because I think yesterday you were asked why don't the hotels just raise their room rates. And I believe you mentioned that room rates aren't independent of the market and supply?

A. That's correct.

Q. Is there any other factor that limits the availability of a hotel to increase it's room rates?

A. I'm not sure how to answer that question. It's -- if they could raise their rates to 1,000 bucks they would, because they'd like 1,000 bucks. You charge what you think you can get. And you try to balance off the number of people staying in the hotel against the revenue that you're getting from each person.

There's a standing joke in my profession that I can fill every hotel in the city, if you let me charge ten bucks to stay there. So there's always going to be a balancing act between the number of people and what you charge. Right now what we're seeing these managers achieving and what they say they -- how they -- how they talk about the market conditions, I don't see a large potential to increase rates beyond that 2-and-a-half percent inflationary adjustment that I've applied.

Q. And is that based on the issues of supply in the market?

A. Largely.

Q. What else contributes to that?

A. Well, if a new hotel opens and it opens at something other than the average room rate, if it's really fancy, and it opens at -- and above the market average, the opening of that hotel by itself will raise the average because it's charging a lot more money.

Conversely, you know, somebody comes in with a lower-end property, it will drop the average. However, if a new hotel does come in and it charges a high rate, if it's a successful new hotel, if a lot of people want to stay there, they may be coming out of their competitive hotels, and those hotels will feel more pressure to drop rates to try to keep their guests. It's a constant balancing act.

This is why hotels no longer quote rates in any firm way. When I started doing this, you could call a hotel and ask what their rate was and they would tell you. But now they just say "it depends." It depends on the day.

Q. So yesterday you talked about the Monaco Hotel and how it's anticipating that it will be renovating its rooms; is that right?

A. Yes.

Q. If we can turn to the Hotel Monaco appraisal, which is Exhibit B to the Hotel Monaco objection.

On page 10, you -- in the current market value section, which is the final paragraph on page 10, you say here that you've estimated the value of tangible personal property at $20,000 per room less 50 percent depreciation.

A. Right.

Q. How did you select that depreciation rate?

A. Well, two ways. One is just being in the hotel and looking at it. But if a hotel -- most hotels, they start out with everything new. And then they start a cyclical program of replacing items. If you're replacing -- if the personal property in the hotel is going to last ten years on average, then the average -- once -- once you pass that ten-year mark, if you've been replacing stuff as you go, the average depreciation ratio is going to be 50 percent. Because you're constantly replacing stuff, so half of it is new and half of it is old. It's unusual for a functioning hotel, a good quality hotel for depreciation to get down below 50 percent in personal property.

Limited service hotels and older properties can deteriorate beyond that because they -- they let them slide. But a high-quality property will be continually buying new mattresses and replacing the drapes and putting in new soft goods and new case goods in the rooms.

If the Monaco -- you could look in the Hilton example, the depreciation ratio that I put in there is very low because they just renovated the place. So I think I used 20 percent in there to account for things that might not have been replaced. But

50 percent, I think, is pretty reasonable for the Monaco in its present condition.

If we were to come back two years from now, I would use a lower depreciation ratio.

Q. So this ratio doesn't include the improvements --

A. The renovation.

Q. -- the renovation that's forthcoming?

A. No.

Q. If I understand you correctly, the depreciation rate for a hotel is assuming -- it's calculated based on the life of the personal property?

A. There's two different depreciation ratios; one for the structure and one for the contents. Hotels typically assume a 10- or 12-year life for their FF -- it means for their things that you're going to need to replace. Appraisers would call them short-lived items, something that doesn't last as long as the building.

So the building is going to depreciate over 40 or 50 or 60 years, whereas the contents will depreciate over 10 or 12.

Q. Next, I would like to look at your appraisal for the Vintage Hotel.

A. Same issue.

Q. Different, actually. That's Exhibit B to the Vintage

objection. And let's turn to page 5, if you would.

A. Okay.

Q. So in the section titled Ownership and Development, it says here that in July 2012, the hotel was sold to the current owner for $32 and a half million.

A. Yes. That's -- that's what is shown in county records.

Q. Okay. And how -- what's the value that you've appraised this property at today?

A. I appraised its overall value right there, 30, 32 million.

Q. So it's actually less than the purchase price eight years ago?

A. That's correct.

Q. So yesterday, during Mr. Shorett's testimony, he indicated that you assisted in the preparation of the appraisal review?

A. I assisted. I'm acknowledged there, having helped with it. What I mostly did was format the reports and make sure that the numbers that we were referencing in the special benefits study tied to the special benefit study, that we had the correct numbers in there.

Mr. Shorett wrote Exhibit 1 entirely on his own and Jesse Baker did most of the work with the quantitative analysis of supply.

Q. So were you -- that's what I'm most interested in today is these property specific -- well, I don't know if I would call them evaluations. But in each of the appraisal review reports that were prepared for each property, preceding the Exhibit 1, there is information about the anticipated revenue and demand that would be required to make up for the cost of the LID improvements?

A. Yeah. Shorthand would be to refer to it as a feasibility analysis.

Q. Feasibility. Great. So these feasibility analyses, did you assist in preparing these?

A. I reviewed them after he had written them. After he had prepared them.

Q. After who had?

A. Jesse. Jesse and Peter designed what was going to be in that section. Jesse put all the numbers together. I reviewed them and then finalized the reports. I didn't change any of the numbers in my review.

Q. I'd like to look at just the -- I think I've asked you to look -- maybe I didn't say this. But if we can look at the Hotel Monaco appraisal review --

A. Okay.

Q. -- which is Exhibit A to the Hotel Monaco objection.

A. Okay. I have it here.

Q. Okay. Great.

So turning to page 10 -- or actually, sorry. Page 9, let's go to.

Okay. So you've seen -- I'm looking at this required revenue increase section.

A. Yes.

Q. And you've seen that?

A. Yes.

Q. And you said that you reviewed this section?

A. Yes.

Q. So can you tell me, this calculation that's being done here, what does this calculation say?

A. What we're trying to show here is how much of a revenue increase would be required to produce the ratio applied in the special benefits study on the assumption that the cap rate is unchanged.

So the NOI would have to increase -- if, for example, the -- I don't recall what the special benefit -- okay. 1 percent for the Monaco.

Special benefit study that the value would have to increase -- would increase by 1 percent as a result of the LID improvements. What this formula is -- what these formuli are trying to show is that if the NOI were to have to increase by 1 percent, what sort of growth in revenue would you need.

The expense ratio for this property was estimated at 20 percent. And that means that in order to get a 1 percent increase in NOI, you would need to have a 5 percent increase in revenue.

Q. And is that assuming that this increased revenue occurs within a year's time? Or what's the timeline --

A. The way the LID -- the special benefit study is done is everything is instantaneous which, of course, makes no sense logically because you can't build the stuff.

But there's no time -- there's no adjustment for time in here at all.

Q. Okay. So this isn't saying that these increases would have to occur within any certain amount of time?

A. That's correct.

Q. So if we can turn to page 10 then. And I'll just ask, you know, to your knowledge, are these formulas in this Hotel Monaco appraisal review, are these formulas the same throughout the reports?

A. Yes.

Q. 00 very similar?

A. Yes.

Q. The numbers change but the formulas are the same?

A. Yeah. The numbers change but the -- exactly, the players change but the end result is the same, or the methodology is the same.

Q. So could you tell me what the formulas on -- this is -- we're at the required demand increase feasibility study, and what are these formulas saying?

A. This is saying that if the average room rate did not change, how many new bodies, how much of an increase in occupancy would you need to create the increase in revenue that you need to create a 1 percent increase in NOI.

Q. And do you know where the ADR in this calculation was derived from?

A. That is a good question. Jesse estimated that. I should say that I put him in a box. This is -- this is my responsibility for why this ADR is what it is.

I told Jesse that we could not use the actual ADR of the hotel because we can't disclose it, and it would be disclosed in this formula.

At the same time, I tried to build a firewall between myself doing the appraisal, and Peter and Jesse doing the review because I didn't want either to be influenced by the other.

I didn't want my appraisal to somehow be influenced by how they reviewed the special benefit study, and I didn't want them coming up with numbers in the special benefits study that were tied into the appraisal. I wanted them to be independent. So Jesse didn't know what I had estimated as the stabilized ADR.

And that's why it's different, if that's what you're going for.

The ADR -- the stabilized ADR that I came up with for the Monaco was $220. Jesse's assumption was $200.

Q. So that difference in ADR would affect the demand that's required?

A. It would affect the results, yes.

Q. And the demand would increase or decrease if you used your prediction?

A. If you used the -- I'd have to think about that because -- because there's no change in the ADR here. It's a fixed number.

Q. Well, I'm saying that let's take this formula.

A. Oh, no. No, you're right.

Q. Yeah.

A. If you increase the ADR you would reduce the number of new rooms that were required.

Q. Okay.

A. In retro -- go ahead. I'll wait for a question.
Q. And do you know whether -- so this first piece here, it's predicting that you would need an increase of 1,869 rooms in order to meet a new revenue of $373,800?
A. Correct.
Q. Is that right? Do you know whether this computation here includes revenue from other sources aside from rooms?
A. No. It's just rooms.
Q. Just rooms. So the 3.06 percent new demand, that assumes that the only revenue the hotel is getting is from rooms?
A. Right. But rooms are also what's supporting most of the NOI. Because as I said yesterday, most of the revenue from food and beverage is absorbed in expenses. They don't make a lot of money running the restaurant.
Q. But they do make -- they do have income from other sources, other than rooms?
A. Well, they have the restaurant, and in the Monaco case they have got some ancillary; those aren't large numbers.
Q. So if we move down the page to about halfway, there's a table here that is showing -- it's called available

guest room supply peak season. And the peak season here defined by the table is May through October; is that right?

A. That's right.

Q. And so, then, under the table there's sort of a calculation here of how the anticipated demand or the required demand increase could be borne in these six months of the peak season?

A. That's correct.

Q. But it's not -- it doesn't include the other six months out of the year.

A. That's right. Yeah. We were trying not to disclose the annual performance on the property.

Q. So --

A. Well, plus, we don't expect there to be a big influx of tourism in the winter. That's the whole point of this, is that the demand -- the potential for new demand is confined to the months when there's high travel, high tourism.

Q. So if I hear you correctly, the computation about demand makes certain assumptions, one of which is that most of the demand will come during the summer months?

A. Correct.

Q. And that per your calculations here, no income will

be derived during the nonpeak months?
A. No new guests --
Q. No new guests?
A. Yeah. -- will arrive during those other months as a result of the LID.
Q. Getting back to the ADR that's assumed here in the demand calculation, do you know -- if you know, was this ADR, the average daily room rate, was that based on the room rates throughout the year? Was that a 365-day average?
A. Yes.
Q. So not an average of just the peak prices?
A. That's correct. Well, you know, now that you said that -- no, I misspoke. Because it's applied to the new guest rooms and they all -- they all appear between May and October.
So that has to be the ADR for the new guest rooms, not for the overall property, not for the annual.
Q. So -- okay.
A. This is not easy stuff.
Q. Well, I guess I'm confused because the ADR here listed in the computation is $200.
A. Right.
Q. And that just from a personal level, that seems like

it would be a low amount for a hotel room in peak season.

A. Well, that's -- that's where Jesse estimated. It is lower than our annual average and it would be well lower than for the peak, you're right. If that rate were to come up, you would have fewer guest rooms. Fewer new guest rooms required. But we haven't done a calculation of what the seasonal rate would be.

Q. So you said a few moments ago that you created or attempted to create a firewall between yourself and the appraisals that you were preparing and the appraisal review that Mr. Baker and Mr. Shorett were developing?

A. That's correct.

Q. So is it -- was there an effort -- once you had each created your -- once you had created your appraisals and once Mr. Shorett had created the appraisal review, did you do any sort of cross-checking to make sure that they were consistent throughout?

A. No. We -- we reviewed each one to be sure that it was consistent within itself. But we didn't compare the two.

Q. So is it safe to --

A. We did have access to them. When I say firewall, it was not that strong. But we didn't allow -- we didn't compare the two to try to rationalize them.

Q. So is it safe to say that there may be inconsistencies across the appraisal review and the individual appraisals?

A. What do you mean by inconsistencies? Because the appraisal review is dealing primary with this focus on the summer season and how many rooms will be needed there. And the appraisal itself doesn't deal with that aspect of seasonality. So there will be numbers that don't tie, but they shouldn't tie.

Q. In terms of assumptions that are made in the reports, I guess -- I can --- I can try to show you an example of what I mean.

So if we turn to the Edgewater Hotel, if we look at the appraisal review for the Edgewater Hotel on page 9, and this is Exhibit A to the Edgewater objection.

In the final paragraph there, and this is part of the sort of individual assessment of these feasibility studies of -- that were prepared as part of the appraisal review.

This is specific to the Edgewater Hotel, correct?

A. Correct.

HEARING EXAMINER VANCIL: I'm sorry, Counsel, what page was that?

MS. THOMPSON: Sorry. This is page 9.

In this last paragraph here there's some statements about supply in the market. And how the -- it says this amount of increase and speaking about the amount of increased revenue that would need to be obtained by the hotel to meet the LID assessed value.

A. Which sentence are you at there?

Q. Sorry. I'm sort of trying to summarize the -- both paragraphs here. But the final paragraph, it's saying this amount of increase seems high -- highly unlikely considering the recent decline in ADR observed at the Edgewater from 2018 to 2019.

And then lower down in that paragraph, it talks about the new supply entering the market. And according to all operators we interviewed, this supply must be absorbed over the next few years, and it will likely be 2020 to 2023 before average rates recover to the levels of surge in recent years?

A. I see that.

Q. Is that right?

A. I see that, yeah.

Q. So here we have a statement in the appraisal review for the Edgewater Hotel. And as I said, these sections were prepared specific to the Edgewater.

And if you turn to your appraisal at page 9, under the market supply section, you say here, no changes in the primary market supply are anticipated in the near term?
A. That's correct.
Q. So my question about whether there could be inconsistencies between what's said in your appraisal versus what's said in the appraisal review, specific property sections --
A. On page 9 of the review, in the last sentence, the, operators are talking about the supply that's already open.
Q. Okay.
A. The recent additions to supply. They're saying that hurt their ADR and they're hoping to have some recovery over the next few years. In our appraisal, we're talking about the current market supply, the current competitive set of the Edgewater, and I'm saying that I don't think any of the proposals to future additions of supply are going to be direct competitors of the Edgewater. So I don't think there's any inconsistency there.
Q. But Mr. Baker didn't use your projected ADRs in his computations?
A. No. No, he didn't.

Q. Okay.

MS. THOMPSON: No further questions.

HEARING EXAMINER VANCIL: Redirect.

REDIRECT EXAMINATION

BY MR. REUTER:

Q. Staying on this section of the appraisal reviews, and this question of the assumed ADR, I don't know if you have this information, but if you use the actual ADR, would there be enough rooms in these five hotels?

A. There would be more rooms. There would be more space. More capacity to accommodate new rooms if the ADR was higher, in the way the formulas are set up.

Q. Do you know -- have you done the math on whether the change in the ADR to the actual -- and I'll have the same question about your projected --

A. I have not done those calculations.

Q. -- would it pencil out to cover the LID costs?

A. I haven't done the calculation, so I don't know.

Q. You testified, I believe, that the numbers you were using for -- I think it was in the revenue -- required revenue increase section, were not considering the value of benefits or the effect on the hotel out in the future, but rather you were looking at the immediate -- the immediate effect.

A. That's right.

Q. And what -- why would you only look at the immediate?
A. Well, that's the same as was done in the special benefits study.
Q. Okay.
A. Where they just say here is the value today as is, the before value. And here is the after value with the LIDs, but we're not actually projecting five or ten years' worth of inflation or trending.
We're saying if it changed today, how much of an increase in value would you have. So that's the same approach that they took in the special benefits study.
Q. Is it your understanding that that's the required approach?
A. I don't know what the requirements are.
Q. Okay. Regarding the Vintage, Case 134, you said that the sale price was higher than the value today.
A. Yes. Which surprised me.
Q. Do you know why that is?
A. Because they made a bad investment. Because they bought something and it didn't appreciate the way they thought they would. The Vintage is an older property. It's not the first line property in downtown. And it's -- it just hasn't been performing.

Q. Okay.

A. We use the same approach in valuing it as we use with the other hotels, looking at their actual performance numbers and using what I think is a reasonable cap rate on it.

Q. Okay. Thank you.

Regarding Exhibit 6, which is your sample analysis, part of your hotel econ 101. The last page is where you discuss direct capitalization and where you call yield capitalization.

A. Correct.

Q. And I believe you said the -- one of the reasons you do the yield analysis is to make sure you're not wildly inconsistent in the direct analysis?

A. That's why we do two methods to try to come up and see -- make sure that they jive.

Q. And when you -- when you did -- and you did this process for each of the five hotels in this case?

A. Yes. Yes, I did.

Q. In doing the analysis for any of those five, did you find a wildly different result in the direct versus the yield?

A. No. If the inputs are consistently applied, there's not going to be a huge swing either way.

Q. All right. The hearing examiner asked you a question

about better view. And whether that would lead to increased value irrespective of its effect on income. I'm paraphrasing my understanding of his question.

I'd like to ask you maybe a more -- I don't believe any of the LID improvements include extra sound or mountain range to look at. They are more like walkways and such, bike lanes and trees.

So let's talk about that kind of an example instead of a water and mountain view.

Do you have an opinion as to whether -- assuming that these properties would even have a view of the waterfront improvements, would -- would -- would a nearby walkway or nice new promenade create or add value to a hotel property irrespective of income?

A. Well, if you left that last phrase off, I would say yes. A view and nice access to the waterfront and a new aquarium and a park, and nice beds, and a fine restaurant and good service all contribute to the value of the property, of a hotel.

It's really hard to pick out one item and say, this is going to add to my room rate. You know, I'm going to charge $0.50 more because there's a nicer stairway going down from the hotel to the water or the view of six trees is worth a dollar more than the view of three trees. We just can't get down to that level.

The only -- the only indicator we have of the perceived value in a hotel is what people are willing to pay for it to stay there.

Q. And are you aware of any data, empirical evidence that could say a nice promenade down the hill would actually affect income?

A. I don't know of anything quantitated that would do that. One of the -- one of the case studies that was talked about in the special benefits study was Tom something park in Portland. There's some park.

Q. Tom McCullough Park, Portland?

A. Tom McCullough. Sorry. I forgot the guy's name.

There is a hotel across the street from that park that used to be called the Riverside Inn. I don't know what name it's going under now. If it were possible to go back and look at that performance of a hotel over a period before and after of when the park went in, you might be able to come up with some relationship and say, well, this is how we did then and this is how we're doing now. But even so, you wouldn't know it was the park that caused it because there's a thousand things that are affecting hotels.

Q. Such as?

A. Such as demand for it. The number of businesses.

The business people who are there versus the tourists, mix of demand that they're getting, the seasonality of the market, whether people are coming in the summer or winter or all year round. Whether the hotel was renovated or not. Whether there's a new competitor next door.

Q. And in a head tax or in a burgeoning homeless population, all those things would go into the mix, would they not?

A. All sorts of things. So what we fall back on is, we say how much are people really willing to spend for this. And if there's two hotels in the same market with the same facilities, we can look at the Thompson and the Charter in downtown Seattle. And if you could say that one of them has got a view and one doesn't, that's the only difference locationally or physically or operationally between the two, then maybe you can draw that conclusion.

But you never find that in real life. You never find two properties that are completely identical except for this one view aspect.

Q. And so trying to say that these LID improvements actually drive value, cause causation, cause value would be speculative, wouldn't it?

A. Well, I guess I wouldn't go -- be that harsh about it. I think that it will be a value to the city. I think that the hotels will benefit. I just think you can't measure it. And that in the general scheme of, things, of all the stuff that's going to affect the hotel, the impact of that has got to be, you know, small to negligible because what really matters to the hotel guests is how nice is the hotel itself, and where is it located, and where is my business, and why am I coming here.

The impact of planting some trees in the sidewalk, it may improve the experience. I don't know that it would make people pay more money to stay in the hotel.

MR. REUTER: Thank you. That's all I have.

HEARING EXAMINER VANCIL: I would like to explore that a little further with you, Mr. Gordon. Because I do want to understand this. I've worked with many appraisal, but not so much hotels. And this is a unique issue that you are bringing today. The appraisal method for them is really restricted to the income capacity.

THE WITNESS: By "them," I wasn't --

HEARING EXAMINER VANCIL: Hotels. We're talking about hotels.

THE WITNESS: Yes. That's how people are

buying hotels. We do use other methods when we're valuing them. But then all the weight, most of the weight, is given to the income.

HEARING EXAMINER VANCIL: What are those other methods?

THE WITNESS: The sales comparison approach and the replacement cost approach.

The replacement cost approach says if -- rather than buying the subject hotel, the one that we're appraising, what if we built our own. I've never seen an investor rely on that when there's an existing hotel. But it is relevant if you're thinking of building a new hotel.

If there's a proposed hotel on 5th Avenue and another one on 4th, then you might want to compare costs on that. We don't use the replacement cost approach in 99 percent of our hotel appraisals. And the banks don't request it they don't require it when they're doing it for lending purposes.

Sales comparison can be relevant if you have sales that are sufficiently similar. We showed -- we provided to the -- for this hearing, a list of the sales that have taken place in the last three and a half years involving full-service hotels in downtown Seattle. And that's the set of sales to work with.

And it would theoretically be possible to look at all those sales and come up with some sort of adjustments that would narrow down to an estimated value. So you'll see in other appraisals, appraisals of other properties that that's frequently done. Residential is the primary source of value, primary method of valuation.

But for a hotel, when there are so many differences, even among the properties, these five properties that we're looking at here, and the eight sales that have taken place, and the 30 other properties in downtown Seattle, it's just -- it's too difficult -- the more complex the hotel, the more -- the less reliable the sales approach becomes.

So I use it frequently on limited-service hotels. If you're doing a Motel 6 or a Super 8, great. Do that.

If you are doing a hotel that's not branded, frequently the sales approach is what everybody relies on. They'll look at the top line revenue and they'll look at what hotels have sold for per room or per square foot. But for complex properties like we're looking at here, I don't think it's relevant.

HEARING EXAMINER VANCIL: And is your methodology the same that was used by the City?

A. Well, we don't really know what was done by the City. We know for their preliminary study, we know that they used an income approach similar to ours. They did not do a yield analysis, at least the printouts, the last exhibit that we submitted shows their analysis. And it's a direct capitalization approach using an income forecast.

They don't go into it in a lot of detail to know exactly how they came up with it. And they -- as we pointed out earlier, they're using unrealistic average room rates. But it's basically the same approach. It is an income approach. The -- it's -- I think that ours is better.

HEARING EXAMINER VANCIL: Just out of morbid curiosity, I'm wondering the limits of this income approach. If you find a gold mine on the property, are you still going to look at income for the hotel? Or is there some point where --

THE WITNESS: No. Then you are going to look at gold.

HEARING EXAMINER VANCIL: Okay. This is a new way of looking at property that I'm not used to. It is strictly what the existing is --

THE WITNESS: It is used for very complex income properties.

HEARING EXAMINER VANCIL: Is it the case that, as I hear you saying that, A, it's hard to measure some of these benefits and that's why this methodology is used?

THE WITNESS: I wouldn't -- I wouldn't go so far as to say that. It's used because this is what investors do.

HEARING EXAMINER VANCIL: You did say that. I was quoting you back. You did say that was why it was difficult to measure some benefits and they weren't included in your evaluation.

THE WITNESS: Are you talking about the comparisons between the sales and these properties?

HEARING EXAMINER VANCIL: No. You indicated --

THE WITNESS: I'm not following.

HEARING EXAMINER VANCIL: -- you indicated that it would be difficult to track the value of special benefits. And so you used a different methodology in doing that. The sidewalk, for example, that would be difficult to do that, you said, so you didn't do that.

THE WITNESS: We didn't try to value --

HEARING EXAMINER VANCIL: Right. Okay.

THE WITNESS: The value of the sidewalk.

You are correct.

HEARING EXAMINER VANCIL: Right. So there's some things that you said it was difficult to do. So you just don't approach it, that is an underlying assumption essentially for you -- the attempts to add appraisal you do for hotels. Some of the valuation of some of these benefits of some items related to the property are simply just too difficult to break out, so what you have available is this income that you can measure. Is that --

THE WITNESS: That's correct. As far as it goes. For example, if there's a guest laundry room in the hotel, that's a good thing to have if you're a guest and you want to do your laundry. But we don't know how much more somebody will pay for a hotel room to stay in there because there might be 50 other things that are different between that and the sample of hotels you're comparing to.

HEARING EXAMINER VANCIL: Is another underlying assumption that you are operating with is the highest and best use of a property is the hotel?

THE WITNESS: Correct. If there's -- if that's not the case, it's a whole different approach.

HEARING EXAMINER VANCIL: So in my hypothetical of a gold mine, suddenly maybe that's

the best -- highest and best use.
THE WITNESS: Then your highest and best use might be tear down the hotel.
HEARING EXAMINER VANCIL: I think I understand your testimony. Thank you. Thank you, Mr. Gordon.
THE WITNESS: Thank you.
MR. REUTER: I've got no follow up on that. And we don't have any further witnesses.
HEARING EXAMINER VANCIL: All right. Any objection to admitting Exhibits 6 to 11?
MS. THOMPSON: No objection.
HEARING EXAMINER VANCIL: Exhibits 6 to 11 are admitted.
(Exhibit Nos. 6-11 admitted.)
HEARING EXAMINER VANCIL: We are scheduled to return. We'll adjourn for the day. We're scheduled to return at 9 a.m. tomorrow with final witness for case 168.
MR. REUTER: I'm not idly checking my e-mail. We do not intend to call anybody.
HEARING EXAMINER VANCIL: So you're completely finished?
MR. REUTER: I'm -- well, this gets back to this question about two things. One is --

HEARING EXAMINER VANCIL: You're finished presenting your case in chief?

MR. REUTER: I presented calling -- I finished calling witnesses. You said yesterday that we had until the end of the hearing to submit anything in writing, like a closing brief. When is that deadline now?

HEARING EXAMINER VANCIL: You've just run out of time. So I'm not -- I'm not keeping things open. I mean, you had a chance to present things and bring things into argument just like every other objector. Some of them had 45 minutes. They said they needed 45 minutes. They came and showed up. We don't keep the record open for just whatever else to come in. What are you proposing? So I --

MR. REUTER: Well, it seems --

HEARING EXAMINER VANCIL: What I need to do is treat you along with 400 people consistently. So when you get the door left open for you, it's 400 other people that get the same privilege. So please present something that is a privilege that everyone can enjoy at the same time.

MR. REUTER: Well, how about the end of my scheduled hearing time, which is the end of the day tomorrow.

HEARING EXAMINER VANCIL: Your scheduled hearing time runs through noon tomorrow.

MR. REUTER: Okay. I'll take it.

HEARING EXAMINER VANCIL: So you want time to do that?

Let me suggest something maybe a little differently.

MR. REUTER: All right.

HEARING EXAMINER VANCIL: You have also raised the question about depositions. Are you involved in that at all? Will you be involved in depositions? Will you be involved in cross of anything -- of anybody from the City?

MR. REUTER: I certainly expect to be involved in the cross-examination when the City puts on its case in response to my case.

I don't know whether I'll be participating in the depositions. But those depositions will be usable as depositions are in any proceeding. So I may use those depositions, even if I don't attend the deposition.

HEARING EXAMINER VANCIL: Assuming I allow you to do that. So --

MR. REUTER: I understand the civil rules don't apply exactly here. But I would -- I would assume that I would have the right to do that.

HEARING EXAMINER VANCIL: Your case is open just like any objector. The case opens for an objector to come in and present what they indicate they're presenting. Not just we're going to open it and then keep it open for whatever we think may come later. That's just boundless.

Right now what you're proposing is that 400 objectors can use whatever they want from the depositions and can make comment on that through the end of the hearing.

MR. REUTER: I'm saying that --

HEARING EXAMINER VANCIL: From a management perspective, I'm not really seeing that that's what's called for under the civil rules or in the opportunity to object.

MR. REUTER: But can't any objector participate in the cross-examination when the other side puts on its case?

HEARING EXAMINER VANCIL: Certainly. Cross-examination. And using something -- you indicated that you were going to use something from a deposition. I didn't know what terms you were talking about you were talking about using it. Are you suggesting you're going to use argument? Or are you just using it for cross-examination purposes? Which doesn't affect us in the record in any way.

We're talking about what we need to do for you in your case to leave the record open.

MR. REUTER: I -- I think that it would be certainly appropriate for me to be allowed to cross-examine whoever the City calls and impeach them with their deposition testimony.

HEARING EXAMINER VANCIL: So you don't have any -- when you are talking about the deposition, you are not talking about introducing anything for additional argument here. You're using it for your cross-examination purposes is what you've just stated.

MR. REUTER: Yes. And that would include any witness called by the City.

So, for instance, if they were to depose Mr. Gordon and call him as a witness, then I could use the deposition transcript with Mr. Gordon.

HEARING EXAMINER VANCIL: Sure. Honestly I'm really not worried about how you use the deposition transcript. That's really up to the parties how they do discovery and et cetera. It's really what we're talking about, what a party is asking to put into the record. You're asking, for example, to have a record left open for additional closing argument today. I assume you're going to also ask for the same after you've cross-examined the City witness. Or are you just going to cross-examine and leave that as your record?

MR. REUTER: This is at the end of April.

I would say if -- if all the other parties are afforded some closing brief after the end of the City's case, then I should be allowed that as well.

HEARING EXAMINER VANCIL: That seems likely. I think if we are leaving parties an opportunity to cross-examine -- I'm not going to leave it open for parties who are not participating in cross-examination. But I anticipate parties will be cross-examining and are going to want to introduce some additional argument at that time. So rather than leaving it open for you twice through tomorrow and then again at the end, I think leaving it open at the end for a single time to submit a closing argument would be more appropriate.

MR. REUTER: That's fair.

HEARING EXAMINER VANCIL: And you're not introducing anything around the depositions. It's just -- that's just for your use. You indicated --

MR. REUTER: I don't understand that

question.

HEARING EXAMINER VANCIL: Well, I didn't understand when I was asking you what you intend to introduce. You mentioned the depositions so -- it doesn't sound to me like you're introducing anything following the depositions, simply based on what you discover at the depositions.

MR. REUTER: Yes. I don't intend to offer any new evidence.

HEARING EXAMINER VANCIL: Setting aside motion, practice, et cetera.

MR. REUTER: And whatever happens in the depositions.

HEARING EXAMINER VANCIL: All right. So you will be included in the list of individuals who the record could be left open for at the end following cross.

MR. REUTER: Okay.

HEARING EXAMINER VANCIL: So no additional submission except that --

MR. REUTER: I accept that.

HEARING EXAMINER VANCIL: -- for closing.

MR. REUTER: Okay.

HEARING EXAMINER VANCIL: In that case we're finished with presentation for this matter until that time. We will not reconvene tomorrow. We are not scheduled to reconvene for the continuance of the waterfront LID until Monday, February 24th at 9 a.m. Thank you.

MR. REUTER: Thank you.

(Hearing adjourned at 11:52 a.m.)

C E R T I F I C A T E

STATE OF WASHINGTON
COUNTY OF KITSAP

I, Carisa Kitselman, a Certified Court Reporter in and for the State of Washington, do hereby certify that the foregoing transcript is true and accurate to the best of my knowledge, skill, and ability.

IN WITNESS WHEREOF, I have hereunto set my hand and seal this 5th day of March, 2020.

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CARISA KITSELMAN, RPR, CCR #2018