CITY OF SEATTLE
OFFICE OF HEARING EXAMINER

In Re Seattle Waterfront LID, Local Improvement District No. 6751	Case Nos. CWF-133, 134, 136, 168, 353 CLOSING ARGUMENT ON REMAND

Mr. Gordon has testified about the income approach and how hotels are valued. The basic elements of a direct capitalization analysis are the income forecast, the capitalization rate, and the value conclusion. The projected net operating income and the selected cap rate are independent variables. The value conclusion is a dependent variable. To determine value, the income is divided by the cap rate.

In arguing that he would offset any reduction in income by simply lowering the lower cap rate, ABS and Mr. Macaulay are standing the formula on its head: they are dividing the income by Mr. Macauley's perception of the value, and then reaching the cap rate. Mr. Macauley implies that value is a market-derived independent variable. In essence, he is saying that the sales on which he relies support a certain value, and therefore the income forecast and cap rate should be manipulated to come to that value. This puts far too much weight on the sales approach.

Mr. Macaulay cannot deny that he is using it to justify his decision to barely move the room rates from those stated in his earlier report. Given the emphasis he now puts on comparable sales, he should have provided a more detailed sales analysis. Like Mr. Gordon, he provides a list

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of sales that defined a range, but he did not apply adjustments to specific sales to derive independent value conclusions. Mr. Gordon did not so either, but the difference is that Mr. Macaulay's analysis relies much more heavily on comparable sales.

Mr. Macaulay identified a few of the sale hotels as being similar to some of the subject hotels, and Mr. Gordon acknowledged some similarities in his deposition. But saying that they are similar does not mean that the sale prices per unit are appropriate for the subject. Without more analysis, Mr. Macaulay makes it impossible to know whether the sales he cites are truly comparable. He should have prepared an adjustment grid for each subject property that shows other factors, such as price per square foot, and a discussion of condition and age of the hotels. There is no evidence showing that he did this work. None has been present by him or Mr. Lukens. By failing to provide more analysis, he implicitly recognizes the limitations of the sales approach and fails to provide evidence sufficient to offset Mr. Gordon's conclusions, which are based on the *actual room rates and financials*.

Mr. Macaulay attacks Mr. Gordon's income projections as too conservative, and says that were he to use Mr. Gordon's lower estimates, he would offset them with lower cap rates. But since the cap rate is an independent variable, it is supposed to be derived from the market. There is no evidence in the record to show investment surveys or other sources that report "conservative" or "aggressive" cap rates and the City provides no evidence of what market data lead to Macaulay's determination of cap rates.

It is the income forecast that represents the most likely performance of the hotel. Similarly, the cap rate selected by the appraiser should represent average risk, taking into account the location, type, age, condition, and quality of the subject hotel. Mr. Macaulay did not take these steps so his work should be rejected in favor of Mr. Gordon.

The differences between Macaulay and Gordon come down largely to income. Mr. Gordon's income projections were based on the actual performance of each hotel (ADR,

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occupancy, revenue, and expenses). Mr. Macaulay's projections were speculative and (in the case of average room rates) much higher than the actual numbers. The objectors provided the actual STAR reports in Mr. Gordon's remand declaration. With that in hand, Mr. Macaulay had no excuse for not incorporating them in his income forecast and relying on them to reach a sound value conclusion.

Lastly, in the Excel table attached to the Gordon remand declaration, the purpose of the column headed "Adjusted" is two-fold. First, it shows the very significant impact of projecting an overly aggressive room rate, as ABS continues to do. Second, ABS's income analysis is contained in its spreadsheets. That analysis relies on speculative financials, including speculative room rates, because ABS did not have the actual numbers. The actual numbers are dramatically different from the ABS numbers. The "Adjusted" column shows what happens when you insert the actual room rates into the ABS's income analysis numbers. This shows just how far off ABS's income analysis is. But the objectors agree the most sound analysis is in the KM column because it is based on actual financials and actual room rates.

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