IN THE COURT OF COMMON PLEAS OF CARBON COUNTY, PENNSYLVANIA
CIVIL ACTION - LAW

GRIFFON MONKEY, LLC.,	:	
Plaintiff	:	
vs.	:	No. 10-1859
JAI SAI HOSPITALITY LLC., GAYATRI KRUPA LEHIGHTON LLC., GAYATRI KRUPA LLC., ASHOK M. DHABUWALA	:	
Defendants	:	

Jon C. Sirlin, Esquire	Co-Counsel for Plaintiff
Dana S. Plon, Esquire	Co-Counsel for Plaintiff
Douglas C. Maloney, Esquire	Counsel for Defendant, Ashok M. Dhabuwala
Jai Sai Hospitality LLC	Unrepresented
Gayatri Krupa Lehighton LLC	Unrepresented
Gayatri Krupa LLC	Unrepresented

MEMORANDUM OPINION

Matika, J. – June 28th 2012

Before the Court is Plaintiff's petition to set fair market value of real property located at 877 Interchange Road, Leighton, Carbon County, Pennsylvania ("Subject Property"). For the reasons that follow, the subject property's fair market value is set at $4,995,000.00

I. FACTUAL and PROCEDURAL BACKGROUND

The Subject Property is a limited service hotel with seventy-eight (78) rooms. The Subject Property currently operates as a Hampton Inn Hotel. It was built in 2004. The hotel is considered to be in average to good condition and is currently being used for its highest and best use, that is a limited service hotel.

In February 2006, Defendant, Jai Sai Hospitality LLC., executed a Note in the principal amount of Four Million Four Hundred Thousand Dollars ($4,400,000.00). To secure the Note, Defendant Jai Sai Hospitality LLC., executed and delivered to Synergy Bank a Mortgage in the principal amount of $4,400,000.00, said mortgage being a first priority lien on the Subject Property. In addition, Defendant Ashok Dhabuwala executed a Personal Guaranty in favor of Synergy Bank in that Defendant Ashok Dhabuwala guaranteed payment to Synergy Bank of all amounts due and owning under the Note and Mortgage. By way of a merger, New York Community Bank became the successor to Synergy Bank, and as a result of such merger, New York Community Bank succeeded Synergy Bank’s position under the Mortgage, Note, and Guaranty. Defendant Jai Sai Hospitality LLC., failed to pay its monthly payments owed under the Note. A foreclosure action was commenced and as a result, on September 27, 2010, a default judgment was entered in favor of New York Community Bank and against Defendants in the amount of $4,280,958.11.

On December 10, 2010, New York Community assigned its interest in the default judgment against Defendants to Plaintiff, Griffon Monkey, LLC. On April 8, 2011, in execution of its judgment, Plaintiff, acting as a creditor, purchased the Subject Property at a sheriff's sale for $4,000,100.00. Plaintiff has now filed a petition for this Court to set the fair market value of the Subject Property.

II. DISCUSSION

"Fair market value" is the price which "a purchaser, who is willing but not obligated to buy, would pay an owner, who is willing but not obligated to sell." *Bryn Mawr Trust Co. v. Healy,* 446 Pa.Super. 501, 508, 667 A.2d 719, 723 (1995)(citing *First Pa. Bank, N.A. v. Peace Valley Lakeside*, 329 Pa.Super. 218, 478 A.2d 42 (1984)). In trying to determine the fair market value of the subject property the Court should consider all elements which might affect its actual value, recent sales of realty of comparable location and description, demand for the realty, and income produced by the subject property. *United National Bank of Pittsburg v. Crump*, 349 Pa. 339, 37 A.2d 733 (1944). It is the role of the trier of fact to weigh the credibility of an expert witness's testimony regarding valuation. *Mellon Bank v. Restaurant of A.B.E.*, 364 Pa.Super. 567, 528 A.2d 654 (1987).

At the hearing, Plaintiff offered the testimony of Douglas

McNight ("McNight") as an expert in commercial real estate appraising to establish the fair market value of the Subject Property. As of April 8, 2011, McNight appraised the Subject Property to have a fair market value of $3,700.000.00. Defendants presented Frederick M. Lesavoy ("Lesavoy") an expert in commercial real estate appraising, who estimated the fair market value of the Subject Property, as of January 26, 2012, to be $5,000,000.00.[1]

There are three different approaches to appraising a property: the Cost Approach, the Sales Comparison Approach, and the Income Capitalization Approach. Both appraisers agreed that the Cost Approach is an inappropriate method to determine fair market value of the Subject Property due to the age of the property. Therefore, both experts used the Sales Comparison and the Income Capitalization Approaches in formulate the fair market value of the Subject Property.

Under the Sales Comparison Approach, the appraiser first needs to reduce each comparable sale to a standard unit of comparison. In this case, both appraisers compared the Subject Property to the comparable sales using the unit standard price per rental room of the hotels. Once the Subject Property and

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[1] Although the fair market value of the property is to be determined on the date of the sheriff's sale, *Loukas v. Mathias,* 207 Pa.Super. 210, 931 A.2d 661, 633 (2007), Lesavoy testified that the value of the Subject Property from April 8, 2011 to January 26, 2012, did not change and thus his valuation of the Subject Property would have been the same if his appraisal was done on April 8, 2011.

comparable sales have been reduced to a common unit of comparison, the appraiser might adjust the value of the property based on any particular characteristic of the realty such as location, physical condition, economic characteristic, real property rights conveyed, and market condition.

McNight's comparable set comprised of the Sheriff's Sale of the Subject Property and two sales from 2008. The Sheriff's Sale of the Subject Property realizes a sale price of $51,283.00 per rental room. McNight then adjusted the sale price of the Subject Property at the Sheriff's Sale as compared to the Subject Property itself by deducting ten percent (10%) from the purchase price. McNight indicated that the ten percent negative adjustment was because the buyer was under duress at the Sheriff's Sale in being required to pay the minimum amount necessary to generate sufficient purchase price to pay for the transfer taxes. If not for this requirement, McNight concluded that the buyer would have paid a far lesser purchase price on the Subject Property.

However, this Court finds that such an adjustment goes against logic. The purpose of a sheriff's sale is to "realize out of the land, the debt, interest, and costs which are due, or have accrued to the judgment creditor." Kailb v. Smith, 454 Pa. Super. 67, 71, 684 A.2d 630, 632 (1996). Therefore, logic would indicate that in order to achieve a fair market value, one comparing a property sold at a sheriff’s sale to a property sold in an open market would have to adjust the purchase price of the property sold at the sheriff’s sale upward to represented what a buyer would pay for fair market value. McNight even testified on cross-examination that there is “nothing typical of a sheriff’s sale” and properties sold at a sheriff’s sale are generally purchased for under fair market value. Therefore, this Court does not find the ten percent negative adjustment to the purchase price of the Subject Property at the Sheriff’s Sale to be warranted nor sound judgment.

The other two sales McNight analyzed to make up his comparable set were a Hampton Inn and a Quality Inn both sold in 2008. The Hampton Inn sold for a price per rental room of $60,000.00, while the Quality Inn had a purchase price per rental room of $62,069.00. For both sales, McNight applied a negative adjustment of twenty-five percent (25%). The rationale given for the twenty-five percent reduction of the purchase price of both comparable sales was that the market condition in 2008 was far superior then 2011.

The only evidence McNight offered to support his negative adjustment was his testimony that no hotels were sold in the area between the years 2009 and 2010 and thus that was an indication of how much the market condition has deteriorated since 2008. However, in Lesavoy's report, there were two hotels sold in relatively similar markets in 2009.[2]

When analyzing the three comparables to the Subject Property, McNight averaged the three comparables to have a purchase price of $46,025.00 per rental room. Based upon the number of rooms in the Subject Property, seventy-eight, McNight valued the Subject Property to have a valuation of 3,590,000.00. However, if the Court does not use the purchase price of the Subject Property at the Sheriff's Sale due to the nature of a sheriff's sale, and remove the twenty-five percent negative adjustments for the market condition McNight used for the other two comparable sales, McNight's comparable set would yield a purchase price per rental room of $61,035.00 that equates to an overall fair market value of the Subject Property to be

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[2] On direct examination, Lesavoy testified that the data does not support McNight's negative adjustment. Lesavoy stated that an accurate determination of the market condition is the capitalization rate that is produced ever in the Korpacz Report. The capitalization rate is an indication of the risk an investor perceives within the market. A high capitalization number means the market is more risky. Conversely, a low capitalization number equates to a more investor friendly market.

Lesavoy examined the Korpacz Reports for 2008, 2009, 2010, and the first quarter of 2011. In 2008, the average capitalization rate for limited service hotels was 9.83%. In 2009, the capitalization rate increased to 10.85%. However, in 2010, the average capitalization rate decreased to 10.2%, and in 2011, the capitalization rate decreased to 9.8%. In analyzing the capitalization rate as an indication of the market condition, although the market for limited service hotels deteriorated in 2009 as compared to 2008, the market has become more stable and investor friendly since 2009 as the capitalization rate for limited service hotels is lower than it was in 2008. Therefore, in examining the capitalization rate, this Court does not find McNight's 25% negative adjustment of the purchase price for both comparable hotels sold in 2008 justified.

$4,760,730.00, which is similar to the overall number Lesavoy reached under the Sales Comparison Approach.

Lesavoy's comparable set consists of four hotel sales that took place in 2008 and 2009. The first sale in Lesavoy's comparable set is a Hampton Inn sold in 2008. This hotel was located outside Pittsburg, in a larger market than where the Subject Property is located, but like the Subject Property, this comparable hotel is located off the Pennsylvania Turnpike. After making a positive adjustment of two percent[3], this Hampton Inn had a purchase price per rental room of $66,162.

The second comparable sale Lesavoy used is the same property McNight used in his report, sale number two. If the twenty-five percent reduction that McNight used for this property due to the market condition is removed, McNight's price per rental room, $60,588.00, is within one percent of Lesavoy's purchase price per rental room of this property, $61,200.00.

Lesavoy's other two comparable sales were hotels sold in 2009. After adjustments, the hotels had a price per rental room of $68,024.00 and $66,000.00 respectively. Based upon the four comparable sales, Lesavoy concluded that a fair market

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[3] Due to the number of rooms this comparable property had, 111, versus the Subject Property, Lesavoy added five (5) percent to the purchase price per rental room. Lesavoy did have a negative adjustment of three (3) percent because the Subject Property has onsite water and the comparable has municipal water, thus having a two percent (2%) increase in the comparable purchase price per rental room.

value price per rental room for subject property is $66,000.00. Given that price per rental room, Lesavoy valued the Subject Property at five million one hundred fifty thousand dollars ($5,150,000.00).

However, Lesavoy's report indicates that this price of $5.15 million includes furniture, fixtures, and equipment. Since furniture, fixtures, and equipment are usually personal property, Lesavoy's final conclusion excludes the estimated value of furniture, fixtures, and equipment, thus reaching a final fair market value for the Subject Property of five million dollars ($5,000,000.00).

McNight and Lesavoy also employed the income capitalization in examining the Subject Property in trying to render a fair market value for the property. The basis of this approach is projecting income and expenses for a given year. Under this approach, an appraiser projects income the property is expected to produce for a given year, subtracting therefrom anticipated expenses and then capitalizing the net operating income to reach a fair market value of the property.

The first step under this approach is to determine the gross income of the Subject Property. To find the gross income, an appraiser ascertain the hotel's average daily rate ("ADR") and the revenue per available room ("RevPar"), which is derived by by dividing the total revenue by the number of rental rooms available. In each appraiser's report, there is an excerpt of the Smith Travel Accommodations Report ("STAR Report") of the Subject Property and the competitive set of hotel properties for the area as presented by Smith Travel Research. The STAR Report is a tool appraisers use to evaluate the performance of any given hotel in comparison to a competitive set of hotels in the market.

McNight produced the May 2011 STAR Report that shows for the past twelve months, that the Subject Property had an occupancy level of 58.4% with an average daily rate per rental room of $93.95. When the Subject Property is matched up to the competitive set, the Subject Property's occupancy level demonstrates that this property performed better than its competitors as the average occupancy level for the competitive set was 46.3% with an average daily rate per rental room of $96.49.

Based upon the running twelve-month report, McNight estimated revenues per available room of $57.00 for total annual revenues of $1,622,790.[4]

McNight next calculated the operating expenses necessary to maintain the property. McNight calculated the

[4] Total annual revenue = number of available rooms in the year X ADR DIVIDED BY Forecast Occupancy level

total expenses to be $1,103,242, which yields a net operating income of $519,548.00.[5]

Once the net operating income is determined, the appraiser then needs to determine the appropriate capitalization rate in order to project future growth of the Subject Property. Due to the fact the Subject Property is a relatively new hotel and has significantly less physical deterioration than the average of hotel of its kind, McNight concluded that an appropriate overall capitalization rate of eight percent (8%) is appropriate for the Subject Property.

Since property taxes are excluded as an expense,[6] McNight included this expense in his overall capitalization rate to create a loaded capitalization rate. McNight calculated a loaded capitalization rate by taking the property tax rate of 60.3 mills and translating that into a percentage of 6.03%. He then added that percentage to the overall capitalization rate of 8%, to formulate a loaded capitalization rate of 14.03%. Based upon the loaded capitalization rate, McNight determined the fair market value of the Subject Property to be three million seven hundred thousand dollars ($3,700,000.00).[7]

On cross-examination, McNight was asked to calculate the

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[5] Net operating income = total annual revenue – total expenses

[6] In McNight's report, under the definition of expenses, the first type of expense listed is real property taxes.

[7] Fair Market Value = Net Operating Income X Loaded Capitalization Rate

fair market value of the Subject Property by subtracting the real property taxes as an expense and then divided the net operating income to the capitalization rate without taxes included (8%).[8] If McNight calculated the fair market value by subtracting the real property taxes as an expense instead of "loading" the taxes into the overall capitalization rate, the Subject Property would have a fair market value of four million nine hundred thousand ($4,900,000.00).

McNight acknowledge that he could have calculated fair market value by subtracting the real property taxes from the net operating income and not use a loaded capitalization rate, but he made an error by excluding the product improvement plan in his calculation.[9] It is estimated that the product improvement plan would cost the new owner around one million dollars. McNight therefore concluded, that if he calculated the fair market value as suggested by opposing counsel, he would get a fair market value of the Subject Property of $4.9 million to which he would then have to subtract another one million dollars

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8 According to McNight's report, the real property taxes for 2011 were $120,489.95. If McNight subtracted the 2011 real property taxes from the net operating income and divide that by the overall capitalization rate McNight would have gotten a fair market value of four million nine hundred thousand (($519,548 - $120,489.95) / .08 = 4,988,225.60).

9 Generally, when a hotel changes ownership, the corporate flag, in this case Hampton Inn, will require the new owner to make certain improvements within the hotel in order to re-license the facility under the same flag. These improvements are usually listed under a property improvement plan. For the Subject Property, it is estimated that the property improvement plan would range from $970,584 to $1,047,705.

to factor in the product improvement plan.

This Court does not find such a calculation rational. The purpose of a product improvement plan is to increase the value of the hotel. Therefore, if a new owner spends a million dollars to make improvements to the hotel, it is expected that such improvements would increase the value of the hotel. If McNight were to calculate the product improvement plan into his calculations, he would first have to figure out the value of the Subject Property with the implementation of the product improvement plan, less the cost of the product improvement plan.[10] Simply subtracting the product improvement plan from the fair market value without projecting the value the product improvement plan would have to the hotel is not sound logic to this Court.

In Lesavoy's report, he used the STAR Report from December 2011.[11] Similarly to McNight, when Lesavoy compared the past twelve months, from December 2010 to December 2011, of the

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[10] In Lesavoy's report, some of the comparable sales under the sales comparison approach demonstrate the value a property improvement plan can have a hotel. Sales comparison 2 has an actual price per rental room of $60,000.00. Under the remarks section of this report, it is indicated that the hotel owner will spend approximately $2,000,000 on a property improvement plan. Since this hotel is going to spend about two million dollars on improvements to the hotel, Lesavoy adjusted the price per rental room from $60,000 to $76,667 in anticipation of the increase value the property improvement plan will have to the hotel.

[11] Upon reviewing the STAR Report from May 2011 and examining the ADR and RevPar as compared to the STAR Report of December 2011, Lesavoy concluded that the fair market value of the Subject Property would have increased only $100,000 from May 2011 to December 2011.

Subject Property, it outperformed the competitive set as it related to occupancy level and revenue per available room. For the December 2011 STAR Report, the Subject Property had an occupancy level of 65.6% with an average daily rate of $94.39. Based upon these numbers, Lesavoy projected the Subject Property to have a 65.5% occupancy level for any given year with an ADR of $94.50.

With an average daily room rate of $94.50 and the Subject Property operating at a occupancy level of 65.5%, Lesavoy forecasted the room revenue for the Subject Property at $1,735,318.00.[12] Lesavoy also projected another 2.63% of potential gross income for various things such as laundry, telephone, vending machine, and rental equipment to have a projected revenue of $1,780,957. After calculating the total expenses, $1,202,112, which includes real property taxes, Lesavoy derived a projected net operating income of $578,845.00.

Due to the fact Lesavoy believes the Subject Property is in average to above average condition, is well cared for, and performing above the competitive set, Lesavoy used a capitalization rate of 11.25%. With that capitalization rate, Lesavoy reached a fair market value of five million one hundred

[12] Forecast Room Revenue = Total available rooms for the year (78 X 365days) X ARD ($94.50) / Forecast Occupancy Level (64.50%)

forty five thousand dollars ($5,145,000).[13] Just as Lesavoy did under the sales comparison approach, under this approach, he once again deducted the estimated and depreciated value of furniture, fixtures, and equipment in order to yield a fair market value of the real estate alone of four million nine hundred ninety five thousand dollars ($4,995,000).

In reaching their final conclusions, both McNight and Lesavoy agree that the income capitalization approach is a better method in evaluating the fair market value of the subject property as compared to the sales comparison approach. Given that, this Court finds the calculations used by McNight to be unsound and against logic, more specifically adding the real estate taxes into the capitalization rate and subtracting the property improvement plan from the overall fair market value. The analysis and date to support Lesavoy’s overall conclusion is more credible to this Court than McNight’s. Therefore, this Court concludes that the fair market value of the Subject Property as of April 2011 was four million, nine hundred ninety-five thousand dollars ($4,995,000).

In reaching this final conclusion, and in the light of the fact that the fair market value of the Subject Property exceeds the amount of the deficiency owed to judgment creditor,

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[13] Fair Market value = Net operating income/Overall Capitalization rate

the judgment debtors are also found to be entitled to a release and discharge from any further liability to judgment creditor in accordance with 42 PA. CONS. STAT. ANN. §8103.