Short Term Rentals

More than just real estate.

Intended Audience
This publication is written for loan originators, appraisal reviewers, and other parties involved in a short-term rental loan within West Virginia.

What is a short term rental?
A short-term rental is often a residential property leased for periods of one week or less. Short-term rentals are prevalent in areas of tourism. The Hatfield-McCoy Trail System has created significant demand for short-term rentals. In a recent study, Marshall University found that the Trails attract more than 60,000 visitors each year and bring in greater than $40,000,000 in revenue annually. Additionally, the Trails sustain 450+ part-time jobs. The growing influx of visitors has created a new industry throughout Southern WV—short term rentals.

Is a short-term rental a business or a rental property?
The answer: it's both. A property used as a short-term rental is residential in nature. Often times, a short-term rental is simply a single-family home that has been adapted to meet the needs of a short-term renter. A short-term rental normally includes furniture, dishes, appliances, cutlery, linens, and basic toiletries. The operation of a short-term rental requires active management and employs all three asset classes to generate revenue (see below). The operation of a short-term rental constitutes a *business enterprise.* The components of a business enterprise are categorized below.

Real Property	FF&E (Personal Property)	Intangibles
Land	Furniture in rooms & public areas	Cash and equivalents (often partially excluded) AKA working capital
Building	Fixtures (Non- Realty)	Assembled workforce
Site Improvements	Equipment (kitchen, office, health care related, etc.)	Contracts with clients and vendors
Lease Interests	Items of personal property plates, glasses, bedding, etc.)	Franchise or flag
	Computer systems	Trademarks, copyrights and patents
	Inventory	Name and goodwill

Diagram 1

What income can be used in the appraisal?
This depends on the lender. The lending institution must confirm what asset classes they loan on. Normally, a conventional bank loans money based on the value of the real property (outlined in **blue** above). It is *not* common for a conventional bank to loan money based on the value of the enterprise (outlined in **gold** above).

Assuming the lending institution only loans money based on the value of real property, only the potential income attributable to the real property should be used in the real estate appraisal.

What portion of my short-term rental's total income is attributable to real property?
Generally speaking, the potential income from real property is supported by comparable leases. The appraiser determines what the typical renter in the market ordinarily pays for a comparable property. If comparable leases aren't available, HUD's market rent survey is a good resource to consult.

"...But my short-term rental generates significantly more than market rent."
This is expected since a short-term rental employs more than real property to generate revenue. The other assets employed (personal property and intangible property) are expected to generate a return. Let's say a hypothetical short-term rental generates $20,000 per year but the appraiser deems market rent to be $9,000 per year. Here is an illustration of how these figures can be reconciled.

Total income generated from short-term rental enterprise	$20,000
Less "Market rent" of real estate	($9,000)
= Income attributable to personal property and intangible assets	$11,000

Diagram 2

Compare the colors in Diagram 2 with the colors in Diagram 1.

In this example, the real estate value will be based on a potential annual income of $9,000 even though the *enterprise* has historically generated $20,000 per year. The difference of $11,000 is attributable to non-real property and represents the economic return for all other asset classes employed in the enterprise. The $11,000 represents the economic return for:

- Personal property
- Operator's entrepreneurship
- Reputation
- Online web presence
- Goodwill
- A trained workforce and more

"...So that's it? There's no way to mortgage the excess earnings?"
This is a question best suited for the lending institution. Some banks will loan against personal property using a UCC filing – this gives the bank a claim to your business' personal property and equipment. Alternatively, there are banks who originate business loans that are insured by the Small Business Administration (SBA). The SBA maintains a list of participating lenders. These lenders loan money to businesses and can base the loan on the value of personal property and intangible assets.

Remaining Thoughts
If you are seeking a loan to acquire a short-term rental, ask your lending institution what asset classes are used to determine the loan amount. If you are a lending institution who wants to loan on non-real property assets, be sure to request a *Going Concern* appraisal from the appraiser.

QUESTIONS OR COMMENTS?

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