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NEVADA COMMISSION OF APPRAISERS

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Maria Gallo
Commission Coordinator
Nevada Real Estate Division
3300 W Sahara Avenue, Suite 350
Las Vegas, NV 89102

Attn: Appraisal Commission

Per the request for comments regarding "short-term rentals and using the income approach (including the income from the short-term rental operation) in developing the market value conclusions for the property," I would like to submit the following observations and comments. Due to a prior appointment, I cannot present my comments in person. Therefore, I am hopeful these can be read, entered into the record, or otherwise accepted by the State and the Appraisal Commission.

As required by the State of Nevada AB363, Clark County and the cities of Las Vegas, North Las Vegas, Henderson, and others have implemented ordinances, procedures, regulations, etc., concerning Short-Term Rentals (STRs) within their jurisdictions. While the policies and procedures vary (for the application and operation of a STR) between the entities, there are fundamental consistencies, as required by AB363.

Specifically:

- A business license is required and issued to the property owner (not the property itself).
- The owner must meet all requirements (stringent background check) like a hotel operator.
- The license to operate an STR is not attached to the property. The license is strictly associated with a specific individual, who must be the property owner, an individual, not a corporation or other business entity, trust, manager, etc.
- In most cases, the property owner must also apply for a type of Use Permit. While the Use Permit is associated with the property, it is not automatically transferable to a new owner (without the owner requalifying, background checks, licensure, etc.).
- The property must be within an area zoned for STR and not excluded. For example, each of the entities has areas that are excluded from this use (Summerlin, Town Center, Skye Canyon, Inspirada, Cadence, etc.) or

limitations as to the buildings (only SFRs and Condo, with some multi-family permitted under certain conditions), with other exclusions.

- There are also distance exclusions with minimum distances between STRs and minimum distances between STRs (650+/- to 1,000+/ feet) and existing resort hotels (2,500+/- feet).
- Most entities classify (by definition) this use as a "commercial use" within a residential area.
- Most entities require approval letters from Homeowner Associations stating the HOA documents permit such a use.
- All required building inspections to confirm the residence meets all building codes, health and safety requirements, etc., including existing signs, smoke alarms, carbon monoxide detectors, and fire extinguishers, must be connected to public sewer systems.
- Must have a State Business license.
- All require the owner to have liability insurance (minimum of $500,000 for most, with Henderson requiring $1,000,000).
- Each requires the collection and monthly payment of "transient lodging tax" to the State. This automatically removes the property's eligibility for the primary residential tax cap permitted in NRS 361.
- Per Clark County, there is a limitation (1% of the total housing units) on the number of STR licenses issued annually. For example, in Clark County, in 2023, the number of housing units was 941,953. This means the total number of STRs permitted would be 9,419.
- The license is annual and not automatically renewed.

The above is a summary of many consistencies between the governing political entities that distinguish the operation of a short-term rental (less than 31 consecutive days) and its income from the STR of the rooms or property to transients) from a traditional owner's rental of property (on a year-round basis) and the appraiser's income approach to value. The operation of a STR is akin to the operation of a private daycare service, where the property owner watches the neighbor's children.

Private daycare operations in a home require a use permit and license. The daycare operators use the home as a safe place to watch the children. The income from the daycare service is not income to the home itself (like monthly rent is) but rather income to the business operation of the daycare and is reported as such to the State and IRS as business income.

Conversely, the income approach to value is applicable when a 1 to 4-unit property is held for investment income. This entails renting the property on a longer-term basis, usually 6 months, and usually 1 year or longer. STRs are typically vacation

rentals, ranging from a few days to a week or more, but limited to a maximum of 31 consecutive days for any tenant. For the appraiser to complete the income approach, the property is compared to physically similar homes in the area, which are also rented annually.

In such cases., the appraiser identifies the property's market rent and extracts the gross rent multiplier from similar properties to produce a value indication for the subject property based upon its stabilized rent over a long time (generally one year) as evidenced by the rentals of many similar properties in the area. Market demand can be estimated by observing the number of available rentals in the area, the absorption rate, marketing times, concessions, etc.

Typically, the units are rented unfurnished, and there are no licensing requirements, no home inspections required, and no restrictions on the unit type (can include mobile homes, condos, SFRs, etc.) unless some exist within the HOA itself. The rental data (and sales data to develop reliable GRMs) is abundant and available through the local multiple listing services over long periods to provide a historical view of trends and identify any short-term trends influencing the potential value. This permits the appraiser to provide reasonable conclusions as to the longer-term viability of the property viability as a rental and its income stream over time.

Also, unlike STRs, there are no licenses, background checks, home inspections, appearances before the City for Use Permits, license and filing fees, collection of transient lodging taxes, etc. The appraiser does not have to identify if the property has a use permit, is within a particular zone that permits rentals, or is within a set distance to other rentals or resort property, etc., like the strict requirements for STR approval.

When considering the income from STRs, the appraiser must now determine if the use is legal, verify the property ownership and the STR license status of the owner, and determine if the property meets the City/County requirements (some of which vary from entity to entity), including proximity to other STRs or resort properties. In addition, the appraiser would now be required to examine the income records of an existing STR property or project the potential income for a proposed STR, along with estimating expenses, reserves for replacements of short-lived items, related licensing, insurance expenses, and associated costs (marketing, management, etc.).

Completing such a detailed analysis of the income and expenses associated with an income-producing property is well within the normal duties and scope of work for a Certified General Appraiser. However, such a detailed analysis may be foreign to the average Certified Residential or Licensed Appraiser. In the past, I believe the State has issued opinions regarding the appraisal of Condotels, which operate similarly to

STRs, advising residential appraisers on the commercial nature of these operations and ownerships.

STRs present the same pitfalls for Licensed and Certified Residential Appraisers. Therefore, I believe it would be appropriate for the State to consider notifying appraisers, AMC, users of appraisal services, and market participants as to who is or isn't licensed in the appropriate classification to do these types of assignments. In most cases, this is a commercial business operation based on how the various governmental entities view the licensing of the owners (non-transferability, rules, etc.).

As such, while any licensed appraiser (in theory) could complete the "fee simple" valuation, the inclusion of income from the business is a valuation of the going concern (which includes personal property in the form of the furnishings, perhaps the websites, marketing materials, etc.) and would require the services of a business specialist or Certified General Appraiser, in most cases.

An AMC or other entities may attempt to coerce the appraiser into including income from the operation of a STR, as there is no liability on their part. In review, it's more likely the appraiser would be found liable. To that end, I'm hopeful the State will take proactive steps to clarify the issues, take a position as to who can and cannot complete such work, and notify appraisers and users of appraisal services of the State's position.

In the interest of "protecting the public trust," we should consider the lending policies of Fannie Mae, Freddie Mac, FHA, VA, etc. (which differ concerning STRs). In most cases, the loan documents preclude the commercial use of the property. This would not be an issue if the property were free and clear of such mortgages. However, it is more likely the property is secure via a mortgage. Allowing appraisers to participate in the valuation of such STRs by including the income from commercial use would violate the appraisal guidelines of most secondary market participants.

I believe Fannie Mae does have a program for financing STRs. However, they must be financed as an "Air B&B" (investor-owned property) instead of primary owner-occupied property, as the rates, risks, etc., differ. Fannie Mae underwrites investor properties by identifying the income source (generated by the STR) and attributing the income to the borrower. They do not have the appraiser capitalize the income from the STR in the appraisal. Rental income can help investors qualify for loans in such cases. However, that income is other income (to the borrower) and not capitalized in the income approach to value in the appraisal. I do not believe that HUD/FHA or VA finance STRs.

Another issue that potentially places the mortgage companies at risk (and places the appraiser squarely in the line of defendants in a related lawsuit) is the entity's provisions for fining the owners and operators of STRs for violations of the restrictions imposed by each of these cities or counties. For example, the City of Las Vegas fined one homeowner $180,000 and placed a lien on the property late last year (or early this year).

I do not know what priority such a lien has, but I recall where the Nevada Courts ruled that an HOA lien was superior to a first mortgage, allowing million-dollar homes to be sold for a few thousand dollars. What potential liability would there be for an appraiser if they included business income in the valuation of a home subject to a secondary market mortgage if that home is subject to a lien that now has priority over the mortgage?

The STR approval is licensed to the owner and not the property. Therefore, the income produced via the STR is the owner's income resulting from the operation of a "going concern" and not attributable to the property alone. There are strict requirements for the property. The property is not licensed. The individual is licensed. This type of analysis and assignment is beyond the typical scope of work for the appraiser. It requires business valuation services, like the scope of work for a hotel or motel.

What happens when a property is illegally operated as a STR, and the appraiser capitalizes the income in the income approach to value? The Greater Las Vegas Short-Term Rental Association already has a lawsuit with local entities and licensing. Per a September 2023 article, less than 10% of the estimated existing 7,700 STAs had been licensed. Who will provide the appraiser with the required information (income, expenses, etc.), and how will the appraiser verify such data to ensure it is consistent with the market?

Where will appraisers get market data for STRs? When appraising an STR, will the appraiser use normal sales from the same location or be required only to consider the sales of STRs? Is this a complex assignment, and if so, what is required? If the property is residential (but is being operated as a "commercial hotel)," are you creating a misleading report by including the "commercial operations business income" as part of what you are calling a residential property under H&BU?

Many residential lenders will not lend on "condotels" for this very reason. They are operated like hotels, with the units included in a "hotel pool" of available rooms. In some cases, the residential lender will make a loan on high-rise units that are in condos based on the resale value. However, income from the Air B&B operation is excluded. If AMCs and lenders want to use this income, they should engage business appraisers to do the cash flow separately from the residential fee simple

appraisal. I think the AMCs and lenders are looking for a quick and easy solution to their problem and, in doing so, are shifting the liability onto appraisers.

At the very least, there should be required disclosures from the AMC, lender, borrower, etc. (perhaps similar to the Seller's Real Property Disclosure Report) provided to the appraiser, along with specific language and prominent statements within the report itself, clarifying what is and isn't being included in the valuation and what has and has not been verified or what sources the appraiser has relied upon so that a reader or intended use is not misled.

Undoubtedly, there will be "unintended consequences," an occurrence many of us have become familiar with since licensing began in the 1990s, as clients and users of appraisal services attempt to edit long-standing and sound appraisal principles to fit a particular need without consideration of the relevance to the appraisal problem or the impact to the value conclusions being reported.

The true impacts on the values of short-term rentals have yet to be fully understood. These are not standard residential property appraisals. These are complex properties with limited data availability, subject to many restrictions, and with significant potential for fraud and liability beyond that currently known. Protecting the public's trust requires the State of Nevada to examine the issues identified thoroughly, consider the potential liabilities and consequences to all involved, and notify appraisers and users of appraisal services as to the inherent risks involved.

Respectfully submitted,



Patrick Egger
Nevada Certified General Appraiser
A.0000154-CG
702-324-6652

Attachments

Additional Sources of Information on Short-term Rentals

https://www.fox5vegas.com/2024/01/23/180000-fine-illegal-short-term-rental-las-vegas/

https://thenevadaindependent.com/article/few-clark-county-short-term-rental-owners-apply-for-license-amid-legal-battle

https://www.steadily.com/blog/airbnb-short-term-rental-laws-and-regulations-in-nevada

https://www.proper.insure/regulations/airbnb-laws-nevada/

https://www.lasvegasnevada.gov/Business/Planning-Zoning/Code-Enforcement/Short-Term-Rentals

https://library.municode.com/nv/clark_county/codes/code_of_ordinances?nodeId=TIT7BURE_CH7.100SHRMREUN

https://www.cityofhenderson.com/government/departments/community-development-and-services/short-term-vacation-rentals

https://www.cityofnorthlasvegas.com/business/short-term-rentals