TYNE HOSPITALITY SERVICES LIMITED

INTERNATIONAL HOTEL & RESORT CONSULTANTS

MAXIMIZING YOUR HOTEL SELLING VALUE

The time to prepare your hotel for eventual sale is right after you make the purchase or open your hotel after having built it.

The process is one of long-term planning, and not one that you commence after you have decided to sell. As a commercial real estate broker I specialize in the sale of hotels. I have seen too many situations where hotel owners have not taken precautionary measures to protect their properties from declining market cycles, increased competition from new development, evaluation of their selected hotel franchisor or management company and changes in customer tastes and demands. For example, I have seen a hotel owner continue to lose market share over 4 or 5 years while still pursuing an inflated price when the net operating cash flow was declining and market capitalization rates were increasing. The result, in this case, was a 76% decline in disposable cash flow over 4 years, leaving insufficient funds to pay the mortgage.

The objective should be to always attract sufficient buyers who are willing to pay the highest realistic price for your hotel. Remember that you are selling a business that has created, hopefully, goodwill over the years, and not simply a real estate asset. ***Buyers are looking to purchase cash flow based on the last 12 months of trailing income before debt service. They are not going to pay for future income unless the hotel is newly built and does not have at least 3 years of operational history.***

The following factors should be taken into consideration in order that you will ***maximize the sales price of your hotel***:

- Maintaining your financial and accounting records in accordance with the procedures in the ***Uniform System of Accounts for Hotels.*** A buyer and his financing sources will want to see comparative departmental financial statements, prepared in this internationally accepted format, for at least 3 years and compared to a budget. A budget for the current year will also be required. If a buyer, during the due diligence period, has to pay for your accounting records to be analysed and presented into this required format, the marketing period will be extended and the cost deducted from the buyer's offering price. Do not co-mingle personal expenses with true business expenses in your accounting records (i.e. automobile, travelling costs or life insurance etc.) Have your accountant deal with expenses of this nature plus owner operated management fees in his adjustments made for income tax statements. Accounting firms that specialize in hotel accounting, such as **Grant Thornton**, can be very helpful in this regard.

- ***Financing,*** or difficulty of obtaining it, is one of the greatest roadblocks to selling a hotel. Make sure that your mortgage is pre-payable on the sale of the hotel or that the financing source is agreeable to having it assumed by a qualified buyer. In today's difficult economic times, it may be necessary for you to consider providing a buyer with a second mortgage as first mortgage lenders are reluctant to provide a loan of more than 50% of appraised value. If you are selling the shares of the company that owns the hotel, then a buyer will not be subject to BC Property Purchase Tax, but the buyer will look for a vendor take back loan. This is to provide the buyer from any contingent liabilities that might arise subsequent to the sale of the property.

- ***Curb appeal*** is so important when a potential guest is selecting a hotel; it is just as important to a buyer. If your property does not have a clean and fresh look it will be more difficult to sell. Do not however, commence to repair major items or commence a major renovation and certainly do not add more rooms or facilities that cannot be supported with an income trail. A buyer will have his own ideas on how to operate a hotel, and may want to change the franchise or to lease the restaurant. It is better to disclose a list of deferred maintenance items as you will be unlikely to recover the cost from a buyer if you have recently completed the work.

- ***Franchise agreements and third party management contracts:*** Be sure to work out terms with these companies to allow the agreements to be cancelled when you sell the hotel. Your number of potential buyers will be expanded if you can sell the hotel, free and clear of these encumbrances. The cost of liquidated damages to cancel a contract can often be significant and a buyer will not likely to agree to paying those costs

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- ***When should I sell my hotel?*** Hotel properties do not trade frequently, as they are very specialized businesses requiring experienced operators. The small to medium sized hotel will likely be purchased by individuals who already own hotels or have just sold and want to reinvest in another property. The public hotel companies, REITS and larger family owned hotel chains, will likely purchase the larger hotels. At this time, with little capital available from the stock markets, there are extremely few buyers for the larger transactions. The pension funds and insurance companies that invest heavily in shopping centres, office buildings and rental apartments are unlikely investors in the hotel industry. In the past REITS and overseas investors have paid over-inflated prices for hotels. Those buying cycles are in the past and there is no sign of them returning for the foreseeable future. Buyers are, therefore, looking for value and the opportunity of upside. In the Greater Vancouver and on Vancouver Island, occupancies have been on the decline for 3 or 4 years now and overbuilding of hotels has occurred in certain markets so today is the time when buyers are looking for opportunities if the asset is priced realistically.

- If your hotel has a good location, has been regularly upgraded, is well operated and has had a successful track record, then buyers will be attracted in spite of the decline in occupancies. The building boom of the past 5 years is over, and so is the strata hotel craze in urban areas, so now is the time to buy and re-position a hotel for future growth in demand.

- ***Establish a realistic selling price.*** Overpriced hotels do not attract buyers. In fact most experienced buyers will not bother to even visit a hotel that is overpriced. Buyers do not make on offer to purchase based on the value of future income. Using the last 12 months of income before debt service they will deduct a management fee of 3% of gross revenues plus a CAPEX reserve of between 3-6% of gross revenue, depending on the age and quality of the property. The final step is to apply an acceptable market capitalization rate to the resultant net income to arrive at a selling price. You will no doubt wish to increase the resultant price calculation to allow for some room for negotiation, but no more than 10-12%.

- ***Capitalization rates:*** This topic has long been debated among appraisers, buyers and sellers and you would be advised to obtain some professional advice from a company such as **Grant Thornton** in conjunction with the advice of an experienced hotel real estate broker that understands your local market.

- ***Finding a qualified buyer:*** As a general rule, hotels are purchased by investors who are already in the industry and have experience in running these specialized businesses. Engage the services of an experienced hotel broker who will have a comprehensive database of known buyers. A broker can help to create incremental value for your hotel, and to generate a competition among buyers, as well as present the information about your business in a professional manner.

Tyne Hospitality Services Limited is a Vancouver based licensed real estate broker, specializing in the sale of hotels, and has assembled specialized teams to develop hotels and resorts along with the sourcing of equity and financing.