Tips for Innkeepers

Preparing for the sale of your inn…

Conventional wisdom among B&B/Inn consultants is that an innkeeper should have an exit strategy the day they purchase the inn, in fact some contend it should be part of the initial business plan. Since it is my job to work with a buyer from an aspiring innkeeper to innkeeper, I thought it might be useful to discuss this issue from a lender's perspective.

If you are planning to market your inn for sale in the near future and had written a business plan prior to buying your b&b/inn, get it out and compare your projections to your actual performance. Just like a Broadway show rehearses to take out the ad-lib from a production script, you may find it useful to get back to basics so that your last three years of ownership are your best.

I see it quite often, that instead of working smarter and harder in the final years of ownership, some innkeepers hire more staff, take more time away from the inn. Income and expense trends are examined closely in underwriting, so I would suggest if you are serious about selling, the focus in the last two to three years needs to be on building the top line (gross income) while responsibly reducing expenses to achieve the largest Net Operating Income (NOI). Reducing taxable income by deducting every justifiable expense may be attractive from a tax perspective, but this practice may negatively impact the appraised value and ultimately impede a buyer's ability to obtain financing.

Your return on investment (ROI) is tied not only to appreciation in the value of real estate, your net income each year will determine how much debt can be supported by the business.

The Loan to Value (LTV) a lender uses is based on an average of the most recent three (3) years tax returns NOT from P&L's.

From a lending perspective, business tax returns are what the bank uses when underwriting a commercial loan request; P&L's are used primarily to compare past and projected year to year income and expense activity and for projection used in the business plan and loan application.

When a prospective buyer submits a loan request to their bank, the underwriters are limited to certain add-backs to the bottom-line income/loss. These items are most commonly:

- Officer's Salaries
- Contributions to retirement/pension account/s
- Rent or Mortgage
- P&I
- Depreciation
- Certain one-time expenses used in preparation for sale

Lenders will generally require a Debt Service Coverage (DSCR) of 1.25 to 1.3 times, this can and should be determined prior to marketing the property. It is important to get it right the first time, so seek the advice of a knowledgeable "B&B Industry Specialist" to consult on how best to position your inn relative to its financial performance and comparable sales data. It is worth noting that in certain markets the real estate value may exceed the inn's business value as a going concern, this is important to determine as early as possible to position the sale properly in the market.

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