MOTEL BUYER'S HANDBOOK

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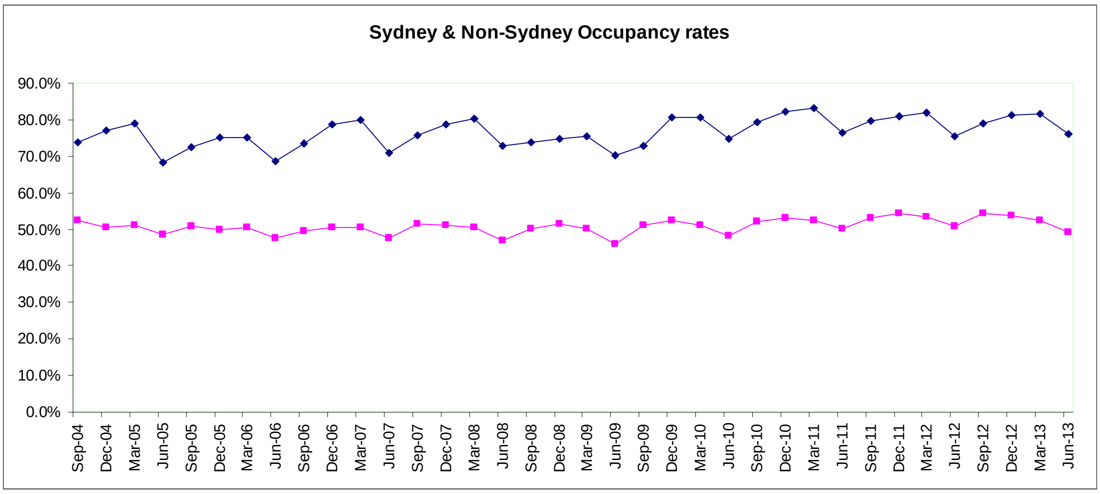
1. The New South Wales Motel Industry

There are currently 1,388 motels, hotels, resorts and serviced apartments with 15 or more rooms in New South Wales. They offer a total of 70,725 rooms, 190,081 beds spaces and employ 30,004 people. [1]

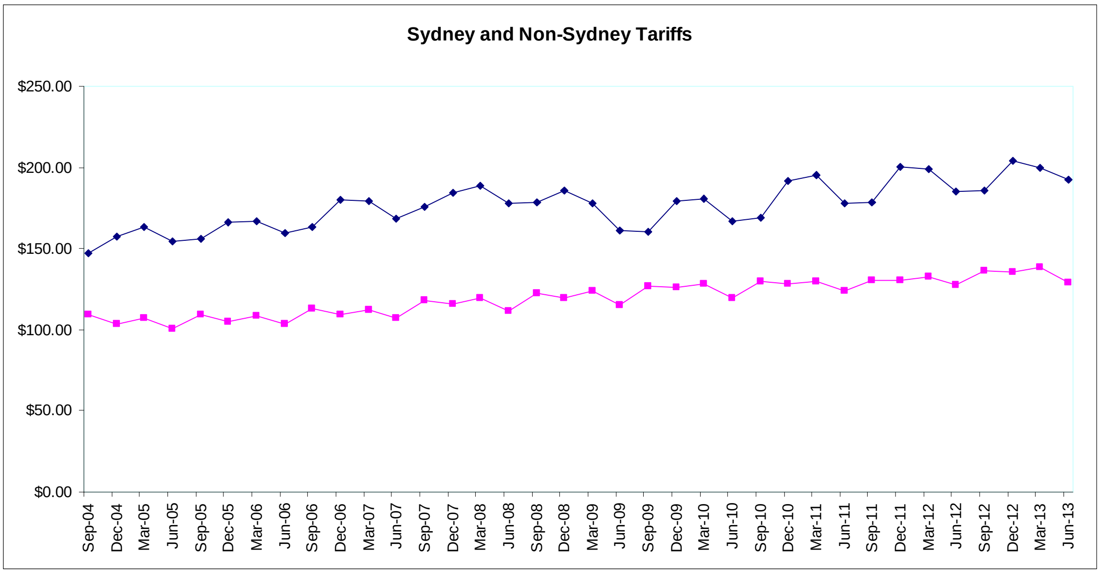
In the 2012/13 financial year these properties produced $1.8 billion in accommodation revenue from an average occupancy rate of 65.2%.

It is important to note that occupancy rates and accommodation revenues are very different for Sydney and non-Sydney motels. Sydney accommodation properties enjoy an average occupancy rate around 80%, while non-Sydney motels have occupancies around 50%. Generally, when the press runs articles on accommodation statistics they refer to capital cities. This can give the false impression that good motels should enjoy occupancy rates around 80%, when in fact good country motels may be running at 50%.

The chart below sets out the average occupancy rates for Sydney and non-Sydney motels for the last nine financial years. Of interest is the very steady nature of non-Sydney motels occupancy rates. If you are planning to purchase a NSW country motel you are entering a very steady industry that was almost unaffected by the recent Global Financial Crisis.



The five star Sydney hotels set the standard for capital city tariffs, and, as expected, they are substantially higher than non-Sydney tariffs. Over the past nine financial years Sydney tariffs have averaged $176.56 while non-Sydney tariffs have averaged $119.64.



1. Australian Bureau of Statistics June 2013 quarter. The ABS publishes motel data that gives motel buyers an excellent snapshot of trading conditions in major country towns and regions. These statistics were published quarterly, but from the 2013/14 financial year they will be published annually. Go to www.abs.gov.au and follow these links Statistics → Topic → Industry → Tourism → Accommodation → Tourist Accommodation, Small Area Data, New South Wales. You can then download current and past quarterly statistics.

   At the time of this update (May 2015) the most recent ABS statistics were for June 2013.

2. Star Ratings

AAA Tourism operates the NSW star classification system which is published online and in the NRMA Accommodation Guide. The various rating are defined as follows:

1 Star	Establishments offering a basic standard of accommodation. Simply furnished. Resident manager.
2 Stars	Well maintained establishments offering an average standard of accommodation with average furnishings, bedding and floor coverings.
3 Stars	Well appointed establishments offering a comfortable standard of accommodation, with above average furnishings and floor coverings.
4 Stars	Exceptionally well appointed establishments with a high level of facilities, plus quality furnishings offering a high degree of comfort. High standard of presentation and guest services provided.
5 Stars	International standard establishments offering excellent facilities, outstanding appointments, furnishings and décor with an extensive range of first class guest services. A number and variety of room styles and/or suites available. Choice of dining facilities, 24 hour room service, housekeeping and valet parking. Porterage and concierge services available as well as a dedicated business centre and conference facilities.
½ Star	The additional half star indicates establishments offering similar standards to the full star, but offering more comfort by providing additional features and items.

Different guests demand different standards of quality and service. Some guests will only stay at 4 and 5 star properties. Others are happy with the lower tariff offered by 1 and 2 star properties. Standard economic theory suggests that the lower the price the higher the demand. However, in the accommodation industry, the reverse is the case. The more expensive 4 and 5 star properties have consistently enjoyed higher occupancy rates than the less expensive 2 and 3 star properties.

In non-Sydney motels the average occupancy rates for the 2012/13 financial year are set out below:

Star	Occ %
1	15.7
2	43.9
3	49.2
4	61.1
5	46.5

The table indicates that

- 2 star motels enjoyed occupancy rates 28.1 percentage points higher than 1 star motels
- 3 star motels enjoyed occupancy rates 5.3 percentage points higher than 2 star motels

- 4 star motels enjoyed occupancy rates 11.9 percentage points higher than 3 star motels
- 5 star motels, of which there are very few in country NSW, struggled to match their 4 star counterparts, with occupancy rates 14.6 percentage points below the 4 star occupancies

As expected, the higher the star rating the higher the tariff. In non-Sydney motels the average tariffs for the 2012/13 financial year are set out below:

Star	Tariff
1	$79.51
2	$83.74
3	$113.74
4	$160.93
5	$426.39

As accommodation revenue per room can be expressed as Occupancy Rate x Tariff the annual accommodation revenue generated by each room can be expressed as follows:

Star	Revenue
1	$4,569
2	$13,413
3	$20,432
4	$35,899
5	$72,408

On average, each room in a 3 star country motel generates $7,020 more in accommodation revenue annually than each room in a 2 star country motel.

The really big jump is between the 3 and 4 star motels, with 4 star rooms generating $15,466 more in annual accommodation revenue than 3 star rooms. A 20 room motel upgrading from 3 to 4 stars might therefore enjoy a revenue increase from $408,640 to $717,980.

Most of this revenue goes straight to profit, because the costs of servicing a 4 star room are little different to the costs of servicing a 3 star room.

This is an important point that motel buyer should bear in mind. Renovations that lead to star rating upgrades are generally very successful, and result in increased revenue and profits.

3. Towns and Regions Compared

By pouring over the ABS figures it is possible to see how the accommodation statistics of various NSW towns compare. The interested party has merely to download the figures, add all the monthly rooms available, monthly rooms occupied and monthly accommodation revenue for various NSW towns, then calculate the average occupancy rates, tariffs and revenue per room per year. This is a very tedious task. Fortunately, I have done it for you.

The table below records the number if motels with 15 or more rooms in each major country town, their occupancy rate, average tariff and accommodation revenue per room available for the 2012/13 financial year.

New South Wales Motel Statistics
Financial Year 2012/13

	Motels 15 rms +	Occupancy Rate	Average Tariff	Annual Accom Rev Per Room
Town				
Sydney	283	79.4	$195.50	$56,684
South Coast				
Batemans Bay	18	43.9	$130.74	$20,942
Bega - Tathra	4	55.3	$139.33	$28,137
Eden	7	35.5	$109.60	$14,207
Merimbula - Tura Beach	17	44.2	$96.60	$15,570
Moruya - Tuross Head	3	27.5	$93.82	$9,431
Narooma - Bermagui	6	54.5	$120.72	$23,999
Berkeley - Warrawong - Windang	3	26.0	$114.40	$10,837
Kiama	5	60.6	$162.00	$35,820
Kiama Hinterland - Gerringong	4	43.3	$140.01	$22,140
Shellharbour - Flinders	3	42.6	$124.49	$19,374
Wollongong	19	62.1	$152.47	$34,556
Berry - Kangaroo Valley	4	35.0	$173.62	$22,163
Huskisson - Vincentia	4	51.4	$136.52	$25,601
Nowra	8	59.7	$109.20	$23,802
Ulladulla	10	51.5	$188.59	$35,450
Total South Coast	115	48.8	$136.60	$24,324
Snowy Mountains				
Cooma	8	40.5	$108.08	$15,979
Jindabyne - Berridale	44	27.9	$235.17	$23,930
Tumbarumba	3	35.9	$91.00	$11,920
Total Snowy Mountains	55	30.3	$196.91	$21,784
Capital Country				
Goulburn	12	67.5	$103.45	$25,503
Yass	6	63.8	$110.24	$25,668
Young	4	54.3	$101.40	$20,099
Queanbeyan	11	53.8	$120.89	$23,742

Bowral	9	50.8	$161.58	$29,974
Mittagong	5	53.9	$132.28	$26,023
Total Capital Country	47	55.6	$123.82	$25,134
The Murray				
Albury - South	29	58.1	$124.35	$26,372
Albury Region	3	58.7	$87.50	$18,762
Lavington	4	55.3	$120.61	$24,328
Wentworth - Buronga	10	32.3	$76.21	$8,975
Wentworth-Balranald Region	6	39.9	$105.57	$15,389
Corowa	6	26.7	$106.84	$10,428
Corowa Region	5	61.7	$115.00	$25,916
Deniliquin	8	40.6	$79.61	$11,807
Deniliquin Region	8	47.7	$87.99	$15,310
Moama	11	57.2	$114.59	$23,935
Tocumwal - Finley - Jerilderie	17	32.5	$94.46	$11,197
Total The Murray	107	48.4	$110.28	$19,481
Riverina				
Hay	6	50.5	$106.33	$19,586
Griffith	11	50.8	$108.36	$20,102
Leeton	3	47.6	$95.99	$16,668
Narrandera	6	42.2	$95.70	$14,754
Cootamundra	5	54.0	$100.28	$19,770
Gundagai	7	52.5	$93.62	$17,933
Wagga Wagga	26	67.6	$136.55	$33,679
Total Riverina	64	56.4	$116.25	$23,934
Central NSW				
Bathurst	14	52.2	$139.65	$26,592
Cowra	7	41.7	$107.66	$16,370
Forbes	6	48.8	$106.79	$19,007
Parkes	9	59.2	$106.74	$23,067
West Wyalong	8	45.5	$85.00	$14,129
Mudgee	8	70.6	$128.06	$33,015
Orange	11	66.2	$125.45	$30,316
Coonabarabran	11	43.4	$102.93	$16,314
Dubbo - East	3	69.2	$116.29	$29,372
Dubbo - South	21	56.3	$117.78	$24,189
Dubbo - West	10	57.3	$110.21	$23,047
Gilgandra	5	36.9	$92.20	$12,432
Narromine	3	47.6	$74.02	$12,874
Total Central NSW	116	54.6	$115.26	$22,951
Hunter				
Branxton - Greta - Pokolbin	13	58.2	$191.91	$40,776
Cessnock	7	47.4	$110.42	$19,091
Singleton	8	57.5	$149.64	$31,431
Maitland	3	58.9	$151.12	$32,485
Maitland - West	3	68.3	$126.54	$31,547
Muswellbrook	8	56.4	$134.53	$27,694
Scone	5	61.2	$106.76	$23,830
Scone Region	4	47.6	$93.77	$16,294
Charlestown - Dudley	4	57.9	$137.96	$29,153

Mayfield - Warabrook	5	57.2	$112.90	$23,580
Newcastle - Cooks Hill	9	73.8	$168.27	$45,328
Total Hunter	69	59.2	$151.47	$32,737
North Coast				
Coffs Harbour - North	15	57.2	$121.74	$25,399
Coffs Harbour - South	16	55.9	$119.96	$24,468
Woolgoolga - Arrawarra	4	61.7	$96.42	$21,726
Nelson Bay Peninsula	14	53.5	$163.19	$31,862
Raymond Terrace	3	46.4	$126.50	$21,428
Tea Gardens - Hawks Nest	5	59.3	$106.28	$23,020
Bulahdelah - Stroud	3	50.5	$100.90	$18,593
Forster	10	44.0	$142.20	$22,857
Macksville - Scotts Head	3	43.3	$109.25	$17,286
Nambucca Heads	3	53.6	$99.44	$19,453
South West Rocks	3	43.9	$107.57	$17,247
Port Macquarie - East	22	61.8	$145.16	$32,720
Port Macquarie - West	8	63.6	$124.69	$28,931
Old Bar - Manning Point - Red Head	4	51.1	$162.49	$30,322
Taree	15	50.6	$97.93	$18,105
Total North Coast	128	54.7	$133.43	$26,618
New England North West				
Armidale	16	60.0	$117.65	$25,781
Glen Innes	6	47.4	$89.23	$15,441
Inverell	5	47.5	$108.13	$18,746
Tenterfield	10	37.4	$97.14	$13,264
Moree	12	57.6	$93.03	$19,561
Narrabri	7	67.2	$112.44	$27,559
Gunnedah	6	60.1	$100.92	$22,121
Tamworth - East	6	42.8	$105.38	$16,461
Tamworth - North	20	55.5	$139.77	$28,325
Total New England North West	88	54.2	$113.14	$22,380
Outback				
Bourke - Brewarrina	3	62.1	$152.98	$34,690
Nyngan - Warren	6	66.3	$81.74	$19,789
Walgett - Lightning Ridge	5	48.5	$88.29	$15,630
Broken Hill	13	59.0	$118.25	$25,484
Total Outback	27	61.6	$107.73	$24,226
Northern Rivers Tropical NSW				
Grafton	10	49.2	$110.86	$19,913
Maclean - Yamba - Iluka	8	58.4	$161.29	$34,361
Ballina	12	56.1	$121.05	$24,774
Byron Bay	14	66.0	$213.84	$51,518
Casino	4	44.4	$98.34	$15,952
Lismore	8	43.8	$107.30	$17,173
Kingscliff - Fingal Head	6	58.5	$132.92	$28,364
Pottsville	4	42.7	$110.71	$17,244
Tweed Heads	8	59.4	$124.97	$27,074
Tweed Heads - South	4	53.0	$87.05	$16,826
Total Northern Rivers Tropical NSW	78	54.5	$139.34	$27,742

Central Coast				
Gosford - Springfield	7	53.9	$111.68	$21,982
Terrigal - North Avoca	5	66.7	$212.12	$51,615
Wamberal - Forresters Beach	3	36.8	$124.17	$16,684
The Entrance	11	50.8	$198.54	$36,834
Total Central Coast	26	51.4	$167.87	$31,493
Blue Mountains				
Lithgow	6	62.8	$123.15	$28,224
Blackheath - Megalong Valley	3	34.8	$133.27	$16,904
Katoomba - Leura	17	53.0	$168.30	$32,574
Total Blue Mountains	26	50.7	$185.05	$34,253
New South Wales	1,388	65.2	$169.83	$40,410
Country NSW (NSW less Sydney)	1,105	52.4	$134.95	$25,818

It is important to remember that these statistics are averages only. In a city like Grafton, for example, the average occupancy rate in 2012/13 was 49.2%, the average tariff was $110.86 and average accommodation revenue generated by each room was $19,913. At the times of writing (May 2014) the NRMA records 2 x 4 star motels, 4 x 3½ star motels and 4 x 3 star motels. If Grafton follows the pattern discussed in Section 2, then it is likely that the 4 star properties are enjoying occupancy rates closer to 60% than 49.2%, the 3½ star properties are around the average, and the 3 star properties have occupancy rates below 49.2%.

The NRMA website records tariffs for the 4 star properties as $125 plus. The 3½ star motels have tariffs starting at $70, $78, $91 and $106, and the 3 star properties have tariffs of $69, $69, $77 and $95.

The table above also highlights the absurdity of valuing motels on a price per room basis, although this is one of the standard methods of professional motel valuers. An average motel room in Wagga Wagga generates $38,480 in accommodation revenue annually. The average motel room in Lismore generates less than half that amount - $15,451.

I have just read a valuation report that suggests a Wagga Wagga motel is overpriced, because its price per room is higher than the price per room achieved in a recent Lismore sale. On the figures above, this conclusion is clearly absurd.

There is no such thing as a good motel town or a bad motel town. Motels generate revenue in accordance with the supply and demand for accommodation. The important things to note when considering a motel purchase are the current return on investment and the expected future return on investment.

4. Advantages and Disadvantages of Motel Ownership

Advantages

- In country NSW, the motelier is in a very steady industry
- The motelier has an excellent opportunity to improve revenue and profits by raising the standard of the motel
- Ownership of a freehold or leasehold property, usually in a prime position.
- Relatively easy access to finance
- Owner can live on the premises
- Possibility of a large capital gain
- Database of loyal guests
- Property can be converted to other uses (eg conversion to strata units in Sydney and other regional centres)
- Limited stock to control
- Very few debtors
- Not reliant upon staff

Steady Industry

The consistent occupancy rates and tariffs in the motel market provide a steady platform for growth and improvement, and give the motelier confidence that the market is unlikely to reverse in the long term.

Opportunity to Improve Profits by Raising Standards

The relationship between star ratings, occupancy rates and tariffs indicates the importance of quality. The higher the standard of accommodation the higher the occupancy rate and the higher the tariff a motelier can charge. A potential purchaser should note that the motel industry rewards quality, and a buyer who strives to improve his property should see a strong improvement in revenue and profit.

Location

Generally motels occupy prime commercial sites on major highways or in the commercial centre of towns. This means that if the motel proprietor wishes to convert his property to a different use, such as strata units, there is sufficient value in land and building to attract a commercial developer. Generally, the value of an asset is related to the stream of profits that asset produces. Motel owners have a second source of value that relates to the position of their asset and the value of other commercial properties in their immediate vicinity.

Relatively Easy Access to Finance

Bankers know that the motels are part of a safe, secure industry. That is why they will lend up to 65% against freehold motels and 50% against leasehold motels.

Live on the Premises

Living on the premise can be an advantage and a disadvantage. By being close to their businesses, motel operators do not waste any time commuting, and they can fix problems that arise after hours quite easily. The disadvantage is the feeling that some moteliers express of being tied to their business. Sydney commuters, who spend up to ten hours a week commuting, may not see this as a disadvantage.

Probability of Capital Gain

Motel owners who build up and improve their business can expect to reap substantial capital gains when they resell. A motel buyer, who purchases a property for $1 million with a 14% return on investment, builds that business by 10% per year and resells in three years with a 14% return on investment will reap a capital gain of $331,000. If the motelier borrowed 65% of the purchase price, then he would have made a capital gain of $681,000.

If the same motelier takes the property from a low start rating to a higher star rating, the capital gain would be substantially higher.

Similarly, the purchaser of a leasehold motel can also achieve substantial capital gains, providing he lease he sells has a substantial number of years left to run. If a motel buyer purchases a 25 year lease for $500,000 with a return on investment of 33%, builds the business by 10% a year, and resells that lease three years later with the same return, he should realise a capital gain of $165,500. If the same motelier borrowed 50% of the purchase price then he would have made a capital gain of $415,500.

Once again, if the motelier improves the star rating the capital gain should be substantially higher.

(Note that these simple examples do not take account of stamp duty and other associated costs)

Known Customer Base

Because guests register with the motel, moteliers know exactly who their customers are. In many other businesses, particularly retail businesses, the customers remain anonymous. Motel buyers begin with a base of loyal customers which they can build on and expand. Motel owners with a computerised booking system or with access to a simple data base program can monitor their best customers and direct their advertising accordingly.

Stock, Bad Debts and Staff

Stock, bad debts and staffing issues can cause problems in other industries. They seem to be absent in the motel industry.

Stock, with its storage, shrinkage and insurance problems, is a minor aspect of the motel operation. Similarly bad debts, which can bring many businesses to their knees, are almost unknown in the motel industry. While corporate clients may be offered credit facilities, the majority pay by company credit card.

In many businesses, a specialised labour force is absolutely vital. In the motel industry, it is not hard to find part-time workers for cleaning and housekeeping duties. Even temperamental chefs tend to be less of a problem in country motels, where alternate employment opportunities are limited.

Disadvantages

The disadvantages of owning a motel are

- Live on the premises
- Long hours
- May be slow to resell

Live on the Premises

The advantages of living on the premises have been discussed above.

Long Hours

Long hours may be a problem, but there are few small business owners who enjoy a 35 hour week. In general, the motel owner must be available for most of the day, but his duties are not necessarily arduous, and it is relatively easy to find relief managers to enable the proprietor to enjoy a holiday.

Time Required for Sale

The time taken to resell a motel depends upon prevailing economic conditions, the condition of the property, the state of the trading figures and whether or not the price is realistic. In general, a well presented property with well maintained trading figures, a realistic price and a knowledgeable and experienced business broker handling the transaction will sell within six months.

As a potential motel purchaser you will come across many properties with poorly presented figures, no statistics and an owner who seems reluctant to impart any information. Do not be surprised if properties such as these have been on the market for a long time.

5. Types of Motel Ownership

There are four main categories of motel ownership:

- Freehold
- Leasehold
- Investment

Freehold

If you purchase a freehold motel you will own the land, buildings and the business which includes the goodwill, stock, furniture and fittings. This is the most straight forward form of purchase and it has a number of advantages. There are no landlord/tenant issues, all decisions regarding renovations and upgrades are made by the owner and so the motelier has more freedom of action.

At the time of writing freehold motels offer a return on investment between 12% and 15%, depending upon location. Sydney and coastal motels offer the lower returns. The further west you travel, generally the higher the returns.

Leasehold

Leasehold motels offer returns on investment between 28% and 35%. These returns are obviously higher than those offered by freehold motels, but there are some drawbacks. The value of a lease will decline as the expiry date of that lease approaches. A 25 year lease offering a 33% return is good value. A five year lease offering a 33% return is not.

For some reason, the market does not suggest a formula that recognises the importance of the length of the lease. Generally the advice to motel buyers is to be very wary of short leases. They are difficult to on-sell. A 25 or 30 year lease is fine. No one considers conditions three decades in the future. But a 10 year lease that will be resold in 5 years has very little value.

There are a few rough rules of thumb regarding rents. These are not set in concrete, and different brokers may have different ideas, but generally rent should not be more than 23% of revenue and not more than 45% of the net profit before rent. The net profit figure is more important, because motels without restaurants will achieve net profits up to 60% of revenue, whereas motels with restaurants will see net profits around the 40% mark.

The table below highlights this difference:

	Motel A	**Motel B**
Restaurant	Yes	No
Revenue	$1,000,000	$1,000,000
Net Profit	$400,000	$600,000
Rent 23% Revenue	$230,000	$230,000
Rent as % Net	58%	38%

Both motels pay rent that is 23% of revenue, but because the revenue of Motel A is derived from food and beverage as well as accommodation, rent as a percentage of net profit before rent is too high.

Motel B, with no restaurant, enjoys a very comfortable rent that is 38% of pre-rent net profit.

Investment Motels

If you purchase an investment motel, you are the landlord. The lessee pays rent to you, and generally you can expect a return on investment of around 9%.

As a landlord, it is important to know what repairs and maintenance are your responsibility. Generally the landlord is responsible for all external repairs – walls, roof and driveways. That is why it is vitally important that you obtain a building inspection before purchasing a motel. If the motel roof needs replacing and the driveways need retarring in one year, your return on investment for that year may very well be zero.

Also, while your tenant might be responsible for the upkeep of all furniture and fittings, you need a lease that clearly states what steps can be taken if the tenant does not comply with these requirements.

Most landlords worry about losing their tenant. In the motel industry, this is a secondary issue. Because tenants pay substantial sums to acquire their leases, they are very unlikely to walk away from the motel if business gets difficult. If, however, they do abscond, the landlord now has a brand new lease to sell.

(On this last point, it is important to get sound legal advice. A bank may have a mortgage over the lease, preventing the landlord from immediately selling a new lease. Also, a departing tenant may leave the furniture and fittings in a very poor state of repair, forcing the landlord to spend a lot of money to bring his motel up to scratch before he can sell a lease).

6. Steps to Take When Buying a Motel

a. Area

Limit your search for a motel to your preferred area. Most motel buyers have a good idea of the area to which they wish to move – eg North Coast, South Coast, inland, within three hours of Sydney etc. At Pacific Rim Business Brokers, we have all NSW motels in our database, and can tell you exactly how many properties there are in your preferred area.

b. Type of Motel

Motels come in all shapes and sizes. You probably have a preference for room numbers, star rating, restaurant etc. Once again, we have all this information on our database.

If you purchase a motel with 15 rooms or less then you and your partner will probably run the operation yourselves with very little external help. Motels with 15 to 30 rooms are usually run by the proprietors with permanent or casual housekeeping assistance. Proprietors who own motels with 30 or more rooms are seldom involved in the day-to-day housekeeping while proprietors of motels with 50 rooms plus tend to run a corporate style operation, often with assistant managers, catering managers etc.

Whether your motel is big or small the chances are you will be working fairly long hours. If you enjoy the industry, as many moteliers do, this will not be a problem. If you find you do not enjoy the industry then call us again and we will sell your motel, hopefully for a better price than you originally paid.

c. Price

The price you can afford is dictated by lending conditions. In general, banks will lend up to 65% of a freehold motel's value as assessed by a professional valuer. Therefore you need at least 35% in cash or 35% in a combination of cash and other real estate assets.

For a leasehold motel the maximum loan is currently 50%.

Lending also depends upon serviceability, so if you are unable to repay the loan from the motel's cash flow, the loan will not be forthcoming.

In addition to the price you will have to pay stamp duty, legal fees and a valuation fee. You will also have to cover the costs of relocating, and you need a small float for the day to day running of the motel.

Stamp duty on both leasehold and freehold motels is set out below:

Price	Stamp Duty
$0 - $14,000	1.25%
$14,001 - $30,000	$175 plus 1.5% of (price minus $14,000)
$30,001 - $80,000	$415 plus 1.75% of (price minus $30,000)
$80,001 - $300,000	$1,290 plus 3.5% of (price minus $80,000)
$300,001 - $1,000,000	$8,990 plus 4.5% of (price minus $300,000)
Over $1,000,000	$40,490 plus 5.5% of (price minus $1,000,000)

As discussed, the return on investment for a standard NSW country freehold motel is around 14%. This is just the net profit divided by the price.

Your return on equity can be substantially more. Take a motel costing $2,000,000 with a 14% return ($280,000 net profit).   Stamp duty will be $95,490. If legal costs, valuation etc comes to $12,000 then the total investment is $2,107,490.

If the bank lends 65% of $2,000,000 ($1,300,000) then the purchaser must have equity of $807,490.

If interest is 6.5%, then $84,500 must be paid from the net profit of $280,000, leaving $195,500.

$195,500 on $807,490 represents a return on equity of 24.2%.

The return on equity will depend upon the return on investment, the amount borrowed and the interest rate, but it will always be substantially higher than the return on investment.

d. Freehold or Leasehold?

Most motel purchasers prefer the security of a freehold purchase, but many lessees make profits and capital gains that are as strong as, or stronger than those of freehold moteliers. A leasehold purchase allows you to operate a larger property for a smaller price, but does not allow you to operate that property forever. When your lease expires, so do your rights to the property, and you must renegotiate with your landlord or move out.

Most lessees sell their leases before they expire, often making substantial capital gains. Therefore the longer the lease, the better the deal. It is unwise to pay a substantial premium for a lease that has less than ten years to run.

Leasehold motels often have problems regarding repairs and maintenance. The landlord is reluctant to cut into his rental return by outlaying vast sums on his property, and the lessee is unwilling to invest in what he sees as a benefit for the landlord. It is therefore important to examine the repairs and maintenance provisions of a motel lease, so you can see exactly who is responsible for the various aspects of a motel's upkeep.

A small, run down freehold motel is often a worse proposition than a larger leasehold property, and if your budget is less than $500,000 you should closely examine leasehold properties and not confine your search to freehold motels.

e. The Great Restaurant Debate

Many potential purchasers prefer motels without restaurants. Others see the restaurant as a source of additional profits and a vital ingredient of the motel business.

The majority of small motels run their restaurants at a loss. A 30 room motel with a 50% occupancy rate can draw restaurant guests from 15 rooms. If there are 1.5 guests in each room, and only one third of them decide to eat in the motel restaurant, then the restaurant will cater for only 7.5 guests. 7.5 guests cannot profitably support a chef, waitress, cooking materials, power etc, so unless the restaurant can attract diners from outside the motel, it will run at a loss.

However, this does not mean that a new owner of a small motel should close down his restaurant. There are many other possibilities, eg

- Lease the restaurant.
- Promote weddings and conferences. With set menus and prepayment there is very little waste, while larger numbers produce economies of scale.
- Make the restaurant the best in town. NSW country towns mostly rely on clubs and hotels for restaurant service and many are desperate for alternate venues.

Motels without restaurants are generally easier to run, but fail to attract bus groups and business representatives. Motels with restaurants that are well managed have the potential to generate a second stream of profits.

f. Contact Agents

Agents are happy to provide prospective purchasers with details of motels on the market providing the purchasers can demonstrate that they are serious buyers. Potential purchasers who have owned a motel previously, have inspected a number a motels with a view to purchasing or have discussed finance with a bank are generally regarded as likely prospects. Purchasers who indicate that the idea of buying a motel has only just crossed their minds might find difficulty obtaining listing details from agents.

Purchasers are often asked to sign a confidentiality agreement. If they refuse they are generally regarded as unlikely candidates for a motel purchase.

g. Inspections

It is important to physically inspect as many motels as possible that are in the area that interests you and within your price range. While agents' reports can be very comprehensive, buyers will discover much more about the motel by inspecting the property and talking to the owner. Owners often tell buyers small details that are not included in sales reports, thereby influencing the buyer's decision to purchase or not to purchase.

Many buyers treat vendors with a great deal of suspicion. This is not a good idea. The majority of moteliers are honest, hard working business people who are prepared to provide buyers with all the information they require. However, they are often concerned about their staff discovering that the motel is on the market, and it is up to the buyer conduct inspections with discretion.

When you inspect a motel always think of things you can do to improve it. The property may need repainting, landscaping, minor or major renovations. Remember that the figures the motel produces are the results of an array of circumstances, many of which are under the control of the motelier. If you can improve the circumstances of the property, you can improve the profitability.

Make a note of your first impressions when you inspect a motel. Your opinion of the property is probably similar to that of a potential guest, and you can use these first impressions to improve the property. It is advisable to prepare a list of questions for the vendor. Ask him about the type of guests he accommodates – holiday makers, business representative, retirees, etc. Discuss annual repairs and maintenance and ask whether there are any major repair projects on the horizon. Ask about the motel staff – how long have they been employed; are they reliable? Discuss the daily routine of the vendor. You will be replacing him, so his daily tasks will become your daily tasks.

Some vendors will provide you with a great deal of information about their property, while others can be very secretive. You must ask yourself “what information do I need to make a decision about this property?” If the information is not forthcoming the broker will strongly advise the vendor to be more open about his business. The vendor, however, will only respond positively if he believes the purchaser is genuine.

Every motel you inspect increases your knowledge of the industry and helps you assess and compare properties currently on the market. You will probably inspect at least half a dozen properties before finding one that almost suits your requirements. You are very unlikely to find a motel that suits all of your requirements, but you are very likely to find one that fulfils 80% of your requirements. You must then decide whether your complete requirements are unrealistic in the current marketplace, or whether you can transform one of the motels you have inspected into your ideal property.

There are a number of potential purchasers on our books who have been looking for motels for over five years. Unfortunately, they will never buy a motel because they cannot accept the sad fact that there will always be something wrong with every property they are likely to inspect. While other buyers purchase, improve, resell and realise substantial capital gains these “professional lookers” see opportunity after opportunity slip through their fingers.

The questions you must ask are:

What is wrong with the motel?
Can I fix it?
If I can’t fix it will it affect future business?

Many motels with small problems such as an inconvenient configuration, secondary location, substandard manager’s residence, trade very profitably and change hands for prices that reflect their profits rather than their minor inconveniences.

h. Checking Figures

You and your accountant will require sufficient supporting evidence to prove that the figures presented by the vendor are genuine. It is important to be diplomatic when you request documents that will substantiate the figures. Many vendors feel buyers request too much information, or information which is not relevant to a purchasing decision. Many purchasers request information in a way that leaves the vendor in no doubt that they distrust him. This often results in a breakdown of the sale process.

When requesting documents to substantiate the vendor's figures it is preferable to use the services of an accountant. Accountants can generally request documents diplomatically and, if they have experience with motel accounting, can quickly establish the veracity of the figures.

To substantiate motel revenue, accountants rely on the Profit and Loss statement, the Business Activity Statements, reports from the motel's computerised booking system, bank statements and the quarterly statements sent to the Australian Bureau of Statistics.

Bank Statement Revenue = Motel Sales less adjustments for debtors.
ABS figures show revenue from accommodation only. This should tie in with the motel's booking system.
BAS revenue less GST should equal the Profit and Loss Statement revenue.

However, note that not all moteliers are scrupulously careful when keying data into their computers. A motelier, or his receptionist, may, for example, enter a coach group as a lump sum, rather than divide the revenue between accommodation, food and beverage, park entry fees etc.

Motels tend not to have many debtors, but this does not mean that annual revenue will always equal banking. If a coach group pays a deposit in one year for a booking in the following year, bank deposits in the year the deposit was paid will be higher than sales revenue.

These adjustments are not difficult to trace, but some motel buyers get tied up in knots when they try to decipher trading figures.

Food and beverage purchases are generally around one third of food and beverage sales, although this can vary considerably. If food and beverage purchasers are substantially higher than one third, there is a good chance the motelier is "living out of the business". Some motel accountants indicate this with a "Good Own Use" account. Others overlook it.

Motel expenses can be divided into fixed and variable. Fixed expenses do not depend upon revenue, variable expenses do. Land tax, rates and insurance are examples of fixed expenses. External laundry charges, guest supplies, food and electricity are examples of variable expenses. Monthly variable expenses should follow the pattern of monthly revenue. If they do not there may be an error in the accounts.

Fixed expenses such as council rates and insurance seldom go down. If there is a substantial variation from year to year the motelier may have paid three quarterly bills in one year and five in the next.

It is quite legitimate for a motelier to add back certain expenses. Valuers regard the net profit of a motel as the profit before interest, depreciation, the owner's wage and any one off non repeatable expenses.

Interest is an obvious add back. The vendor's level of borrowing will be quite different to the purchaser's level of borrowing, so it makes sense to consider the net profit before interest.

Adding back depreciation also makes sense. Take two motels, A and B. Both have a net profit before depreciation of $250,000. Motel A has brand new furniture and fittings that are depreciated at $80,000 per annum. Motel B has no depreciation. Its furniture and fittings are on their last legs. It is clearly ridiculous to value Motel A less than Motel B, when A's depreciation helps keep tax down, and the owner of B will soon need to completely refurbish his property.

	Motel A	**Motel B**
Net Before Depreciation	$250,000	$250,000
Depreciation	$80,000	$0
Net After Depreciation	$170,000	$250,000

The owner's wage add back can cause difficulty. One owner might work incredibly hard, thereby keeping down other staff costs. Another owner might work part time only, and therefore run the motel with additional staff.

Most 15 to 40 room country motels are run by a couple, and a valuer will generally adjust the wages so they reflect the staffing requirements of a reasonably hard working husband and wife or partnership.

One off, non-recurring expenses are legitimate add backs. But if they crop up every year then they may not be one off.

Many discrepancies in motel accounts are the result of minor honest errors. If they do not affect the net profit they can, in some cases, be overlooked. Unfortunately, a small number of motel accounts contain major dishonest errors, and if you come across properties in this category it is best to look for alternate propositions, or make an offer that reflects your opinion of the true net profit.

i. Making Offers

While a number of moteliers place a price on their property and refuse to negotiate, the majority expect potential purchasers to make offers. Many buyers make the mistake of not making an offer for a motel that interests them. They feel that the vendor will be insulted by their offer and, rather than take the matter further, they back away from the deal. These buyers are often surprised when they discover a few months later that the property in question sold for the price that they were too timid to offer.

Very few motels sell for prices outside the market price and very few moteliers expect to get offers outside the market price. A motelier with a property worth, say $1,000,000, may start with a price tag of $1,200,000, but will eventually accept an astute purchaser's offer of $1,000,000. If the motelier gets fed up with the time his property has been on the market, he may accept a price below the market level. Only buyers who are not afraid to make offers secure these bargains.

You should decide on your offer price based both on the trading record of the motel, and what you believe the motel can achieve. The latter is very important. The majority of buyers look at past figures only, and do not take into account the potential of the property. The few buyers who take both into consideration make the best decisions and secure the best capital gains on resale. The top five clients of Pacific Rim Business Brokers who secured the highest capital gains when they resold their motels all purchased properties that were running at a loss. Had they only taken into account past trading they would not have achieved their spectacular capital gains.

Do not be timid when submitting offers. If you are dealing through a broker he will submit the offer on your behalf. Brokers are not concerned about submitting low offers – a broker has the hide of a rhinoceros.

7. Valuations

The majority of motel sales depend upon bank finance. Banks in turn depend upon the report of a professional valuer. Therefore, the most sensible way to examine the methods of valuing a motel is to examine the methods used by professional valuers. There is little point in a buyer and seller agreeing upon a price if that price is way above the price in a valuer's report. This leads to the absurd situation where a buyer expends all his energy talking the price down in negotiations with the seller, and then is forced to talk the price up in an effort to convince his bank that the valuer's report is too conservative.

Banks lend a percentage of the price in a valuer's report, not a percentage of the price agreed by the buyer and seller. If, for example, a bank is currently lending 65% on motel purchases, a motel with an agreed price of $1,100,000 and a valuation of $1,000,000 will receive a loan of $650,000.

Valuers try to understand the motel market by looking for examples of other motels that have recently sold. Most valuers conclude that at the moment:

Sydney freehold motels sell for returns on investment between 10% and 12%
Coastal freehold motels sell for returns on investment between 12% and 14%
Rural freehold motels sell for returns on investment between 13% and 15%
Leasehold motels sell for returns on investment between 28% and 33%

At Pacific Rim Business Brokers we keep an updated list of past sales, so our clients know how valuers are likely to view their potential purchases.

The best way to understand a professional valuer's valuation is to read a valuation report.

The reports are usually divided into the following major sections.

1. Summary
2. Title Details
3. Statutory and Council Details
4. Site Identification
5. Improvements
6. Qualifications
7. Comparative Market Data
8. Trading Analysis
9. Valuation Methods
10. Replacement and Insurance Value
11. Valuation

1. Summary

In the summary the valuer sets out his instructions – who asked him to value the property – the date of inspection and the date of valuation and whether the property represents suitable security for lending purposes.

2. Title Details

Title details include the Lot Number, Deposited Plan Number and Folio Identifier. If there are any encumbrances, encroachments, restrictions or covenants these are noted as they may adversely affect the rights of the owner and hence the value.

3. Statutory and Council Details

Statutory and Council details include the zoning and highest and best use description. Highest and best use is defined as the most profitable legal use to which the land may be put. In most cases a motel operation represents the highest and best use, but there are cases where conversion to strata units or even demolition and redevelopment may be more profitable.

4. Site Identification

The site identification includes the physical description of the motel's boundaries, the distance from the motel to major centres and developments in the surrounding area. Services and amenities, such as water, sewerage, telephone and electricity are identified. The road system, access and exposure are also noted.

5. Improvements

Improvements include a physical description of the motel including details of the construction, furnishing, accommodation type, restaurant, manager's residence and office. If any major structural defects are apparent these are noted, although most valuations include a disclaimer stating that the valuer is not a structural engineer and therefore not an expert in this area.

6. Qualifications

In this section the valuer tells the client what he has not done. For example, he may not have sighted a certificate of compliance, an environmental report or unregistered leasing agreements. While the valuer may have been told that all plant and equipment is unencumbered and in good working order he will point out that he has not tested all equipment or sighted any license, hire purchase or lease agreements. The valuer is basically relying upon the statements of the owner or manager.

7. Comparative Market Data

Comparative market data includes information from external sources – usually the Australian Bureau of Statistics, the NRMA Accommodation Guide and the local tourist authority - regarding the number of motels in the area, visitor arrivals, length of stay, occupancy rates etc. This information is compared with data from the motel.

8. Trading Analysis

The valuer analyses the trading figures of the motel and notes the amounts that should be added back to the net profit. Add backs usually include interest, depreciation, management wages (depending on the size and nature of the operation) repairs, maintenance and replacements that are of a capital nature, or are non-repeatable expenses, and abnormal losses or profits (eg sale of assets).

9. Valuation Methods

In this section, the meat of the valuation, the valuer uses a number of methods to arrive at a value for the subject property. The standard methods employed are:

a. Traditional Capitalisation Approach
b. Direct Comparison Approach
c. Hypothetical Lessor's Interest and Lessee's Interest

a. Traditional Capitalisation Approach

By examining comparable sales of similar motels, the valuer sets out a range of yields, or returns on investment. The yield is the average annual net profit before interest, depreciation and owner's wage divided by the sale price. Yields tend to vary with size and location. Large Sydney motels will sell on lower yields than small country motels. Similarly, coastal motels sell on lower yields (ie they are more expensive) than inland motels. Therefore, it is important for the valuer to note sales of motels of a similar size in a similar area at a date as close to the valuation date as possible. If he feels that the average yield for a motel of the type under examination is 14%, then if the motel is netting $400,000 he will value it at $2,857,000.

While the traditional capitalisation method is probably the best way to value a motel, it does have a number of drawbacks, namely:

a. There may be no comparative sales data.
b. Comparative sales data may be misleading. The registered sale price of a motel may not be its true price. There may be a secondary contract for the sale of the goodwill, plant and equipment which is not a public document.
c. The owner's wage may have to be adjusted. Motel A may be run by a husband and wife team working 100 hours a week, while Motel B is run by a single owner working few hours with high staff wages. If the valuer is not aware of these operational considerations, he may not correctly compare the two yields.
d. The net profit may be high or low in one year for reasons not usually associated with normal motel trading results. (Floods, bushfires etc).
e. The motel operation may be improving or declining, in which case the valuer should focus on the last year's trading results and likely future profits, not the average of the last few years.
f. The motel may be under performing due to poor management. If reasonable management can quickly turn around its performance the valuer will take this into account. Naturally there is a bit of guesswork in this area.

b. Direct Comparison Method

This method examines recent sales of other motels on a price per room basis. As the price per room varies between $20,000 and $200,000 it is important that the valuer compares properties of a similar age, physical condition, location and profit stream.

If Motel A has 20 rooms and sells for $1,000,000 ($50,000 per room) it cannot be compared to Motel B with 20 rooms and twice the net profit.

c. Hypothetical Lessor's and Lessee's Interest

This valuation method divides the motel into a landlord's passive investment and a lessee's active investment. If the commercial return a landlord in the motel market expects is 9%, and the return a lessee expects is 30%, then with a little mathematical juggling the valuer can produce a price that will satisfy both a lessor and lessee.

The first thing a valuer must know is the industry rental standard, and here he will encounter difficulties. There are various rules of thumb for defining rental standards and none of them are very satisfactory. Rules that define rent as a percentage of revenue are misleading because they do not take into account the effect of a restaurant. If Motel A has no restaurant and revenue of $400,000 it will be more profitable than Motel B with a restaurant and revenue of $400,000. This is because the cost of food and restaurant staff will reduce the profit of Motel B.

An industry standard which is reasonably widely accepted states that rent should be no more than 45% of profit. Once again, all the problems relating to profit are encountered (owner's hours of work, increasing or declining profits, underperformance due to poor management etc). If, however, the valuer overcomes these difficulties and sets the net profit at $400,000, then rent should be no more than $180,000.

For a 9% return the landlord would be prepared to pay $2,000,000. The tenant, who will enjoy a net profit after rent of $220,000, would be prepared to pay $733,333 for a 30% return. The total value of the motel would therefore be $2,733,333.

With a net profit of $400,000 to an owner operator, this price produces a 14.6% yield using the capitalisation method in section a.

10. Replacement and Insurance Value

In the current market, the cost of building a motel greatly exceeds the cost of purchasing an existing operation. Therefore replacement value generally does not resemble market value.

Insurance value depends upon the type of policy. As replacement value exceeds market value and an insurance policy aims at replacing lost property, insurance value should also exceed market value.

11. Valuation

In the final section, the valuer brings all the strands together and sets out what he considers to be the current market value.

8. SWOT Analysis

If you approach the motel you wish to purchase using the methodology of a professional valuer you will save a lot of time and effort and should be able to secure bank finance. Remember that the capitalisation method, direct comparison method and hypothetical lessor and lessee's interest provide guidelines only. You must also take into account all aspects of the property that will increase or decrease the price. A number of valuers neatly summarise these aspects using a SWOT analysis (Strengths, weaknesses, opportunities and threats).

Factors That Add Value to the Motel (Strengths, Opportunities)

Good state of repair, or recent renovations
Good location
Strong base of repeat business
Unlikely to see other motels built in town in foreseeable future
Can be quickly improved with better management
Can be quickly improved with better marketing
Profits have been increasing

Factors That Detract From the Value of the Motel (Weaknesses, Threats)

Poor state of repair. Money must be spent to bring the property up to scratch.
Profits declining.
Other motels will be built in town.
Difficult to maintain star rating.
Restaurant is unprofitable.
Poor manager's accommodation.
Little repeat business.
Over reliance on discounting.
Encumbrances, encroachments or other restrictions on title.

Neutral Factors

The performance of the motel relative to other motels may be important from an operational point of view, but it should not affect the value. If, for example, the average occupancy rate in the town is 55%, and the motel is only achieving 45% this may mean that a good operator has scope to improve the business, or it may mean that 45% is all the motel is likely to achieve. Either way, the net profit is the more important indicator.

While occupancy rates are widely used in the motel industry they are misleading indicators of profit. Take two similar 20 room motels – Motel A and Motel B. Motel A has an occupancy rate of 70%, achieved by discounting its average room rate to $50. Motel B has an occupancy rate of only 35%, but enjoys average room rates of $100. The revenue of both the motels is therefore the same.

Motel A – 20 rooms x 70% x $50 x 365 days = $255,500
Motel B – 20 rooms x 35% x $100 x 365 days = $255,500

Motel A, however, has to clean and service twice the number of rooms cleaned and serviced by Motel B. Therefore Motel A's costs are higher and profits lower, although its occupancy rate is twice that of Motel B.

9. The Contract

As a buyer you might think that when you have agreed on the price of the motel, negotiations are over. Sadly, this is not always the case.

The standard Contract for the Sale of Business – 2004 edition, contains a host of additional clauses which must be agreed between the parties. If you are unaware of these clauses you might find that you, or your solicitor, have to enter into a series of minor negotiations that can be time consuming, expensive and at worst lead to a breakdown of the sale.

It is therefore important that you purchase and read the 10 page standard business sale contract. It is easily obtainable from most good stationers.

Generally, the vendor's solicitor will prepare the contract and forward it to your solicitor. Nine times out of ten, all the additional clauses will be in line with business conventions in the industry, so it is important to know what these conventions are.

The Deposit

This is generally 10%. You can ask for a smaller deposit and the vendor might agree under certain circumstances. The general rule is the deposit must be substantial enough to cause a lot of pain to a purchaser who does not proceed to completion and forfeits the deposit to the vendor.

If you ask the vendor if he will allow a smaller deposit the vendor may be concerned that you do not have sufficient funds in place to complete the purchase and may ask for proof of funds.

The Deposit Holder

This is generally the agent, and sometimes the vendor's solicitor. Bear in mind if an agent holds your deposit before you exchange contracts, and you decide not to exchange, the agent is obliged to return your deposit to you.

Investing the Deposit

If the deposit is a substantial sum, the deposit holder will generally be instructed to invest the deposit in an interest bearing bank account, then split the interest 50/50 between the purchaser and vendor on settlement. In the current low interest rate environment, many solicitors do not bother to tick the invest deposit box, thereby obliging the agent to hold the deposit in his non-interest bearing trust account. Remember, 50% of the interest belongs to you, so unless the sum is inconsequential (and that means different things to different people) make sure the invest deposit box is ticked.

Restraint of Trade

Generally the contract prohibits the vendor from purchasing or establishing another motel or similar business within a certain distance from the motel you have purchased and for a certain period of time. There are no generally accepted conventions for restraint of trade in the motel industry, but 50 kilometres and 3 years is reasonably fair.

You certainly don't want the vendor buying another motel in the same town, then contacting all his old guests and inviting them to his new property. However, if the vendor did that after 3 years you should be sufficiently established in your own business not to let this worry you.

It is a sad fact that while some moteliers think guests come to their property because of the motelier's sparkling personality, in general people stay at motels for reasons of convenience, comfort and price. The person who hands them the key to their room, or wishes them a happy trip in the morning, generally doesn't affect the potential guest's decision.

Training Period

The 2004 Business Sale contract suggests a training period 7 days before completion and 7 days after completion.

Running a motel is not terribly complicated, and after a few days most sensible and organised people can claim to be competent moteliers. Learning the booking system, the housekeeping routines, restaurant operation etc is not hard and most people pick it up after a few days. Becoming a great motelier will take a bit more time.

Vendors are generally less happy with pre-completion training than with post-completion training. While the contract obliges the purchaser to complete on a certain date, if the purchaser is overwhelmed by the training process and has second thoughts about the prospect of running a motel, the pre-completion training period might become a bit tense. Also, if the purchaser is interfering with the smooth running of the motel by upsetting the staff, not dealing well with regular guests, or "throwing a wobbly" the vendor will naturally be annoyed.

Post completion training, when the vendor has the money in the bank and a holiday to look forward to, generally finds vendors in more amenable moods. If the purchaser makes silly mistakes, it's his or her business that suffers, not the vendor's business.

Therefore don't be surprised if the vendor wants all training to be post completion. You might agree to this, but ask for 14 days rather than seven. In fact, most purchasers are keen to say goodbye to the vendor as soon as they have acquired the basic motel running skills. As an independent business person you probably don't want to watch your predecessor shake his head as you try new things or adjust schedules to suit your style of operation.

Trading Stock

Generally the vendor estimates the value of the trading stock – food, drink, cleaning materials etc. If, when the stock is counted on settlement the value is above the vendor's estimate, then the purchaser can demand the vendor reduce the stock to the estimated value. This means that if the vendor has not carefully estimated the value of his stock he may end up with unwonted cans of baked beans, or enough alcohol for a number a parties.

Usually the vendor's estimate is pretty close to the value of the stock, and we generally recommend over-estimating rather than under-estimating to avoid the inconvenience of carrying away excess stock.

Apportionment of Price

The price of a freehold motel is generally divided into Land and Buildings, Furniture and Fittings, Goodwill plus stock at valuation. Land and buildings, furniture and fittings and goodwill form the total of the negotiated price.

The value of the furniture and fittings will generally be the value in the motel's latest depreciation schedule adjusted for the period from 30 June to the date of completion. If the value is higher the vendor will have to pay tax on the difference. If the value is lower your depreciation allowance will be reduced and hence you will be liable for more tax.

Goodwill is an intangible asset. There are many complicated definitions that cover this interesting aspect of the business, but from an accounting and taxation purpose it is just "the sum left over after land, buildings, furniture and fittings have been deducted from the total price."

If, at a later stage, you decide to sell off a lease of your motel, and there was no goodwill noted in the contract when you purchased the property, then the Tax Office may regard the sales as a piece of goodwill that you have created, and tax the amount of that sale as normal income.

Having goodwill apportioned in your purchasing contract may avoid this problem further down the track. Naturally this is something you will need to discuss with your accountant.

Many freehold motels are sold with two interdependent contracts – a Contract for the Sale of Land which covers Land and Buildings, and a Contract for the Sale of Business, which covers goodwill, furniture and fittings. You may be advised to buy the land and buildings in your own name, and the business in a company name.

There are many taxation and superannuation advantages and disadvantages to various methods of purchase and a good accountant will help you navigate this area.

Certificates and Inspections

The vendor must allow the purchaser to have the premises inspected to obtain any certificate or report reasonably required. Generally a purchaser will obtain approval for finance before entering into a contract, and so a valuer will inspect the motel prior to exchange.

However, if completion of the purchase is subject to the purchaser obtaining finance (see below) then various parties such as the valuer, building inspector, pest inspector and bank manager may require access to the motel.

The standard contract also states that the purchaser will have access to any accounting records relating to the business inspected. Once again, you generally inspect accounting records before exchanging contracts, but there may be good reasons for requesting and receiving a contract with completion subject to validation of the accounts. If you are in competition with another party to purchase the motel, and the vendor says he will sell to the first party that exchanges contracts you may agree to this providing the contract is subject to substantiation of the trading figures.

GST

When a motel is sold as a going concern there is no GST payable. However, the standard clause states that if the Tax Office decides GST is payable then the vendor will present the purchaser with the Tax Office's demand and the purchaser will promptly pay the 10% GST. Note that this is extremely rare. The vendor, purchaser and their accountants are usually very clear on whether or not the motel is sold as a going concern.

Furthermore, if the purchaser was forced to pay GST he could generally claim it back on his next BAS return.

Adjustments

Generally all money owing to the vendor and all money owed by the vendor up until completion is the vendor's to collect and pay. The purchaser should start on day one with no debtors and no creditors (apart from the bank).

As the purchaser receives payments from guests who stayed at the motel when it owned by the vendor he must pass these payments on to the vendor. As most companies use credit cards this isn't often a big issue.

It is generally accepted in the industry that the vendor hands the motel over to the purchaser with all rooms cleaned. The vendor is entitled to the revenue from guests who stayed at the motel the night before settlement. If an employee cleans these guest rooms after settlement has taken place, it is the vendor who should pay this employee.

Generally the vendor pays all housekeepers and the breakfast cook for work undertaken on the day of settlement. The purchaser pays all restaurant staff for work undertaken on the day of settlement.

Adjustments must also be made for guests who are staying at the motel both before and after settlement. Usually the vendor, working with the agent, prepares a list of these adjustments and the parties arrange payment without reference to the solicitors or the settlement. Adjustments relating to water and council rates are prepared by the vendor's solicitor and form part of the settlement.

Employees

The important thing to remember about employees is that the law in NSW does not allow the transfer of a business to affect employee entitlements. Therefore if the vendor sacks all employees on settlement day and you re-employ them, and the vendor refuses to pay holiday or long service leave entitlements that were accrued when he owned the motel you will be responsible for their payment. Naturally, you can sue the vendor for this amount, but only if you can find him and if the legal costs warrant this action. Bear in mind the court may well take the view that the contract price was agreed between the parties knowing the liability for employee entitlements would be passing from the vendor to the purchaser.

The standard contract states that the purchaser will offer employment to each employee in the business he wishes to employ prior to completion. This means you will need to interview all staff and decide who you want. The terms and conditions of employment that you offer must be no less favourable than those offered by the vendor.

The vendor must then, on settlement, pay to the purchaser the monetary value of any entitlements accrued by the employees who stay with the business. (The ones who are not offered employment by the purchaser must be paid out by the vendor).

Long service leave entitlements are calculated according to a table in the Contract for Sale of a Business. The table works on probability theory as follows:

It is unlikely that an employee who has worked less than 5 years in the motel will remain with the motel for another 5 years and be entitle to long service leave. The probability value is set a zero, so no money changes hands. Of course, if that employee did stay for another 5 years you would have to honour long service leave accumulated over 10 years.

At the other end of the scale, an employee who has been with the motel for 9 years is very likely to be eligible for long service leave in one year's time. Therefore the vendor must pay you, on settlement the value of that employee's long service leave multiplied by 60%. If the employee does not stay for the remaining year then you have made a windfall profit (although you may also have lost a valuable staff member).

The long service leave calculator is about as fair a method of calculating employee payment adjustments as possible, but there will always be winners and losers on the margin.

The important thing is to make sure employees know that their entitlements are safe and have been adjusted between the purchaser and vendor. Otherwise you might be presiding over a suspicious and mutinous workforce.

Subject to Finance

If you do not have finance in place you may ask for the contract to be subject to finance. Many solicitors do not like this. Ignoring business realities, they suggest that buyers get their finance approved first, then exchange contracts.

However, virtually all banks require a valuation before lending for a motel purchase. If the nominated valuer is any good, he will have a lot on his plate and may not be able to value the property for a couple of weeks. This means the buyer has to hope that no one else buys the property during this time, and that the money he pays the valuer is wasted.

We generally advise vendors to exchange “subject to finance” contracts providing there period before the contract becomes unconditional is not too long, and the terms of the loan that are acceptable to the purchaser are in line with current lending practices. The “subject to finance” clause should include the loan amount required, the maximum acceptable interest rate and the maximum acceptable fees and charges. It should also state that the contract becomes unconditional after a certain date unless the purchaser informs the vendor in writing that he was unable to secure finance with acceptable terms and conditions as set out in this clause.

We can, as agents, continue to offer the motel for sale to other parties providing the vendor does not enter into a contract with any of these parties before the day the contract becomes unconditional, and providing we tell the other potential purchasers that there is a conditional contract currently in place and signed.

In our experience over the past 20 years, 98% of deals with contracts “subject to finance” have settled. The purchaser is comfortable paying valuation and bank fees, knowing that the motel will not be sold to a third party. And the vendor is comfortable, knowing that he has a buyer in place who is finalising a loan that is in line with current lending practices.

10. Case Studies

The following case studies are based on actual negotiations involving Pacific Rim Business Brokers. The names and numbers have been altered slightly to protect the innocent (and guilty).

Case Study 1

Mr and Mrs Johnson owned a well presented freehold motel in the Central West of New South Wales. The motel occupancy was around 28%. The average occupancy rate for the town was 52%.

The vendors listed the motel for $1.2 million. The net profit was $120,000, a return on investment of 10%. At the time the prevailing rate of return was around 14%, so the motel appeared to be about $350,000 overpriced.

I sent brief details of the motel to my database of buyers, and 54 requested complete details. When they received details of the motel, 53 of the 54 potential purchasers suggested the motel was overpriced and they would only be interested if the price was dropped to around $850,000 (a 14.1% return).

I suggested they look closer at the business. There had to be a reason why a well presented 3½ star motel was trading 34 percentage points below the town average. In fact, there were at least five reasons.

The vendors were elderly and very tired. They did not have the energy to promote their business and were just "ticking along".

The motel vendors took a lot of breaks. For 20 weeks a year the motel was run by a relief manager. The owners didn't ask much of the manager, and there was anecdotal evidence that he displayed the no vacancy sign around 6pm.

There was no debt on the motel. The vendors made a comfortable living, but didn't have the motivating threat of a bank on their backs.

The motel did not have a website. There were a few mentions of the property in the local tourism site, but that was about it.

The motel was not linked to any internet booking sites. Potential guests who searched for a place to stay on Wotif, Quick Beds or Need it Now would not have found this property.

One of the 54 buyers agreed with my assessment. Mr and Mrs Fergusson felt they could turn the motel into a thriving business that in no time would be worth more than the asking price. However, because they were the only potential purchasers with enough confidence to turn the business around, they were also the only parties who physically inspected the motel.

The Fergusson's made an offer of $1 million. That was a 12% return on investment, and still much more than prevailing market rates of return. As they were the only buyers the vendors felt they had to accept the offer.

Between exchange and settlement Mr and Mrs Fergusson organised a cutting edge website complete with booking engine, and signed up to all the internet motel booking companies.

Within 6 months of settlement their motel slightly surpassed the town average occupancy rate and within a year it was running at 56%.

By increasing the occupancy rate from 28% to 56% they increased profits by 100% to $240,000. They now had a business with a 24% return on investment.

The Fergusson's continued to improve the motel and sold it a year later for $2,100,000 on a profit of $294,000 (14%).

They made a capital gain before stamp duty and legal fees of 110% because they analysed the reason for the motel's poor performance and set about correcting it.

No doubt some of the other buyers who rejected the motel as overpriced went on to buy a motel at the prevailing market price with a strong track record of steady profits based on average occupancy rates. But is doubtful whether any of them made a 110% capital gain in 24 months.

Case Study 2

The vendors of a coastal motel called to say they wanted to sell their freehold property for $2 million. It was netting $360,000, so with an 18% return this was a definite bargain.

It was the start of the GFC, and the vendors were aware that buyers were scarce.

They emailed their trading figures, and I could see that the motel was offering an 18% return, but only if all the add backs were accepted.

Their add backs included interest, depreciation and their own wages – add backs generally accepted in the industry. But they also included about 15 other items such as breakfast cook, 25% of the repairs and maintenance, non performing advertising, accountancy fees (which they felt were too high) and various other expenses.

If all 15 items were not accepted the net profit would have dropped by $20,000 to $340,000 - still a very acceptable 17% return on investment.

I found one interested buyer (buyers were indeed scarce at this time) and he immediately questioned each of the add backs. The vendor had a good explanations, but many of them could be categorised as "in the grey area".

Then began a long email correspondence between Mr Robertson, the potential purchaser, and the vendors. Generally all correspondence goes through the agent, but

Mr Robertson seemed determined to tell the vendors directly that their add backs and grasp of accountancy were at best dubious.

I was copied into the emails, and saw that whatever relationship there was between the buyer and seller, it was on very shaky ground. Mr Robertson didn’t go as far as telling the vendors they were presenting false figures, but he went very close.

A couple of times I suggested that even if the full $20,000 of add backs were disallowed the motel was still selling for a return on investment of 17%, well above the market rate of 14%. Mr Robertson disagreed.

He and his accountant thoroughly checked the motel figures and agreed they were correct, but refused to accept $20,000 of add backs. He submitted an offer of $1,888,888, exactly an 18% return on the net profit of $340,000 (which excluded the $20,000 of add backs).

The vendors said they would consider the offer, but made it plain they were not happy with Mr Robertson and his 15 emails.

While they were considering the offer a second buyer inspected the motel. Mr Gilbertson was just back from overseas, received details of the motel from me and arranged an inspection three days later.

The inspection went well, and Mr Gilbertson submitted an offer of $1.8 million. I told him there was a higher offer on the table, but I would (as obliged by legislation) submit the offer. I asked him if he was concerned about the add backs. He said he disagreed with most of them, but at that price he didn’t care. He wasn’t going to raise the matter with the vendors.

As you can probably guess Mr Gilbertson’s $1.8 million offer was accepted and he proceeded to exchange and settle contracts.

So why didn’t the vendors accept the higher offer of $1.88 million.

Conventional economics suggests that rational business people always try to maximize their profits. Behavioural economics, which is much more interesting, suggests that there are many more processes at work.

The vendors were angered by the tone of Mr Robertson’s emails. They felt they were offering their property at a bargain price and that both parties should agree to disagree about the $20,000 of add backs. They also felt Mt Robertson was more interested in giving them a lesson in accounting than buying a motel.

Basically, they were sick of Mr Robertson, and when Mr Gilbertson appeared on the scene they had the opportunity to show Mr Robertson what they thought of him.

The winner, of course, was Mr Gilbertson. He purchased the motel for a return on investment of either an 18.89% or 20%, depending on whether or not the add backs were accepted.

Three years later he sold it for $2.85 million, a 14% return on the net profit of $400,000 (with no add backs).

Case Study 3

A young couple was interested in purchasing a motel and had discussed the matter with their bank. The bank told them they could be financed if they purchased a motel up to $800,000. Naturally, finance was dependent upon a valuation and compliance with all the bank's lending policies.

They found a motel that suited them and asked the vendor if they could enter into a contract with settlement conditional upon the obtaining of bank finance. The bank had briefed a valuer who was ready to inspect the motel within five days, and they were told the loan should be ready in 21 days.

The standard contract has a 42 day settlement period, so they felt they had plenty of time for formal approval of the loan.

The vendors' solicitor prepared a contract with settlement conditional upon the obtaining of bank finance and sent it to the purchasers' solicitor. Then things started to go astray.

The purchasers' solicitor strongly advised his clients not to sign. He said a contract conditional upon finance was not worth the paper it was written on. He advised his clients to secure their finance first, then sign contracts.

Being young and naïve, the purchasers thought solicitors were always right. They told the vendors they would exchange after obtaining a formal offer of finance, then paid the valuer $4,500 to value the motel.

The vendors were a bit put out. They felt they were the ones taking the risk by entering into a subject to finance contract. They felt they were giving the young buyers a chance and were risking losing an alternate buyer during the "subject to finance" period.

The contract their solicitor had prepared was watertight. There was no way the purchasers would lose their deposit if they did not obtain finance. They really had nothing to lose.

The purchasers told the vendors they had to accept their solicitor's advice. "That is what we pay him for."

Three weeks later they rang the vendors to tell them that they now had formal approval from the bank for their finance. The vendors congratulated them, but told them they had exchanged contracts with another party.

The vendors might be considered a bit heartless, but to their minds they had a hand shake deal and had agreed to take a small risk to help the young couple. They didn't sell the motel for any more money, but they did sell it to a business person who made his own decisions.

Case Study 4

A very keen motel buyer was seeking a freehold property priced to $1,000,000 offering at least a 14% return on investment. We sent details of a motel priced at $1.2M offering an 11.5% return on investment ($140,000 net).

The buyer liked everything about the motel except the price and the return. We encouraged him to make an offer but the buyer said, "I don't want to insult the vendor."

A month later another buyer offered the vendor $950,000 and the vendor, realising that at $1.2M his motel would never sell, accepted.

After contracts were exchanged and settled the original buyer called and asked what happened to the motel. We told him it had sold for $950,000 – the sale was on the public record.

The buyer was quite upset. "I would have offered one million," he said.

If he had both he and the vendor would have been very happy. The fact that he didn't want to offend the vendor meant that he had missed out on a motel he really liked, and the vendor had missed out on an extra $50,000.

The moral of the story? Always make offers.

11. Improving a Motel

External Presentation

When a potential guest drives into a town he usually has a fair idea of the type of motel in which he wishes to stay. He may be on a tight budget, and will only look at one or two star properties. He may be in the middle range and will look at three star properties, or he may be willing to pay more to stay in a four or 4½ star motel. If there are three or four properties in his tariff range he will probably drive past all of them before making up his mind. So the first rule for improving a motel is improve the external presentation. A well painted three star motel with lush gardens and a tariff of $100 will always attract more guests than a poorly presented three star motel with an $80 tariff. Potential guests will not always choose the cheapest accommodation. They often feel that if the motel is charging more, it is offering more.

Reception Area

Once the guest enters the motel he will begin to think about whether or not the external presentation matches the internal presentation. Therefore it is important to have a well presented reception area. If the reception area is dingy, untidy, and filled with unhappy motel staff the potential guest will assume his room will be a reflection of the reception area.

Guest Room

Once the guest reaches his room he is fairly unlikely to turn back, and the motelier has secured the guest for the night. However, if the guest's room does not live up to expectations the motelier will never see that guest again. In most businesses the best customer is the repeat customer. It is the same in the motel industry. A one off guest might be worth $100, but a repeat guest might be worth 2, 3, 5 or 10 times that amount over a year.

To keep a guest it is therefore essential to have guest rooms that offer a superior presentation, a better quality of furnishings etc. Small things such as noisy refrigerators, air conditioners that are hard to operate, faulty televisions, dripping taps etc will annoy guests. If a guest does not tell the motelier about these problems they may never be fixed. Therefore it is a good idea to have a guest feedback sheet in each room. A guest who cannot be bothered telling a motelier to his face that his property is a disgrace may be willing to note defects on an anonymous form.

You should consider ways to improve the motel on your first inspection. If a motel with overgrown gardens, peeling paint, a dull reception area and dingy rooms is running at 40% occupancy think about the occupancy rate you could achieve with a little money invested in repairs and maintenance and a little time devoted to improvements. When you inspect a motel for sale you should note your first impressions, list defects, calculate the cost of making improvements and the anticipated profit benefits.

Website

Most motel guests use the Internet to find accommodation. Therefore, a well presented website is as important as a well presented motel. Your website should have photographs taken by a professional photographer, an easy to use booking engine, and will be more successful if it publishes the motel's tariffs.

A motel that does not have a website and is not linked to the main booking engines such as www.wotif.com.au and www.quickbeds.com.au is missing out on a substantial quantity of business.

Weddings and Conferences

If you have a conference centre in the motel then promoting weddings and conferences will improve your bottom line. Catering for these functions is relatively easy because you have set menus, a prepaid number of guests and therefore no wastage.

Coach Companies

Many moteliers have improved their businesses by contacting coach companies and offering dinner, bed and breakfast at group rates. Coach groups also have the advantages of set menus, prepaid guests and repeat business.

Accounting

Motels and other businesses benefit from good record keeping. If you record your occupancy rates, average tariffs, revenue from each section of your businesses and all costs then you will always know how your motel is performing and whether it is necessary to make any changes. You will also find it much easier when, in the future, you decide to sell your motel.

List of Potential Improvements

Many new moteliers tend to get overwhelmed by the day to day running of their business and forget the need to improve the performance of their motel. So the last piece of advice on how to improve a motel is don't forget to improve the motel. Keep a list of improvements close to hand, add to them and implement them.

Upgrade the Motel

We have seen how higher star ratings produce higher occupancy rates and higher tariffs. Let us now look at the calculations a motelier might make when deciding whether or not to upgrade.

Suppose the motelier is running a 3 star property that has occupancy rates and tariffs that are the NSW country average – 49.2% and $113.74. The motelier assesses the demand for quality accommodation in town, the competition and feedback from his guests, and decides to spend $15,000 per room that will result in an upgrade from 3 to 4 stars.

If the upgrade yields country average results, each 4 star rooms should produce an occupancy rate of 61.1% and a tariff of $160.93.

Assuming the motelier owns a 25 room property, the results of his upgrade should be as follows.

Before Upgrade	
Rooms Available	25
Occupancy Rate	49.2%
Rooms Occupied	4,490
Average Tariff	$113.74
Accommodation Revenue	$510,636
Cost of Room Service per Room	$25.00
Total Cost of Service	$112,238
Gross Profit	$398,398
After Upgrade	
Rooms Available	25
Occupancy Rate	61.1%
Rooms Occupied	5,575
Average Tariff	$160.93
Accommodation Revenue	$897,245
Cost of Room Service per Room	$25.00
Total Cost of Service	$139,384
Gross Profit	$757,861
Gross Profit Increase	$359,462
Gross Profit Increase %	90.2%
Cost of Upgrade per Room	$15,000
Total Cost of Upgrade	$375,000
Return on Investment	95.9%

His return on a cash investment of $15,000 per room is 95.9%. There are very few other businesses that can produce similar figures.

12. Conclusion

The NSW motel industry offers exciting opportunities for new buyers. If you decide to join this growth industry you should take the following steps.

1. Decide on the type of motel you wish to purchase, your preferred area and price range.
2. Contact Pacific Rim Business Brokers. We will provide you with complete details of all properties on the market that fulfil your criteria.
3. If we do not have a motel for sale that suits your requirements, we will contact all motel owners in your preferred area that fulfil your criteria to see if they would be willing to sell.
4. INSPECT ALL PROPERTIES on the market that come close to meeting your requirements. Remember, you will never find a motel that is 100% acceptable, but you will find a motel that is 80% acceptable and can be converted to 100% acceptability.
5. When inspecting properties always ask yourself “what can I do to improve this motel?”
6. Base your price on the current trading figures, but also take account of future potential.
7. MAKE OFFERS! If you make an offer based on a realistic perception of the market price you are very likely to be successful. If you never make an offer you will never buy a motel.
8. Keep in touch with Pacific Rim Business Brokers. Our satisfied clients are enjoying excellent profit growth and capital gains in the motel industry. We want you to join them.