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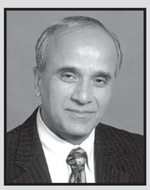
Key factors to consider when acquiring a hotel/motel/country inn

j.d.t J.D. Thakral

T&T Commercial Capital, LLC.



My son often writes articles in this publication and always begins with a sports analogy. Unfortunately, "sports" is not my true love and my son often pokes fun at me for confusing Michael Jackson with Michael Jordan. After seeing a recent picture of Michael Jackson, I understand why my son is so amused. My true love is real estate and I have had many positive experiences as a real estate owner and property manager throughout my career. It was my experience as a motel owner/operator in the Hamptons, New York, that I found to be most rewarding and challenging and if you are in the market for this type of business, there are key factors that you should consider.

First of all, it is important to differentiate between a large hotel acquisition (Marriott, Hyatt, etc.) and a small to medium size motel/hotel/country inn (Quality Inn, Sleep Inn, Holiday Inn, private owner, etc.) or even a resort based hospitality property. This article relates only to small and medium size properties because different factors and standards apply to this type of acquisition as compared to large hotel properties.

Identification of the property

This sounds like a simple task, but in actuality is the most important of all the factors. It is critical to identify the right property that would make not only good business sense to you, but also be in close proximity to your residence. Keeping a close control of your small property is imperative.

Financial strength of the buyer acquiring the property

Before actually buying a property, take into consideration the required down payment (usually between 20% – 30%). There are low down payment (10%) programs offered by governmental agencies such as the Small Business Administration (SBA) so make sure that you fully explore this avenue because it can be financially beneficial. Also, make sure that your credit score is adequate and that your personal debt obligations are consistent with your current income level.

Economics and commerce of the general area in which the property is located

Try to get an understanding of the local economics of the town where the property is located:

- Are there any special yearly events that attract tourists and/or business people on a consistent basis?
- Is there a possibility of other properties being built in the vicinity? Try to verify what other properties in the area are achieving occupancy wise and if there is a glut or shortage of rooms.
- Who is your direct competition and is the property getting its fair market share?
- The property should be located in an area that is easily accessible not only by car, but also by public transportation and reasonably close to a major airport.
- Is the local chamber of commerce effective and are they involved with the local businesses in an active way?
- Verify that the local and state agencies that promote tourism are doing so in an active manner in conjunction with the local chamber of commerce.

Financial analysis

Obviously the business has to generate enough cash flow to meet annual principal and interest (PI) payments on the debt obligation associated with acquisition. Most Lenders look for a Debt-Service Coverage Ratio of 1.15 or above in the hotel/motel industry assuming that your personal debt obligations are consistent with your current income level. Make sure to have your CPA perform a thorough due diligence on the financial information of the hotel/motel. The due diligence should include a three to five year average daily rate (ADR) and occupancy analysis. ADR and occupancy trends should be moving in an upward direction or the seller must provide a reasonable explanation. A similar analysis should be performed of the other hotels in the area that would be considered direct competition. If the property is located in a resort area that has definitive season changes, consideration should be given as to how low the occupancy and rates go during the "off season" and whether the property can sufficiently cover the debt service through slower months with the earnings from the "on season" months.

Membership and flag considerations

Properties that fall under a franchise flag (Quality Inn, Best Western, Holiday Inn, etc.) have been very successful. However, franchise fees can be significant and it should be determined whether the continuation in usage of the brand name is important to continue the growth of the business. Thoroughly review the franchise agreement (if applicable) to determine benefit factors and requirements. Many flag companies require the property to follow a strict Property or Product Improvement Plan (PIP) which would include upgrades and/or renovations on a yearly basis to meet the flag's standards of quality. The PIP could have a significant effect on the buyer's total project cost. The buyer can limit their financial exposure to the upcoming PIP costs as part of the purchase and sale agreement.

I hope your venture into the hotel/motel industry is as rewarding as mine, but make sure that you have taken into consideration many of the key factors in the article.

J.D Thakral, MBA is president and chief executive officer of T&T Commercial Capital, LLC. Assistance provided by Ron Bhandari, business development officer of T&T Commercial Capital, LLC, Queens Village, N.Y.