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Serving the B&B marketplace

I N N V E S T M E N T S

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SERVICES OFFERED TO CURRENT INNKEEPERS AND ASPIRING INNKEEPERS:

- *Commercial brokerage*
- *Professional marketing programs*
- *Market valuation and feasibility studies*
- *Business Plans*
- *Assistance with the placement of financing for purchases,*



DETERMINING THE MARKET VALUE OF A BED & BREAKFAST

What motivates people to invest in income-producing real estate such as a bed & breakfast? Most likely they're looking for a predictable cash flow. Possibly they are looking for a change in life-style. Maybe they anticipate some tax benefits. In most instances, it is a combination of some or all of the above objectives. Almost certainly, however, they do expect to realize a capital gain, selling the property at some future time for a profit. The projection of the future worth of the property can, therefore, be an important consideration in their investment decision.

In the process of determining a market value for a bed & breakfast, it is helpful to start by agreeing to the classification of assets included in the

bed & breakfast investment. These can be segregated into three broad groupings: ⁽¹⁾ Real Property (Land, Buildings and Property Improvements), ⁽²⁾ Personal Property (Furniture, Fixtures, Furnishings and Inventory), and ⁽³⁾ Intangible Assets more commonly called Goodwill (the value of the business including the name, customer list, cash flow, permits, trade name, logo, and so forth). The total market value of a bed & breakfast should reasonably approximate the sum of the market values for each of these three component asset classifications.

As with most types of income-producing real estate, what the current owner paid for the property is

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IT'S A SELLER'S MARKET

If you are at all contemplating the sale of your bed & breakfast, consider acting now to take advantage of the favorable market condition. There are many more buyers than there are properties available. It's simply a case of demand exceeding supply.

I represent several highly qualified buyers who are prepared to pur-

chase inns ranging in size from five guestrooms to 25 guestrooms. All transactions will be handled with discretion and confidentiality.

Interest rates are low and commercial loans are available through several lenders who specialize in our industry.

Please call me to arrange for a professional market evaluation.

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not likely to make much of an impression on a new buyer. The typical investor will be interested in the income that the property can generate now and into the future. He or she is not only buying real property but also, and equally importantly, they are buying a business and an income stream.

Investors commonly use capitalization of income as one method of estimating value. You have probably heard this referred to as a Cap Rate method. It assumes that an investment property's value bears a direct relationship to the property's ability to generate net income. A property's capitalization rate is the ratio between its net operating income (NOI) and the total original investment: $Cap\ rate = NOI/Total\ Investment$. The cap rate is a very simple and basic measurement of return on investment.

NOI, earnings before interest, depreciation and amortization, and income taxes, is the cash flow from operations, after all expenses, but before the payment of the mortgage and income taxes. These are the earnings, or operating cash flow, that are most commonly used for financial analysis by banks and investors.

Some investors place greater emphasis on Cash-on-Cash returns, defined as the ratio of pre-tax cash flow to the cash invested, which measure the more immediate returns to the investor. Essentially, this is NOI less debt service but before income taxes: $Cash-on-cash\ return = Pretax\ Cash\ Flow/Cash\ Invested$. This ratio is analogous to the calculation of the dividend yield on a stock. A stock that offers a higher dividend yield, for example the typical utility stock, will generally offer lower capital gains po-

tential. People buy this stock for the immediate cash flow. On the other hand, a stock with greater earnings potential and, therefore, greater appreciation will typically offer a lower dividend yield. Investors are willing to balance long term appreciation with immediate cash returns.

When calculating the overall return on investment, the purchaser of a bed & breakfast should take into consideration the NOI, or Net Operating Income, and Capital Appreciation, the projection of future worth. Additionally, there may be an implicit return in the value of innkeeper's quarters and other expenses which are covered by the business which are not reflected in the numbers.

Capital Appreciation is a measure of the longer-term increase in the value of the investment, in other words the difference between the Net Sale Value at some future point in time, typically five to seven years for forecasting purposes, and the Total

CALCULATING THE OVERALL RETURN ON INVESTMENT

	Year 1	Year 2	Year 3	Year 4
Occupancy Rate	55%	57%	59%	61%
ADR	\$ 125	\$ 128	\$ 131	\$ 135
Room Revenues	\$ 200,750	\$ 213,251	\$ 226,252	\$ 239,770
Variable Expenses	80,300	85,301	90,501	95,908
Fixed Expenses	17,625	18,242	18,880	19,541
Total Expenses	97,925	103,542	109,381	115,449
NOI	102,825	109,709	116,871	124,321
Mortgage @ 75% LTV	77,346	77,346	77,346	77,346
Net to Innkeeper	\$ 25,479	\$ 32,363	\$ 39,525	\$ 46,974
Debt Coverage	1.33	1.42	1.51	1.61
Property Value	745,000			
Goodwill @ 1.0x Revenue	200,750			
Sale Price	945,750			1
Cap Rate	10.9%			
GRM	4.71			
NOI PLUS CAPITAL APPRECIATION				

Original Investment. Capital appreciation refers to the increase in the value of real property and personal property due to the effects of inflation and the general health of the economy and real estate market, as well as the increase in the value of the intangible assets (goodwill), reflecting the innkeeper's accomplishments in building the business during the investment period. Although I am sure that there are many different opinions on this topic, it is my experience that the value of the goodwill component of a bed & breakfast approximates one to 1.5 times (1.0x to 1.5x) the annual room revenues.

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These concepts are illustrated in the table on the preceding page which assumes the purchase of an 8 room bed & breakfast, at a purchase price of \$945,750, with 25% down, and a \$709,000 mortgage at 10% interest amortized over 25 years. In this example, the buyers were willing to pay 4.71 times the first year's room revenues (\$945,750/\$200,750) which is termed a Gross Rent Multiplier (GRM) and is a commonly used measurement in the industry to compare the relative prices of different bed & breakfasts. To quantify the capital appreciation portion of the Return on Investment, it is assumed that the property is sold at the end of the fifth year at a sale price of \$1,096,721. This assumes an annual appreciation of 2.5% in the real property value and \$53,072 increase in the value in good-

will based on the higher revenues. As illustrated in this table, the pre-tax cash flow of \$25,479/\$236,750 (Cash Down Payment) = 10.8% cash-on-cash return in the first year and grows to 23.1% by the end of the fifth year. The overall return to the innkeeper during the five-year holding period of the inn is \$585,793 in NOI and \$150,971 in appreciation, for a total of \$736,764 or approximately \$147,000 annually. In the above example, the buyer was willing to pay the equivalent of a 10.9% cap and 4.71 GRM and to later sell at a 12.0% cap and 4.32 GRM.

Substantiating a market value is often done through the use of Comps, or comparable sales. This involves locating recent sale information of comparable properties, determining the important characteristics

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B&B'S OFFERED FOR SALE

Six Cottages and Innkeeper's Residence on 1.4± Acres - Napa Valley. Each cottage has a sitting room, bedroom and bath, and kitchen. There's a separate two-bedroom residence for the innkeeper. This property would ideally be remodeled and converted to a small upscale inn or resort property. **\$695,000.**

San Francisco Bay Area. This inn has consistently been honored as one of the premier Bed & Breakfast Inns in the country and has been prominently featured in many magazines and TV shows. This distinction stems from the exacting attention to detail, as well as the romantic & whimsical charm atten-

dant to every facet within. The inn is known as one of the most charming and romantic sites in Northern California for the hosting of memorable weddings and other special events. **\$1,250,000.**

Napa Valley Wine Country. This Victorian Mansion is listed on the National Register. The inn offers the perfect starting point to explore the spectacular Wine Country. Most of the rooms feature fireplaces and spa tubs and, of course, all have private baths. The owners have achieved an enviable record of growth in revenues and have a well-established base of business for the new owners. **\$1,800,000.**

If you want results in today's market, you cannot afford to entrust the purchase or sale of your Bed & Breakfast to anyone but a qualified professional. With my many years of experience as an innkeeper and Realtor, I will provide expert professional advice and the highest level of service.





BECK & TAYLOR
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CREATING TRUST
BY MEETING THE NEEDS
AND EXCEEDING
THE EXPECTATIONS
OF BUYERS AND SELLERS
OF BED & BREAKFASTS
THROUGHOUT
CALIFORNIA



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of these properties, and then adjusting the sale price of these comparable properties to what they would have sold for if they possessed the same characteristics as the subject property. This frequently involves the use of industry indices such as GRM's, price per room, cap rates, price per square foot, and so forth. It should be recognized, however, that these are very blunt instruments and should be used with great care. Relying solely on these measurements to establish market value can be dangerously misleading. The cap rates and GRM's for a five room inn, for example, will be very different from the cap rates and GRM's for a 15 room inn. A B&B in a start-up mode will differ

from an B&B with an established track record. An inn in the Gold Country will have very different characteristics than an inn in Mendocino. It is, therefore, important to establish the underlying asset values if one is to reasonably approximate the fair market value of a bed & breakfast.

The Fair Market Value of a property is the most probable selling price in a competitive market, given a willing and able buyer and a willing seller, each acting in a prudent manner. Establishing that value in advance of a negotiated sale is an art and not a science.

Please feel free to call if you have any questions.