

“SEVEN MISTAKES SELLERS MAKE ” (THAT CAN COST THOUSANDS)

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Hotel veterans know the hospitality industry is cyclical, and even sometimes volatile. Values go up and down based on the economy, supply/demand, interest rates, world events and profits. On the other hand, hotels represent an operating business with a significant real estate component, a business model that will always attract investment. Notwithstanding the economic climate, if selling your hotel is your objective, there are a number of pitfalls that you should avoid. The **TOP SEVEN MISTAKES** sellers make when placing their property on the market that can cost thousands. Here they are:

1. Don't Price Your Property Appropriately:

If you are placing your property on the market “just to see if you can get your (inflated) number”, don't do it. Oh sure, everyone believes they will find the “needle in the haystack” buyer, the one who pays too much. However, these buyers are rare today. Qualified buyers (the ones who close deals), know the market and won't consider, or even evaluate, an overpriced offering. Overpricing is the quickest way to get your property pitched into the circular file. If your property lingers on the market due to its pricing, the marketplace will further discount it as time passes, making it more difficult to sell later. Most owners have a decent perspective of the marketplace. Those that expect sale prices similar to those in the mid to late 90's will be disappointed today.

Conversely, if your hotel has a special story to tell, such as exceptional cash flow, a superior market area, a great flag or barriers of entry, don't be afraid to price it appropriately. Not all buyers will give it its due, but there are those that will. But, be prepared for an extended marketing period and a wide variety of offers.

Bottom line, put yourself in a buyer's shoes and you will have a better perspective of what to expect from the marketplace.

2. Don't Watch Your Expenses:

It often surprises me how little attention some owners pay to cash flow. Sure, top line revenue is important, but if you spend it all in operations, your property isn't worth much. In general, onsite owners are the most efficient in controlling expenses. If you are thinking of selling, evaluate each line item of expense, so that you maximize your net income. Limit your personal expenses and check your staffing expenses closely. Employee salaries, taxes and benefits can “destroy” a P/L statement and is the most common drain on profitability.

Place your property and casualty insurance out to competitive bid each year. Appeal your real estate taxes, if necessary. Evaluate your advertising expenditures and track the results. Eliminate those programs that don't produce the expected results. Control your energy consumption as much as possible with insulation, caulk and installation of energy efficient lighting. The objective is to squeeze as much profit as possible without jeopardizing your service or facility.

Everyone knows that net income is the engine that drives prices **and** financing. Once a buyer agrees to your price, he must also obtain financing, or your deal won't close. Without cash flow, financing will be difficult to obtain. There are two kinds of deals being done today, those with cash flow and those that are distressed. If you don't have cash flow, you are distressed.

Finally, don't expect a buyer to pay you for "unrealized" upside. Sellers of under performing properties often claim that a new operator should be able to create value by improved operations, or renovation or repositioning....and then..., expect the buyer to pay them for the unrealized potential. I am amused that a seller would actually believe that such a buyer exists. In any economic climate, buying a physically or economically distressed property has an increased level of risk. Don't expect a buyer to compensate you for his efforts. Look at the attributes and shortcomings of your property objectively, then set a realistic price range. You'll be better prepared to recognize the deal you should accept.

3. Don't Provide Accurate and Complete Information:

Would you buy a new car without seeing its features or the invoice? Probably not, so don't expect a buyer of your property to make a multi million dollar investment decision without accurate and complete information. If you need to get a confidentiality agreement, have the buyer sign one. Then provide enough information to permit a reasonable evaluation of your property. Once an agreement is reached and a contract is signed, provide copies of **all** the information generated by your business, including all operating/service agreements, leases, three years operating statements, federal tax returns and sales tax returns. Other documents should include QA reports, copies of required operating permits, real and personal property tax statements and personal property inventory. Create a list of all documents delivered to the buyer, so there will be no questions of what was provided.

Withholding appropriate information raises red flags to any buyer and will end up costing you money, either in renegotiation or failure of the buyer to close the transaction at all.

4. Don't Consider the Appearance of Your Property:

It is often said that, unlike residential real estate, commercial transactions carry no emotion. Nothing could be further from the truth. If your property exhibits deferred maintenance, it creates an immediate and obvious emotional response.

Take a half day, and really look closely at your facility, inside and out. Any questionable item that can be cured inexpensively with paint, carpet, caulk, grout or by cleaning, do it. By doing so, you will provide a positive perception of a clean, well maintained property. Even if your property is older, maintenance can overcome many objections that pertain to age. On the other hand, if you face major renovation, that's a different story. Generally speaking, if you face significant renovation, you will not recoup your capital investment unless you can back it up by a corresponding increase in revenue(cash flow). Therefore, you must evaluate your selling objectives. For example, after you renovate, you might end up holding your property in order to reap the benefits of the improvements. With major renovation or reposition looming, you must put yourself in the buyer's shoes. That is, "If I invest "X" dollars in renovation, what increase in revenue do I need in order to recover my investment"? That's a difficult question, especially in today's market. By the way, it's the same question a buyer will ask. Unfortunately, you might be forced to upgrade (and spend the renovation dollars) **just to stay competitive and avoid erosion of revenue.**

5. **Don't Care About Your QA Scores:**

If your property is franchised, you will be subject to periodic inspections. Marginal or failing scores are a huge red flag for a buyer. Any buyer that reviews poor QA reports automatically assumes he will have an uphill climb with the franchisor and with the punch list requirements. Correspondingly, his opinion of value will **immediately** go down. I haven't conducted a scientific survey, however, I suspect that most of the low or failing QA scores are not directly related to capital items, but are maintenance or operations problems. Stuff that can be fixed without a lot of effort and money. Carefully check the short comings in your QA reports and rectify those that cost little money, first. Then, make sure you have the systems in place to be ready for inspections, even if unannounced.

Most inspectors have never run a hotel or have no concept of its real life operation. Some might even be unreasonable and as a result, many owners believe that their QA inspectors are members of the "Evil Empire". However, if you make enemies of them, it can cost you thousands. Try to keep them on your side. High QA scores will, no doubt, help you sell your hotel.

6. **Don't Expose Your Property to the Appropriate Marketplace:**

If you have the capability to market your property for sale on your own, then do it. If you have compiled an ownership database with thousands of buyers, go for it. If you are prepared to advertise your property, ***then*** field all the phone calls and questions, ***then*** send your property information to scores of people, ***then*** show your hotel to every type of individual, some with no money, you don't need a broker. If you are a skilled negotiator that can deal face to face without getting emotional, you are ready to go. If you're familiar with the many provisions of a purchase agreement and know the details of closing a

transaction, why wait ? **BUT** if you hesitate on any of the foregoing points, you may need the services of a specialized brokerage firm. Even as you consider the many, many details of these complex transactions, exposure to the marketplace specific to your hotel is still the most important. Statistically, the more qualified buyers that see your offering, the better chance you have of obtaining your sales objectives.

As you evaluate the services of a real estate firm don't make the mistake of hiring your relative's neighbor that sells houses. (Correspondingly, Leisure Real Estate Advisors would never accept a listing to sell a house, apartment building, or a shopping center; we do not have the expertise to market those assets correctly and it would be a disservice for us to consider it). When you are interviewing firms, ask them about their marketing plans. Advertising and marketing options should include any or all of the following:

1. Targeted Direct Mail.
2. Targeted Telemarketing
3. Trade Publications
4. Local advertising
5. Company Website
6. Other Internet Sites
7. Broadcast Email and Print Notices

Again, the idea is to get your property in the hands of the greatest number of buyers that fit the profile for your property. Finally, ask your broker if he/she cooperates with other hotel/commercial brokers. If the answer is no or very limited, don't hire them. No firm knows every possible buyer. Excluding cooperating firms might cost you a transaction. On the other hand, if you selected a firm because of their low fee, don't expect outside co-operating (buyer's) brokers to "waste" their qualified buyer on your offering. They won't.

Once you have entered into a listing agreement, follow the advice found in Mistake # 3 above. Take some time and effort to supply your broker with the relevant property information. A little time spent up front will save many questions later.

7. **A. Don't Talk To Your Attorney Until a Problem Comes Up or**
B. Don't Talk To Your Accountant Until One Week Before Closing:
 - A. If you are contemplating the sale of a multimillion dollar asset, it makes sense to have a team of experts on your side. Unless you are an expert on all the terms of real estate, business and tax law, you should have a real estate attorney guide you through the process. Don't make the mistake of negotiating the legal language into its "final" form and then seek legal advise. If your attorney reviews your work after the fact, you will then be faced with changing (renegotiating) the language in order for your attorney to correct your mistakes and to protect your interests. Get your attorney involved at the start, it will save

time and money in the long run. We always advise clients to seek the advise of an attorney specializing in real estate. One that has the experience with hotel real estate is even better.

Over the years, we have found that the best negotiators usually aren't the "tough guys". On the other hand, those who place themselves on both sides of table are often the most successful in negotiating the deal they want, while understanding the objectives of the other party. Any deal where both parties feel that they have accomplished their objectives is more likely to close.

B. It is surprising how many sellers haven't thought about their net proceeds and furthermore, are shocked after Uncle Sam and the State get through with them. Before you structure a sale, have your accountant review tax avoidance strategies **before** you enter into an agreement. Several questions should be asked:

1. How does allocation of the purchase price affect me and how should I break down the purchase price ?

Several items to consider are:

- Land
- Land Improvements
- Real Property
- Personal Property
- Good Will
- Non compete covenant

Our tax regulations are complex and ever changing. Failure to pay attention to them can cost you needlessly.

2. Should I consider a tax deferred exchange? Remember, when it is all over, as much as 30% of your gain may be taken by Federal, State and Local taxes. Section 1031 of the IRS code permits you to defer taxes on real estate held for investment. You can exchange for any type of investment real estate including another hotel, a shopping center, vacant land, or a net leased building. The rules governing the exchange process are very specific and require legal expertise. Failure to comply with any one of the appropriate steps could jeopardize your tax deferment. A 1031 tax deferred exchange should be considered by every seller, even if it is not utilized. See the article "Using Section 1031 to Defer Taxes" for more information.

In closing, selling your hotel takes time, effort and common sense. Avoid the "Seven Mistakes" and you will find the path to a sale much easier and more profitable.

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