

Chris Tinning & Company

Hotel – Motel Brokers, Auctioneers and Consultants

Hotel Market Place: Spring 2010

2010 started reasonably well. There was some enquiry for country hotels from a variety of purchasers; in most cases we found that potential purchasers had some knowledge or local connection with the hotel offered – I describe these as local area buyers. Often time these Local Buyers had little or no hotel experience and were chasing a long term dream to own/operate a country pub. There remains a large variance in the price of hotels offered for sale – some at a reasonable market level, however many well above current market prices.

Midway through 2010 and the market place have slowed. Recent events such as the Federal election and interest rate pressure have slowed enquiry. Following the Federal election we saw a government decided by 3 independents. Promises were made to minimise Poker Machine dependence and the ability of patrons to bet large amounts of money – this has further depressed the hotel market place. The majority of recent sales (the few there have been), are either mortgagee in possession or bank pushed results from these sales exaggerate the current poor market.

We are now in a **buyer's market** ... where the purchaser decides price! There are a number of key factors effecting price:

Hotel Profitability: A vendor needs to provide up to date financial information, demonstrating the ACTUAL (not potential) business profitability and its future sustainability.

Hotel Presentation: Purchasers want everything ... TAB, glycol bulk beer system, modern furnishings, large flat screen T.V's, Poker Machines, outdoor areas.

Owners Unit: Many decisions are made by the female partner With one of the most important being; Yes I can live here! Expectations are fully self-contained, modernised with space.

Location: Not just overlooking the beach, how much competition, how far from family facilities such as schooling?

Poker Machine Entitlements: Purchasers want to minimise the goodwill payment. The more machines for a lower price the better.

Conservative prices are further reinforced by a steady flow of receivership sale occurring in the market place.

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The Freehold Hotel market place has broken into a number of sub-markets with each having their own determinants of price.

These markets can be roughly described as follows:

- a) **Hotels without gaming machines**
There are few examples of hotel sales without poker machines – part of the reason is that there is less demand from potential hotel purchasers for a pub with no pokies. Pricing must be close to “bargain” levels.
- b) **Freehold hotels to \$1.5m with Poker Machine entitlements underpinning the value. (property = asset value NOT business value)**
Demand for freehold properties is highest where the goodwill value is minimised. That is the asset value of poker machine entitlements is close to the asking price of the hotel. The last six months have seen buyers become more conservative in their estimate of value of PME’s. Some receivership sales have indicated that the \$100k per PME has been discounted. We are now seeing hotels sold below the perceived asset value of PME’s, land & building (as an alternate use)
- c) **Freehold Hotels to \$4.5m where value is directly related to Business Profitability. (Gaming machine numbers are still important yet price is determined by overall hotel profitability)**
There have been very few hotels that authentically fit this category that you could say were genuinely on the market (many hotels are on the market at asking prices too high to attract potential purchasers).
The correction to values pre- 2006 appears to have continued. With falling numbers of buyers in the market and the consistent availability of receivership sales, (falling demand/increased supply) values have softened and some hotels are unable to find a purchaser.
- d) **Premium freehold properties (generally in excess of \$5m) sought after by corporate style purchasers.**
Very few examples on the market. There is enquiry from ex-hoteliere (who were lucky to sell at the peak of the market), looking for returns (Capitalisation rates) of 15 to 16% for these premium properties.

During the last 18 months there have been a number of properties placed on the market at levels above their achievable price. The market place is rejecting these properties and in fact damaging the perception of these properties even when a price reduction has occurred.

Purchases for hotels in the (a), (b) or (c) market have in the majority been local or have intimate knowledge of the hotel of interest. Many of the potential purchasers are guided by experienced hoteliers who sold their properties during the last few years and believe that opportunities will exist to purchase hotels at returns close to “bargain” prices.

To achieve a sale you need to be priced correctly and stand out from the crowd.

Property Value:

The value of a hotel today as judged by the marketplace is a combination of core asset value and business profitability.

The State Government recently announced a new Poker Machine Duty scale for hotels. (Commenced 1st July 2010) Under these scale hotels with gaming duty profits (before GST) under \$200,000 pa would attract NO (\$0) gaming duty. Many country hotels see this as a tremendous boost to cash flow. Whilst brokers are keen to point out the increased profit we are yet to see the resultant increase in value reflected in the market. The major gaming question presented by potential purchases is the sustainability of profits with threats from the Federal Government to implement restrictions on bet size and player time.

Traditionally a capitalisation rate has been applied to the business profit (earnings before interest, taxation, depreciation, amortisation and exceptional items - EBITDAE).

The last decade has seen a roller coaster ride for hotel capitalisation rates. The introduction of corporate style purchasers looking to buy premier hotels in major NSW country cities commenced the sudden price increase, which flowed right the way through the industry. This was further fuelled by a relaxing of the traditional borrowing ratios and competitive bank lending practices. Positive press and poker machine fuelled profits lead to record prices across the industry.

Freehold Country City

	Capitalisation Rate	Value for \$100,000 net	Dollar value increase	Percentage value variance from previous
1998	20%	\$500,000		
2000	18%	\$555,000	\$ 55,000	+10%
2002	17%	\$588,000	\$ 33,000	+6%
2004	16%	\$625,000	\$ 37,000	+6%
2006	14%	\$667,000	\$ 42,000	+6%
2007	12%	\$830,000	\$163,000	+20%
2009	17%	\$588,000	-\$242,000	-21%
2010	20%	\$500,000	-\$88,000	-15%
2011	(prediction 20+ %)			

A number of corporate entities discovered that operating a hotel also involved the publican (the face presented to the patron) and operating a hotel was not just about being efficient, negotiating tough supply deals or spending monies on renovations.

Along with these failing corporate hoteliers, came bad press and with the anti-smoking fight won the attention has turned on poker machines in hotels.

With many hotels purchased from 2003 to 2007 now being outside their banks loan to valuation lending ratio, there is obviously some clean out still to occur. How this is managed by the bankers will have ramifications for the hotel market place.

Hotel Sales:

Property: Terminus Hotel, Temora, New South Wales;
Contract Date: February 2010;
Sale Price: \$590,000;
Poker Machines: 0
Gross Turnover: \$745,000 (\$14,325 per week);
Net Income: \$132,000;
Cap Rate (est): 22.5%;

Building Description: Attractive hotel refurbished extensively in recent years. Facilities on the ground floor include a public bar, restaurant, commercial kitchen, parlour lounge, ladies lounge, office, three store rooms, male and female amenities, laundry, coolroom, and bottle shop. Accommodation on the upper level includes a two bedroom manager's flat, together with seven accommodation rooms, male and female amenities, and kitchenette. Additional improvements include partially covered beer garden, open carpark, boundary fencing, and large awning/verandah fronting both Crowley and Loftus Streets. The building appears structurally sound and has recently been painted externally;

Comment: The subject property sold in February 2009 for \$600,000.

Property: Black Swan Hotel, North Wagga Wagga, New South Wales;
Contract Date: June 2010
Sale Price: \$475,000;
Poker Machines: 2
Land Area: 4116 square metres;

Building Description: Single storey small old style suburban pub, includes public bar, lounge, gaming room, commercial kitchen and manager's residence. No turnover figures were available – believed to be approx \$8,000pw;

Property: Royal Mail Hotel Braidwood
Sale Date: March 2010
Sale Price: \$960,000
Poker Machines: 6 entitlements
Estimated Turnover: \$16,300 per week
Estimated Net Profit: \$220,000
Cap Rate (Est): 22.9%

Comments: A two storey, c1890 hotel comprising public bar, gaming room, lounge, TAB, bistro, beer garden, 16 first floor letting rooms and managers residence. Receivership sale – failing to sell at auction initially. The hotel needed approximately \$20,000 expenditure in order to gain compliance with BCA fire standards.

Property: Royal Hotel Yass
Sale Date: April 2010
Sale Price: \$800,000
Poker Machines: 9 entitlements
Estimated Turnover: approx \$17,000 per week
Estimated Net Profit: \$200,000 p.a.
Cap Rate (est): 25%

Comments: Sold in receivership. The sale price represents a 54% drop in value from its original acquisition price of \$1,750,000 in November 2004. The hotel is located in the centre of town, sits on a site about 2,079 square metres. Includes a bistro, main bar, nine poker machines, 13 rooms of accommodation, a manager's flat, outdoor entertaining area and a 3am liquor licence.

Property: Windmill Tavern - Nyngan
Sale Date: September 2010
Sale Price: \$500,000
Poker Machines: 2 entitlements (+ 2 in dispute)
Estimated Turnover: approx \$19,950 per week (\$12,000 bottle sales)
Estimated Net Profit: \$153,000 p.a.
Cap Rate (est): 30%

Comments: Sold in receivership – 2nd auction sale. The sale price represents a significant drop in value from its original acquisition price of approx \$850,000 in August 2006. The hotel is well located on the highway, sits on a site about 2,023 square metres. Constructed in 2004 includes an open plan bistro, main bar, four poker machines, outdoor entertaining area and Drive-Through Bottleshop. (Note no residence)

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