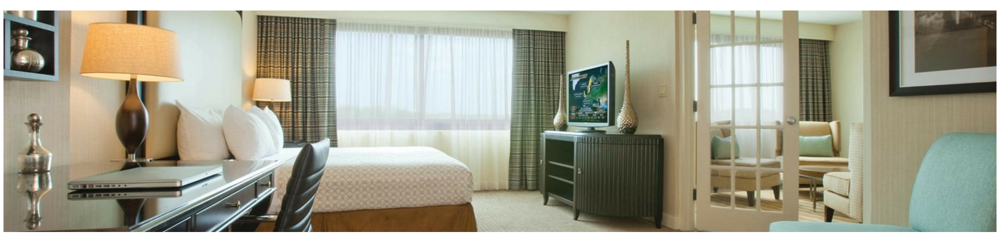
Navigate the Pitfalls Motel Valuations – Part 2

June 20, 2019 / By Rodney G. Clough

In **Part 1**, I discussed the importance of determining the true revenue and expense levels of a property, which may not be overtly evident by statements or tax returns provided by a motel owner. When reconstructing a true (or as close to true as possible) statement, this may diminish the reliability of the direct capitalization method and discounted cash flow in the reconciliation if these opinions are based on estimated statements. Conversely, this heightens the importance of the RRM if the rooms revenue is the most documented line item, as well as the importance of the sales comparison approach; moreover, these two may be the most highly relied-upon methods by sellers and buyers in the motel investment space.

It is essential that the hotel consultant research all local motel comparable sales to make sure it is understood when these assets were last sold and the circumstances surrounding each sale. When I am appraising any independent motel, I will take inventory of all similar motel properties within the competitive radius. From this inventory, I will investigate when each hotel last sold and do my best to determine the circumstances regarding the sale. Many motel transactions represent off-market sales, as hotel owners at this level may be less willing to put their properties on the market and subject their daily routines to the rigors of showings and other activities required of an active listing. But knowledgeable local brokers are always on the lookout for buyers and will do their best to connect these buyers with local motel owners that will consider a disposition of their property. From a valuation perspective, it is important to know if the hotel was marketed openly and if multiple offers were brought and ultimately considered. If it was an off-market transaction, and if the parties were related in any way (which in many cases they are in the budget, independent motel space of a single community), it may diminish the importance of that sale.



Buyers of motels know their comparable sales. It is smart to interview the buyer and seller and ask them about local transactions and what they know about them. What transactions played a part in their investment decisions and why? Ultimately, it is important to understand where a neighborhood trends in terms of RRM (on true, actual rooms revenue; see my Part 1 article) on recent motel sales; it is also critical to review the various data points on sale price per room. I have worked in markets where the predominant RRM is 2, 3, or even 5. Most often, an RRM tends to rule the market, and buyers and sellers are most comfortable transacting at that understood and accepted level. It is often not a guess or a wonder, as the prevalent RRM of a market often shines through.

Another pitfall of a proper motel valuation is not correctly estimating capital expenditures required at the time of a sale. At this level of property, an investor will rarely develop a thought-out budget for capital improvements that will be made following the sale of a motel. It is critical that a careful inspection the motel is done to account for the most critical items that are needed for upgrade in the next year. Potential upgrades to review include but are not limited to the following examples:

Summary

In Part II of this article, I discuss the importance of diving into local market comparable sales when facing an independent motel valuation. Equally important is knowing the market's prevalent RRM and sales price per key.

Comments

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- Replacement of broken windows
- Replacement of the roof covering (how old is the current one?)
- New exterior paint, lighting, signage, and/or landscaping
- Select furniture upgrades and replacements
- Parking lot pavement and striping
- Replacement of broken equipment
- Installation of security cameras and monitoring equipment

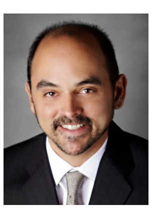
The property may not need very many upgrades, but most motels I have inspected need at least a little something following the sale. I work up my own best estimate and deduct this cost from the value result that is generated from the various approaches to value. It may not be more than $50,000 to $100,000, but that investment is often required to maintain the income generating capability of the property over the forecasted ten-year holding period.

One bright spot in the world of **motel investment** is that new supply threats are typically muted, or non-existent, as most new hotels are targeting prices well above the $50 to $80 room rates that are normal in most motel competitive markets. These newer hotels, often branded, with interior corridors and featuring all the latest bells and whistles, are not typically competitive threats to motels built 40 to 60 years ago. Therefore, motels may represent lower risk, stable sources of revenue for owners and ultimately for banks, as long as there is a thorough understanding of the true revenue of the property.

One last thought to consider. When an investor is considering a motel purchase, note that the furniture, fixtures, and equipment (FF&E) may have little to no contributory value. Any positive value that a few pieces may bring, such as a functioning laundry room or newer televisions, may be offset by negative value other furniture may bring to the equation (negative value meaning that you would have to pay someone to actually take the furniture because it is so old, unattractive, and not useful). I have appraised many motels where the net value of the FF&E is simply $0. The furniture is so old and deteriorated that you could not sell it for any substantive amount. In this case, no value should be allocated to the FF&E component of a property.

In conclusion, motel valuations are not as simple as one might think. The data available from the property may be significantly limited, requiring the appraiser and/or investor to dive deep into his/her industry and market knowledge to derive a proper operating statement. The importance of local motel sales is significant, as is the importance of knowing the market's prevalent RRM and sales price per key; other factors, such as capital expenditures and FF&E value, require special consideration, and one should not over-complicate an analysis with new supply that may not ultimately affect a motel. If you are facing a challenge with a motel investment and need an expert that truly understands the concepts that I've set forth in these two articles, please reach out to me. I'd be pleased to connect you with one of the motel/hotel valuation experts that I have on my team.

About Rodney G. Clough



Rod Clough, MAI, President - Americas, oversees strategy execution throughout 40 Americas locations. He recently brought together all US Valuation Consulting offices under common ownership, and has revolutionized the way the company is led and managed. This group of offices represents over 120 hotel industry professionals and executes over 4,000 assignments a year. Rod has been working in the hospitality industry for 30 years and is a graduate of Cornell's School of Hotel Administration. He is a Designated Member of the Appraisal Institute (MAI) and a state-certified general appraiser. Contact Rod at (214) 629-1136 or .