



Inn Partners

Innovative Solutions for Current and Future Innkeepers

Morning Bird Inn Valuation

March 2018

There are many approaches to value for Bed and Breakfast and Dinner Service Inns. Some are simple and some are complex. Some are specific to Inns while some are used in the Valuation of larger hospitality properties. The significance of each approach will vary with size, location, style and financial performance. Larger Inns will find validity in industry wide approaches while smaller Bed and Breakfasts will find credibility in more specific measures

The six approaches of value of use for Inns are as follows:

- 1. Asset Value.** This can be replacement value (larger Inns) or alternate use value (smaller Inns). For many smaller Bed and Breakfast Inns, the real estate value may define the highest and best use of the property.
- 2. Income multiples.** Different departments have different multiples. Most important are B&B multiples which normally range from 4 to 5.5, and food and beverage income; usually 1 times. Items with low Cost of Goods have higher multiples; up to 8 for net income items.
- 3. Capitalization rate (CAP rate) of an income stream.** This usually does not work for smaller Inns. Because individual owners have divergent operating styles, this can be unreliable. Also, the CAP rate used will strongly affect Value. Again, the rate is arbitrary, but usually runs about 3 points above commercial lending rates. As they are around 6%, we will use a Cap rate of 9%. Establishing Income (or Cash Flow) can be tricky for many Inns, because owner operators tend to draw a fuzzy line between business and personal expenses.
- 4. Asset Value as an Inn.** This is usually used in conjunction with the Cash Flow as projected for near future performance. Asset Value as an Inn is established by formula involving three components: Rooms, Contributing Assets and Non-Contributing Assets.

A. Rooms

Rooms are valued at \$300.00 per square foot for the first 300 square feet. Square footage over 300 is calculated at \$150.00 per square foot. Included in this measurement would be all room or suite space, bathroom, closet and entry. We add to this base room value an estimated replacement value for furnishings, and window, wall and floor treatments. Amenities such as fireplaces, spa or soaking tubs, wet bars, fine woodwork and decks add value. Other special features will also add value.

B. Contributing Assets

Included in the core room value are reasonable support facilities. These include a common room, kitchen and dining facilities, office and storage and adequate grounds and landscaping. Extras, such as a pool, spring pond, acreage and many other assets are above the norm and add value. All the values in the “Contributing Assets” column are additional values, beyond the expected norm for those categories.

C. Non-Contributing Assets

Often there are real assets that have tangible value, but do not contribute to the Income. Non-contributing assets could include excess land or separate owners’ home, or any other assets that have significant value, but do not add to the income stream.

Once we have established the Asset Value, we look at the ability of the business to support that Value and either produce a negative or positive business value to combine with the Asset Value.

5. **Business Income from Cash Flow generation.** Actual performance is compared to standard costs, and then, because the value of any business is the ability to produce a stream of income in the future, a near future projection is used to establish cash flow. Because this takes into account both the value of the physical assets, often defining future prospects for growth, and business cash flow generation, this is normally the most significant measurement of value for viable business Inns.
6. **Cash Flow coverage of debt service.** We back into value by establishing cash flow available for debt service. This should be 125% of the full debt service after a 20% down payment. While this is a measurement dear to the heart of bankers, it does not take into consideration differing styles of operation, generating divergent cash flow results from similar income streams.

For the Morning Bird Inn, the size and cash flow capability will be the most important components of value. However, we will look at all 6 approaches in our valuation. An analysis of the business will help us to understand the available financing for a business purchase.

1. **ASSET VALUE:** This can be replacement value (larger Inns) or alternate use value (smaller Inns). For many Bed and Breakfast Inns, the real estate value may define the highest and best use of the property. The configuration of the Morning Bird Inn and the Barn and Cottage rooms in particular make it obvious that the “highest and best use” of this facility is as an Inn. Therefore, this approach will not be used in our Valuation.
2. **INCOME MULTIPLES.** Our multiple ranges from 4 to 5.5 for room sales, depending on size and location. As the number of rooms (and volume of business) increases, the multiple typically decreases. Given that the Inn is on the large size, we use a multiple of 4.5 for the projected room sales:

B&B Income, Projected:	516,840.00 X 4.5	\$2,325,780.00
Food & Beverage	0.00 X 1	0.00
Gifts & Other	36,539.00 X 2	<u>73,078.00</u>
Income Multiple Indicated Value		\$2,398,858.00

3. **CAPITALIZATION RATE.** Capitalization rates of a stream of income are usually not very reliable for Inns. It is difficult to determine what cash flow one should use, and there is no clear standard for what the CAP rate should be. Here, we have chosen to deduct a management fee and a reserve for replacement. The CAP rate of .09 is arbitrary, but based on three points over current commercial interest rates for Inns (Around 6) it is viable.

Future Cash Flow	<u>\$254,952.00</u>
Less reserve for replacement (3% of Future sales)	-16,601.00
Less Management Fee	<u>-35,000.00</u>
Equals	\$203,351.00
/ Cap rate of .09 =	\$2,259,456.00

4. ASSET VALUE AS AN INN. See the next page. The Asset Value as an Inn is **\$1,948,600.00**. While this Inn Asset Value has some use independently, it is normally combined with the Business Analysis in 5 below to produce a combined Business Value.

5. BUSINESS INCOME. See Business Analysis, attached. In the Business Analysis actual performance for 2017 is presented in Column H. Column I uses actual income with standard cost expenses to compare actual performance with industry standards for well run Inns. Column J blends the actual with the standard cost analysis, to use as a reference for future projections. Column K projects a possible near future performance of the Inn, combining industry standard costs with the actual expenses of the Inn. Further future performance is presented in Columns L and M, but these are not used in the Valuation. Since the value of any business is the ability to produce a stream of income in the future, these projections are carefully developed, combining current performance with industry standards where appropriate. We believe they represent likely future performance for the Morning Bird Inn.

Lines 2-6 are the vital statistics of Occupancy (Line 3) and Average Daily Rate (Line 4). Lines 7 through 18 summarize the detail of income and expense on lines 19 through 139. Net Income before debt, owner compensation and depreciation is on line 17 of the summary.

Once we have established the Asset Value as an Inn and the projected future cash flow, we bring these together in the form, Combined Asset and Business Value. The business cash flow must do three things. It must first support the Asset Value. That amount is set at 8% of the Asset Value. In this case, that is \$155,888.00 (Line 3, Col. B). It must also provide some compensation for owner labor and it must generate income to replace assets that wear out. On Line 10, the indicated cash flow needed is \$207,489.00. Our projected near future Cash Flow is \$254,952.00. This creates a surplus cash flow of \$47,462.00, which is multiplied by 3.5 to represent the positive impact over time over time. The result is an indicated value of \$2,114,718.00.

6. CASH FLOW COVERAGE OF DEBT SERVICE. The projected cash flow is \$254,952.00, adjusted for management and replacement reserve to \$203,351.00. To provide 125% coverage of debt service, the minimum usually required by banks, the debt service would be no more than \$162,681.00/year. (To get this number, divide cash flow by 1.25) At 6% interest on a 20 year payment schedule that would service a debt of \$1,892,297.00. Assuming a 20% down payment, (\$473,074.00; Divide debt by .8) the indicated value is **\$2,365,371.00**.

Morning Bird Inn
Asset Value

	A	B	C	D	E	F	G	H
1	Room Value	Sq Ft	Value	Fpl/Whrlpl Decks	Furnish Plus 6K	Other	Bath	Total
2								
3	Room 1	342	102,600	30,000	1,000	1,000	1,000	135,600
4	Room 2	361	108,300	30,000	1,000	1,000	1,000	141,300
5	Room 3	332	99,600	30,000	1,000	1,000	1,000	132,600
6	Room 4	332	99,600	30,000	1,000	1,000	1,000	132,600
7	Room 5	286	85,800	30,000	2,000	2,000	1,000	120,800
8	Room 6	286	85,800	30,000	1,000	2,000	1,000	119,800
9	Room 7	294	88,200	20,000	2,000	1,000	1,000	112,200
10	Room 8	344	103,200	20,000	2,000	1,000	0	126,200
11	Room 9	332	99,600	10,000	0	500	1,500	111,600
12	Room 10	206	61,800	0	200	500	1,500	64,000
13	Room 11	195	58,500	0	-1,000	500	0	58,000
14	Room 12	193	57,900	0	-600		-5,000	52,300
15	Room 13	273	81,900	0	1,700	-1,500	-3,000	79,100
16	Room 14	94	28,200	0	-3,600	-1,500	-5,000	18,100
17	Room 15	221	66,300	20,000	-500	-5,000	0	80,800
18	Room 16	159	47,700	5,000	-2,100	-1,000	-1,000	48,600
19			0	0				
20	Total rooms		1,275,000	255,000	5,100	2,500	-4,000	1,533,600
21								
22	Other Assets							
23	Owners' Quarters							0
24	Owners Qtrs Fireplace							10,000
25	Office							0
26	Kitchen							5,000
27	Dining (2 Rooms)							0
28	Guest Pantry							5,000
29	Living Room							15,000
30	LR Fplace							10,000
31	Library							50,000
32	Library Fpl							10,000
33	Sun Room							25,000
34	Porch							20,000
35	Patio							20,000
36	Entry							25,000
37	Storage							50,000
38	Fitness							20,000
39	Massage							5,000
40	Laundry							5,000
41	Pool							60,000
42	Garage							30,000
43	Acreage							<u>50,000</u>
44								
45	Total Other Assets							<u>415,000</u>
46	Total Asset Value							1,948,600

Morning Bird Inn
Business Analysis

	A	B	C	D	E	F	G	H	I	J	K	L	M
1	Morning Bird Inn						Standard Cost	2017 Actual	Pro forma	Blend	Future 1	Future 2	Future 3
2	Number of Rooms							15	15	15	15	15	15
3	Occupancy Rate						Rms Sold/#rms X 365	28%	28%	28%	32%	38%	40%
4	Average Price/Room						Rm Rev/Rooms Sold	\$318	\$318	\$318	\$295	\$300	\$305
5	Annual # of Rooms							1533	1533	1533	1752	2081	2190
6	Number of Guests/Year						1.9 X Rooms	2913	2913	2913	3329	3953	4161
7	SUMMARY												
8	Sales						Line 33	\$486,993	\$486,993	\$486,993	\$553,379	\$664,150	\$707,950
9	Cost of Goods						Line 40	\$23,977	\$13,107	\$18,933	\$31,702	\$40,194	\$41,547
10	Gross Profit						Line 8 - Line 9	\$463,016	\$473,886	\$468,060	\$521,677	\$623,956	\$666,404
11	Expenses												
12	Labor Related						Line 59	\$73,252	\$84,951	\$84,951	\$96,531	\$115,854	\$123,494
13	Operating Expenses						Line 101	\$101,949	\$72,609	\$80,262	\$87,216	\$95,181	\$98,152
14	Marketing						Line 116	\$23,617	\$20,045	\$23,091	\$28,368	\$32,245	\$34,278
15	Occupancy Expenses						Line 136	\$58,018	\$52,355	\$55,860	\$54,610	\$62,334	\$65,725
16	Total Expenses						Sum Lines 12-15	\$256,836	\$229,960	\$244,163	\$266,725	\$305,614	\$321,650
17	Cash Flow pre Debt, Owner, Deprec.						Line 10 - Line 16	\$206,180	\$243,926	\$223,897	\$254,952	\$318,342	\$344,754
18	Ratio Cash Flow to Sales						Cash Flow/Sales	42%	50%	46%	46%	48%	49%
19	Income												
20	Room Revenue												
21	Room Revenue						ADR X Rms Sold	486,993	486,993	486,993	516,840	624,150	667,950
22	Room Revenue Other												
23	Total Room Revenue							486,993	486,993	486,993	516,840	624,150	667,950
24	Other Income												
25	Food						Vary; 40% (sm)-80%Lge of Rm Sales						
26	Beverage						30% Food Sales						
27	Spa Services						0.6% Rm Sales				10,000	15,000	15,000
28	Weddings/Site Fees										10,000	15,000	15,000
29	Gifts and Products						1.4% Rm Sales				7,236	10,000	10,000
30	Sales Tax												
31	Other						1.8% Rm Sales				9,303		
32	Total Other Income							0	0	0	36,539	40,000	40,000
33	Total Income							486,993	486,993	486,993	553,379	664,150	707,950
34	Cost of Goods Sold												
35	Food						\$4.50XGuest+.35XFood	22,208	13,107	18,933	21,637	25,694	27,047
36	Beverage						40% Beverage Sales	0	0	0	0	0	0
37	Function							1,769					
38	Gifts and Products						70% Gift Sales	0	0	0	5,065	7,000	7,000
39	Spa Services						50% Spa Sales	0	0	0	5,000	7,500	7,500
40	Total Cost of Goods Sold							23,977	13,107	18,933	31,702	40,194	41,547
41	Expenses												
42	Labor Expense												
43	Wages												
44	Uncategorized Wages						15.6% Total Sales	71,350	75,971	75,971	86,327	103,607	110,440
45	Front Desk/Innkeeping												
46	Housekeeping												
47	Accounting/Bookkeeper												
48	Food Service						Ownr/Chef Sm; Pro Lgr						
49	Less Owner Compensation												
50	Maintenance/Grounds												
51	Total Wages							71,350	75,971	75,971	86,327	103,607	110,440
52	Other Labor Costs												
53	Casual Labor							465					
54	Payroll Taxes						9% Labor Cost	0	6,837	6,837	7,769	9,325	9,940
55	Workers Comp						2% Labor Cost	1,437	1,519	1,519	1,727	2,072	2,209
56	Benefits						0.7% Labor Cost	0	532	532	604	725	773
57	Recruitment/Training						0.12% Labor Cost	0	91	91	104	124	133
58	Payroll Service												
59	Total Other Labor							1,902	8,980	8,980	10,204	12,246	13,054
60	Total Labor							73,252	84,951	84,951	96,531	115,854	123,494

Morning Bird Inn
Business Analysis

	A	B	C	D	E	F	G	H	I	J	K	L	M
1	Morning Bird Inn						Standard Cost	2017 Actual	Pro forma	Blend	Future 1	Future 2	Future 3
61	Operating Expenses												
62	Supplies												
63						Inn and Guest	2.9% Total Sales	30,862	14,123	20,000	20,000	19,260	20,531
64						Restaurant	1.5% Fd and Bev Sales	0	0	0	0	0	0
65						Office	0.3% Total Sales + \$200	3,207	1,661	1,661	2,860	3,192	3,324
66						Other							
67						Total Supplies		34,069	15,784	21,661	22,860	22,453	23,854
68	Bank Fees												
69						Credit Card Discounts	2.75% Total Sales	14,181	13,392	13,392	15,218	18,264	19,469
70						Other Charges							
71						Total Bank Fees		14,181	13,392	13,392	15,218	18,264	19,469
72	Laundry												
73						Service and Supplies	.50 X Total guests+5% F&B	5,816	1,456	5,816	6,500	5,000	2,500
74						Purchases	0.3% Total Sales	0	1,461	0		1,000	1,500
75						Total Laundry		5,816	2,917	5,816	6,500	6,000	4,000
76	Communications												
77						Telephone	0.7% Total Sales + \$1000	4,798	4,409	4,409	4,874	5,649	5,956
78						Internet Connection							
79						Other Communication							
80						Total Communications		4,798	4,409	4,409	4,874	5,649	5,956
81	Professional												
82	Consulting												
83	Legal												
84						Accounting	0.02% Total Sales + \$1400	3,460	2,374	2,374	2,507	2,728	2,816
85						Other							
86						Total Professional		3,460	2,374	2,374	2,507	2,728	2,816
87	Vehicle												
88						Operating	1.4% Rm Sales	9,434	6,818	5,000	5,000	5,000	5,000
89						Insurance	1,000		1,000	1,000	1,000	1,000	1,000
90						Lease							
91						Total Vehicle		9,434	7,818	6,000	6,000	6,000	6,000
92	Maintenance												
93						Inn and Rooms	3% Rm Sales + \$2,500	21,668	17,110	17,110	18,005	21,225	22,539
94						Restaurant	2% Rest Sales	0	0	0	0	0	0
95						Grounds	0.8% Rm Sales + \$500	4,396	4,396	4,396	6,635	7,493	7,844
96						Other							
97						Total Maintenance		21,668	21,506	21,506	24,640	28,718	30,382
98	Other Operating												
99						Travel and Education	0.2% Rm Sales + \$1000	5,463	1,974	1,974	2,034	2,248	2,336
100						Commission	0.3% Rm Sales	2,156	1,461	2,156	1,551	1,872	2,004
101						Miscellaneous	0.2% Rm Sales	904	974	974	1,034	1,248	1,336
102						Total Other Operating		8,523	4,409	5,104	4,618	5,369	5,676
103	Total Operating							101,949	72,609	80,262	87,216	95,181	98,152

Morning Bird Inn
Business Analysis

	A	B	C	D	E	F	G	H	I	J	K	L	M
1	Morning Bird Inn						Standard Cost	2017 Actual	Pro forma	Blend	Future 1	Future 2	Future 3
104	Marketing Expenses												
105	Internet						2.0% Total Sales + \$1000	11,211	10,740	10,740	12,068	14,283	15,159
106	Management												
107	Listings												
108	Pay Per Click												
109	Website												
110	Total Internet							11,211	10,740	10,740	12,068	14,283	15,159
111	Advertising						1.5% Total Sales + \$2000	6,555	9,305	6,500	10,301	11,962	12,619
112	Publications												
113	Brochures and Print												
114	Organization Dues							5,851		5,851	6,000	6,000	6,500
115	Public Relations												
116	Direct Mail												
117	Total Advertising							12,406	9,305	12,351	16,301	17,962	19,119
118	Total Marketing							23,617	20,045	23,091	28,368	32,245	34,278
119	Occupancy Expenses												
120	Utilities												
121	Misc. Utilities						3.5% Total Sales + \$ 5000		22,045	22,045	24,368	28,245	29,778
122	Gas							7,685					
123	Heating Oil							7,430					
124	Electric							6,553					
125	Water/Sewer												
126	Cable/Sat.							1,815					
127	Total Utilities							23,483	22,045	22,045	24,368	28,245	29,778
128	Other Occupancy												
129	Waste Removal						0.3% Total Sales + \$500	1,704	1,961	1,704	2,160	2,492	2,624
130	Equipment Rental						0.2% Rm Sales		974				
131	Contract Services						0.3% Total Sales + \$1000	13,485	2,461	13,485	6,660	6,992	7,124
132	Insurance- Prop. Liability						2% Rm Sales + \$500	4,816	10,240	4,816	6,500	7,000	7,500
133	Real Estate Taxes						2.5% Rm Sales + \$1500	13,574	13,675	13,675	14,421	17,104	18,199
134	Other Taxes							821					
135	Licenses						1,000	135	1,000	135	500	500	500
136	Miscellaneous												
137	Total Other Occupancy							34,535	30,311	33,815	30,241	34,089	35,946
138	Total Occupancy							58,018	52,355	55,860	54,610	62,334	65,725
139	Total Expenses							256,836	229,960	244,163	266,725	305,614	321,650
140	Total Net Business Cash Flow							\$206,180	\$243,926	\$223,897	\$254,952	\$318,342	\$344,754

Morning Bird Inn
 Combined Asset and Business Value

	A	B	C
1	Asset Value		1,948,600
2			
3	Cash Flow needed to fund Asset Value @ 8%	155,888	
4			
5	Owner Compensation Equivalent	35,000	
6			
7	Replacement @ 3% of projected sales	16,601	
8			
9			
10	Cash flow needed		207,489
11			
12	Projected Cash flow		<u>254,952</u>
13			
14	Surplus (Negative) Cash flow		47,462
15			
16	Surplus multiple	3.5	
17			
18	Surplus (Negative) Value		<u>166,118</u>
19			
20	Asset Value plus Business Value		2,114,718

MORNING BIRD INN VALUATION SUMMARY

Asset Value	NA
Business Value by Multiple of Income	\$2,398,858.00
Business Value by Income Capitalization	\$2,259,456.00
Asset Value as an Inn	\$1,948,600.00
Combined Business and Asset Value	\$2,114,718.00
Cash Flow Coverage of Debt	\$2,365,371.00

Normally, the most accurate measurement of value comes from the Combined Asset and Business Value. Usually, the least reliable measurement of value is Income Capitalization. A small difference in the Cap rate used makes a large difference in the value. Also there are many non-economic decisions that drive the way Innkeeper/owners operate their Inns.

We believe the Combined Business and Asset Value gives the correct weight to the balance between facility and business strength, although the other business measurements indicate a stronger value Therefore the near future Value is

\$2,150,000.00

However, since this is a future Valuation, we deduct 5% of the Value to represent the time and money cost of moving the business forward, giving us a present Value of

\$2,042,500.00

Rounded to:

\$2,050,000.00