Financing a Bed & Breakfast/Inn

By Richard K. Newman – Commercial Capital Network, LLC

All Bed & Breakfasts/Inns are unique by design; in fact, it is that unique quality that separates one Bed & Breakfast/Inn (B & B/Inn) from the next. Innkeepers invest their energy and capital over time to create a welcoming and hospitable environment that is unique to their community and valued guests. While the charm and ambiance of an inn add to a patron's experience, such intangibles have only an indirect effect on the actual value.

An Inn's commercial market value will ultimately be determined by evaluating the values of the real estate, cash flow, good will and sometimes furniture, fixtures and equipment (FF&E). It is important that you are comfortable with this value before making an Offer to Purchase or a Contract of Sale. Realtors who specialize in marketing and selling Bed & Breakfasts/Inns have access to comparable sales data and property specific financial information that should support the asking price and may be made available to "Qualified Buyers". An accountant or qualified industry consultant's services should be used to analyze the financial data to be sure that income from the property can support the debt service relative to the down payment and your investment objectives.

The Contract of Sale is the controlling document in a purchase and should reflect terms that are practical relative to the down payment and the financing terms for which you are best qualified. The value of the business's "Good Will" and FF&E may be assigned separate values from the real estate in the Contract of Sale. Try to avoid this if possible as loan programs that accommodate financing anything other than real estate are less flexible and sometimes difficult to obtain. It is always a good idea to consult with a knowledgeable lender before entering into a Contract of Sale, since a lender who is familiar with bed & breakfast properties can pre-qualify you specifically to the property you have identified.

Most Contracts of Sale contain a mortgage contingency clause of 30 to 45 days, the exception being cash transactions, 1031 exchanges of equal value or sales where the seller has agreed to be the primary lender. The contract will also contain inspection clauses for items such as insect infestation, plumbing, HVAC, electrical and the structural integrity of the building(s). During this 'due-diligence period,' it is also common to incur attorney fees, survey fees and title fees. It is therefore important to note, that should the appraised value be determined to be less than the contract sale price, the appraised value will be used to determine the actual loan-to-value, rather than the contract price. If this should occur and the parties cannot agree on a revised value or contract terms, the buyer risks losing all or a portion of his/her due-diligence expenses.

Value Determination: Your lender will require and order an appraisal of the property. Appraisal fees generally range from $2,400 to $5,000 depending on the nature of the property and customary charges in a given geographical area.

Down Payment may be as little as 10% for qualified buyers, although interest rates typically increase proportionate to the Loan to Value (LTV). Funds from 401ks or IRAs can be used as a down payment on a B & B/Inn. The programs are quite complicated but can be managed professionally by a qualified plan facilitator.
Resumes will be necessary on purchases for all partners with an interest greater than 10%. A resume containing experience in the hospitality and/or restaurant industry will be extremely beneficial, as the lender must determine that the borrower's work history is sufficient to maintain and/or improve the cash flow of the business. Transferable skill sets may be used to offset this requirement
Credit Scores are extremely important to a lender in evaluating the merits of a loan. Your credit (or FICO) scores have a direct impact on the rate, term and loan program you for which you qualify. ***Note**: Individual lender guidelines may vary. For a copy of our Credit Guide, please visit our web site at:*
www.InnFinancing.com

Financing Overview

Because each property is unique in some way, so then each financing option must be analyzed carefully as to which financing programs are available in your state and what financing options you will have for the property you desire to purchase. A Conventional loan application package will contain such information as the Contract of Sale, 2 to 3 years business tax returns, an interim financial statement, bank statements and in some cases a business plan. In addition, for all partners with an interest greater than 10%, a credit profile, 2 years personal tax returns and resumes will be required.

The following is a brief overview on the various aspects of commercial financing:

- The business has income, but the Bed & Breakfast's/Inn's financials show a modest profit, or even a loss, and will not support the debt service on its own.
- Banks local to the property may not understand the industry because they are not comfortable with the industry and or the business itself.
- The concentration of Bed & Breakfasts/Inns in a particular area may be insufficient to develop the comparable sales data.
- The borrower's resume does not contain the skill sets that would give a lender confidence that the borrower has the ability to manage and maintain the business going forward.
- The combination of the buyer's down payment and the loan amount of the first mortgage falls short of the asking price or appraised value. Before non-bank lenders, if a local bank would not lend on a B & B/Inn, seller financing was the only way to facilitate a transaction. Seller financing still has its place in some transactions, as it broadens the pool of potential buyers and, in fact, may be the last and only way to consummate the sale.

Conventional Commercial Loans:

- For Viable inns only (Inns that cash flow principally on the business income however, underwriting may use global Debt to Income Underwriting DTI)
- 60% to 70% Loan to Value (LTV)
- 20 Year Term
- May require a balloon payment
- 2% to 3% in Closing Costs
- Cash Flow 130% Debt Service Coverage Ratio (DSCR)
- Yearly Business Financials are generally required

SBA FINANCING OVERVIEW

The 7a Program allows for financing of all types of business needs from purchasing real estate and fixed assets to working capital, business acquisitions and leasehold financing.
SBA's 7(a) Loan Guaranty Program offers the actual lender, Bank or Non-bank, a loan guarantee currently up to 90% of the loan amount. These Bank and Non-bank lenders are called "participants" as they participate with the SBA in providing funds to eligible borrowers. The SBA guarantees or insures the lender against loss resulting from a default and collateral shortfall. This guarantee allows the lender to provide for financing not ordinarily offered using conventional policies.

The SBA 7(a) loan program highlights are:

- Up to 90% financing
- 3 and 5 Year Fixed Available
- Fully amortized loans with no balloons
- Terms to 25 years
- Loans up to $2 million
- Reduced Closing Costs
- Loans may be assumed
- Variable and fixed rate financing at 1.25% to 2.75% Over Prime

The SBA 504 loan program highlights are:

The SBA 504 Program provides a method to finance real estate expansion projects through long-term, fixed-rate financing and is differentiated from the 7(a) program in that it is offered in partnership with a participating lender (Bank or Non-bank)."

The 504 loan program consists of two loans. The first loan and lien position is offered by an authorized lending institution and the second loan or second lien position is offered by the US SBA via the efforts of a certified development company (CDC).

Most CDC's are private organizations used by the SBA to process the 504 loan application and assist borrowers in obtaining proper funding which meets their needs.

The 504 loan program can be broken down into 2 distinct stages. The first or application stage consists of the completion of all SBA loan documents as well as any pertinent financial information. Once The SBA criteria have been met, the CDC as well as the lender will perform their underwriting processes. If the loan has been approved by both entities, it is then submitted by the CDC to the SBA office. Once the SBA provides an Authorization and at that point the loan then enters the closing process. At this point, the lender takes over and closes both the permanent loan #1 and interim loan #2. Assuming no construction, this temporary loan usually lasts approximately three months until the SBA is able to "take out" this loan. If construction is involved, then the interim period can last up to 12 months, or longer with extensions.

504 eligible project costs include;

- Land and building acquisition
- Site improvements
- Building improvements
- Professional fees, including architect, appraisal, environmental
- Other costs, including title insurance, survey, points and interest on interim loan
- Machinery and equipment acquisition

The main advantages of the SBA 504 program are as follows;

- Loans to 5 Million
- Small equity injection, as little as 15% toward the total eligible project
- Long-term financing is available, up to 25 years on loan 1 and up to 20 years on loan 2
- Very favorable, fully amortizing fixed-rate pricing on loan 2 at market
- Most closing costs are eligible for project financing
- SBA 504 loans may be assumed

Richard K. Newman, Managing Member
Commercial Capital Network, LLC
800 Main Street
Stroudsburg, PA 18360
Direct: 609-577-2209
E-mail: Newman.Rick01@gmail.com
Website: www.InnFinancing.com