THE PENNSYLVANIA STATE UNIVERSITY
SCHREYER HONORS COLLEGE

DEPARTMENT OF HOTEL, RESTAURANT AND INSTITUTIONAL MANAGEMENT

FEASIBILITY STUDY FOR THE PURCHASE OF AN EXISTING HOTEL PROPERTY

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Abstract

This thesis is a feasibility report concerning the purchase of an already existing hotel property. The main goal of the report is to objectively look at and analyze the property as a whole to determine if it is a viable lower risk purchase. The report covers concepts such as: property overview, recent renovations, past financial performance, and potential future performance. The report concludes with whether or not this hotel is a positive lower risk purchase.

Hotel Feasibility Study

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Summary of Findings

This report gathered and looked at information pertaining to the Maui Oceanfront Inn. Past financial data was analyzed and possible future financial ability was forecasted five years out from the initial purchase year. The value of the hotel was calculated as well as the return on investment. The competition was studied. Recent renovations and their impact on the hotel were discussed.

The past financial performance is positive. The hotel has positive earnings before debt every year. The profit ratios are positive. The forecasted years show this trend continuing with an increase in revenues each year. The value of the hotel is calculated to be above the negotiated selling price. The return on investment is positive.

The competition in the surrounding area is a negative for the hotel. The occupancy percentage, ADR, and RevPAR for the hotel are low compared to the competition set. However, this must be taken in context. The surrounding competition is composed of higher end luxury brand hotels. The Maui Oceanfront Inn, being a Days Inn, is at the lower end and is not a luxury brand. Recent renovations in 2001 and 2007 are positives. They will decrease expenses.

The Maui Oceanfront Inn is a lower risk buy. However, it is suggested that more definitive information be gathered and analyzed before a final decision is made regarding the purchase.

Introduction

The purpose of this report is to objectively look at the information provided by the Maui Oceanfront Inn to determine whether or not the property is a lower risk viable purchase. The report is to be used as a tool by the prospective buyers of the Inn. It is to be utilized as a source of information and facts regarding the hotel property, hotel franchise, competition, and any and all other aspects of the hotel. Financial information has been gathered to show past performance. Potential future financial achievements were forecasted, and a possible financing plan for the purchase of the property was provided. The report is unbiased and offers both positive and negative findings.

The report was compiled using information provided by the Maui Oceanfront Inn. The profit and loss statements from past years were used to showcase the past financial performance. These statements were also used to forecast future potential profits. Calculations were used to present what the value of the property is based off of potential future earnings.

The methodology for determining whether or not the Maui Oceanfront Inn is a lower risk purchase was to look at what the hotel is and what the hotel offers. To determine if the purchase is lower risk, earnings are forecasted five years out from the purchase year. The value of the property is calculated and compared to the negotiated selling price. The profits to be gained by the investors are highlighted in the financing plan and the return on investment for the investors is calculated.

This is an unbiased report to be used by the prospective buyers of the Maui Oceanfront Inn to find out if the buy is lower risk. The report is needed to help with this decision by compiling essential information. Past financial performance, potential future performance, and the property itself are looked at and analyzed to conclude if the purchase is lower risk.

Overview of Property

The Maui Oceanfront Inn is an eighty-seven room hotel located in Kihei, Maui, Hawaii. The hotel is thirty years old. It is located on two land lots. The first lot is 1.19 acres and the second lot is .60 acres in size. The eighty-seven rooms are divided into eighty-four standard rooms, two oceanfront suites, and one Owner's Luxury Suite which also doubles as a potential timeshare model.

On-site amenities include: exercise room, wireless internet access throughout the property, laundry, ice machines, and an activity patio on the beach. There is cable television with HBO, Showtime, and seventy-seven other channels. In-room amenities include: twenty-seven inch televisions, irons and ironing boards, air conditioning, coffee makers, hair dryers, and Tempur-Pedic bedding.

The hotel is located adjacent to a sundry store and the 5 Palm Restaurant. Sarentos Restaurant is a Mobile Five-Star eating establishment located on hotel property. Kahului, Maui Airport is twelve miles away, and the shops and golfing at Wailea Resort are two miles away. The Hotel is considered directly on the beach and guestrooms are approximately one hundred feet from the water.

The land is currently leased from the Department of Land, State of Hawaii. Twenty-three years remain on the current lease. The monthly ground lease for both lots is $7,387. There are two parking lots with a total of one hundred and forty three spaces. Current zoning is for Resort/Hotel/Timeshare. The current franchise is with Wyndham as a Days Inn.

The property has gone through two separate rehabilitation processes. In 2001, the restaurant conducted a complete rebuilding. In 2007, the hotel had a complete interior rehabilitation.

The zoning of the property includes timeshare status. One of the rooms of the hotel has been converted into a timeshare model, and both time and money have been invested by the previous owner into research pertaining to a possible timeshare conversion. However, this does not affect past performance of the property, and the ability to convert to a timeshare hotel would take a few years to achieve. Thus, it has not been included in this report.

The Maui Oceanfront Inn is an eighty-seven room hotel located in Hawaii. It is located on land leased by the state of Hawaii and is on oceanfront property. Sarentos Restaurant is located on property and adjacent to the Inn. Sarentos pays fees for the use of the location and building to Oceanfront Inn. The buildings received renovations in 2001 and 2007.

Previous Rehabilitation/Rebuilding and Potential Future Upgrades

The Maui Oceanfront Inn has gone through two separate rehabilitations. The first occurred in 2001. The on-site restaurant was completely rebuilt. The construction and pre-opening costs and expenses came out to $1,686,120.82. The interior of the hotel was renovated completely in 2007 to the cost of $667,345. This included such concepts as the installation of wireless internet throughout the entire hotel.

Since the hotel underwent renovation in 2007, the deferred maintenance is low and would not be a burden to the operating budget. Being only two years out, the upgrades are still in good condition.

Possible upgrades could be applied to the parking areas. The parking area is divided into two lots culminating in one hundred and forty three spaces. There are areas and spaces of the parking area that are paved. However, this cannot be said for the entire parking lot. One potential upgrade could be paving the entire parking area. This would be an aesthetic upgrade to the hotel and would improve upon one of the main negative customer comments management has received.

During the upgrade of 2007, the hotel changed flags from a Best Western to a Days Inn. This was done because the Days Inn brand required less of an upgrade than the Best Western brand did. The change to a Days Inn was essentially a monetary move.

The property experienced upgrades and renovations in 2001 and 2007. The restaurant was rebuilt completely in 2001, and interior renovations to the hotel were done in 2007. The interior renovations in 2007 influenced the change from a Best Western to a Days Inn.

The Restaurant

Sarentos Restaurant is located on The Maui Oceanfront Inn property. The restaurant is an Italian inspired AAA Four-Diamond establishment. The restaurant has been in business since 1973 and has established itself to be a successful eatery. Sarentos is open for dinner only.

The restaurant is housed in a 6,400 square foot building. The building is leased to the restaurant by the Oceanfront Inn. The current lease was a ten year lease set to end December 2010. Three five-year options were included in this agreement. The restaurant has requested to option the extension. Sarentos pays a minimum monthly rent charge of $18,000. A percentage rate of 8.5% to 9% of gross receipts plus maintenance fees are paid to the Oceanfront Inn.

Competition

The Smith Travel Research report for the Maui Oceanfront Inn compared to a competitive set repeatedly shows the hotel being in the bottom of the rankings. Focusing on the year to date numbers, occupancy percentage for the Inn had the property placed at six out of eight for the year 2007 and five out of eight for the year 2008. This means the hotel had the sixth highest occupancy percentage of the eight total hotels in the competitive set for 2007 and fifth highest in 2008.

Applying the same ranking system to ADR, in 2007 the Inn was six out of eight. In 2008, the hotel was seven out of eight. With RevPAR, the Inn was seven out of eight in 2007 and eight out of eight in 2008.

These numbers, while not completely positive, must be taken within context. The Maui Inn is a Days Inn branded hotel. This means it is on the lower end scale of limited service properties. Many of the surrounding hotels, who are compiled within the competitive set, are world class upper end full service establishments. This difference would affect ADR and RevPAR numbers considerably. For example, in 2008 the ADR for the Inn was $109.71. For the competitive set, the ADR was $146.35. This large difference could be explained by the difference in scale of the brands.

According to the Smith Travel Research report, the Maui Oceanfront Inn ranked toward the lower end of the competitive set. This, however, could be explained by the differences in brand scale for the surrounding hotels.

Franchise

Currently, the Maui Oceanfront Inn is a Wyndham franchised property. The flag is Days Inn. Up until 2006, the hotel was a Best Western. The property is the only Wyndham Resort in Hawaii.

The Days Inn has an initial franchise fee of $36,000 and an on-going royalty fee of 5.5% of gross room revenue. For a conversion property, the franchise lease is for fifteen years.

Marketing support includes: co-op advertising, ad slicks, national media, and regional advertising. On-going support includes: newsletters, meetings, toll-free phone line, internet, purchasing cooperatives, and field operations/evaluations. Training includes: five days at Days Inn headquarters, two days at the franchise hotel, and one to three day regional workshops. For 2010, Days Inn ranked number twenty one on the Franchise 500 rank. It ranked seventeenth for 2010 in America’s Top Global Franchises.

Overview of Financials

The Maui Oceanfront Inn is an eighty-seven room hotel property for sale in Hawaii. The current asking price is eleven million dollars. The profit and loss statements for 2005, 2006, 2007, and 2008 will be studied as indicators of past performance for the property. The statements are charts 4, 3, 2, and 1 respectively. The profit and loss statement for 2009 will not be looked at. The statement was incomplete at the time of this study and contained items not pertaining to the hotel or other related businesses (i.e. Sarentos Restaurant).

In 2005, the Oceanfront Inn produced total revenue of $2,839,382.23 and total expense of $1,466,684.33 with a net income before debt of $1,024,180.15. The Profit and Loss Statement for 2006 (Chart 3) shows a total revenue of $3,306,771.10 and total expense of $1,876,378.48 with a net income before debt of $1,135,361.22. The Statement for 2007 (Chart 2) shows revenue of $3,004,039.83, expense of $1,544,126.00, and net income before debt of $1,459,913.83. 2008 (Chart 1) has revenue of $3,108,061.95, expense of $1,901,127.31, and net income before debt of $1,206,934.64. These numbers reflect the fact that the Inn is, on average, producing revenue far exceeding its expenses. The profit percentages before debt had a low of 36.07% in 2005 and a high of 48.59% in 2008. The net income for the four different years indicates the hotel produces a profit consistently after expenses are paid.

The Pro Forma Profit and Loss Statement (Chart 5) shows future years 1-5 after purchase of the hotel property. The projected numbers are based off of past performance as indicated by the Profit and Loss Statements for years 2005, 2006, 2007, and 2008. Because the formats for the statements received were not consistent, assumptions had to be made with the design of the Pro Forma. With revenue, rooms revenue and telephone revenue remain the same. Any other revenue is classed as other. With expenses, advertising remains the same. Property operation and utilities department are classified as property operation. All other expenses are classed as other.

The calculations have assumed numbers. The assumptions for year one are that the hotel will perform relatively the same as the previous years. There will be no major changes to the expenses or revenue. The economic climate will stay relatively the same, thus the number of guests and sold hotel nights will not experience noteworthy changes. To predict the numbers for each item, the average of the four previous years was calculated. This gives an average indication of what the potential numbers will be, since it is assumed the numbers for year one will not differ all that much from previous years.

Year two of the Pro Forma Statement has a modest change. The assumption with year two, while believing revenue will stay consistent with previous years, is that expenses will be decreased. After resort renovations were completed for 2007, it is assumed maintenance and repair fees will decrease. This will affect the total expense number sufficiently, since 2008 (Chart 1) showed Maintenance and Repairs was 15.6% of the total expense for that year. The previous year (Chart 2) this same item was only 2.8% of the total expense. It is assumed this number will be approximately 5% of total revenue. Advertising expense will also decrease. The numbers for the advertising expense have consistently gone down throughout the years, thus this will be reflected in year two.

Year 3 assumes revenue will increase. The room revenue contains the assumptions that there will be 90% occupancy of the 87 total rooms at an ADR of $100. The ADR is based off of previous years' ADRs which range from between $95-$110. Occupancy consistently ranges from 85%-95% throughout the year for previous years. Thus, 90% is used. Expenses will go down. Property operating expense will stay at 5% of the total revenue. Advertising is assumed to be at .6% of the total revenue. This is based off of past performance. Years 1 and 2 had advertising at .92% and .58% of the total revenue while 2008 and 2007 had advertising at .82% and .62% of the total revenue. .6% is in line with these previous numbers. With year 1 other expense at 47% of the total revenue and year 2 at 48.6%, it is assumed year 3 will be relatively the same at 48%.

Year 4 assumes room revenue will increase. Room revenue is assumed to include an occupancy percentage of 92% average for the year with $105 as the ADR. The ADR and occupancy percentage are assumed to increase with the assumption that economic conditions will have improved, facilitating an increase in leisure travel. Telephone revenue will decrease with the continued trend of guests using their personal cellular phones and other wireless communication devices instead of landlines provided by the hotel. Expenses are assumed to stay in approximately the same percentage range of total revenue as previous years.

Year 5 assumes an increase in room revenue. Occupancy percentage for the year will average out to 90%, a slight decrease from the previous year. However, ADR will increase to $110. The occupancy percentage is assumed to settle into an overall trend of 90%. The increase in ADR is staying consistent with the forecasted trend of increased leisure travel amid improved economic conditions. Telephone revenue is expected to go down slightly with the same assumption as year 4. Expenses are to stay consistent with previous years' percentage of total revenue ranges.

The Pro Forma Statement for years 1-5 show an increase in net income before debt every year. Total revenue increases yearly. These are both positives. Expenses do increase, but in ratio to the percentages of the operating budget.

The Maui Oceanfront Inn produced a positive income both before and after debt service in 2005, 2006, 2007, and 2008. 2009 was not used because it was incomplete at the time of this report. Years one through five after purchase have been forecasted, and the trend of positive incomes continues.

Maui Oceanfront Inn

Income Summary December 31, 2005

	Current Period Actual	%	Current Period Budget	%	Year to Date Actual	%	Year to Date Budget	%
Revenue								
Rooms Dept.	209,295.97	86.16%	193,652.00	84.79%	2,431,877.96	85.65%	2,281,340.00	84.80%
Telephone	759.57	0.31%	816	0.36%	5,187.34	0.18%	9,661.00	0.36%
Other Dept.	32,865.96	13.53%	33,913.38	14.85%	402,316.93	14.17%	399,365.05	14.84%
Total Revenue	242,921.50	100.00%	228,381.38	100.00%	2,839,382.23	100.00%	2,690,366.05	100.00%
Op. Exp.								
Rooms Dept.	59,747.14	24.60%	55,791.46	24.43%	706,997.34	24.90%	670,331.52	24.92%
Telephone	2,050.38	0.84%	1,159.00	0.51%	14,083.14	0.50%	13,800.00	0.51%
Other Dept.	2,097.26	0.86%	923.67	0.40%	12,545.94	0.44%	10,372.40	0.39%
Admin.& Gen.	28,386.45	11.69%	27,842.00	12.19%	342,242.80	12.05%	334,500.00	12.43%
Adver.& Promotions	3,865.71	1.59%	1,858.61	0.81%	31,823.53	1.12%	28,192.25	1.05%
Property Op	6,547.17	2.70%	12,907.80	5.65%	143,828.83	5.07%	153,484.17	5.70%
Utilities Dept.	10,948.41	4.51%	12,165.00	5.33%	148,411.79	5.23%	143,847.00	5.35%
Franchise Fees	4,827.87	1.99%	3,354.00	1.47%	66,750.96	2.35%	39,721.00	1.48%
Total Op. Exp.	118,470.39	48.77%	116,001.54	50.79%	1,466,684.33	51.66%	1,394,248.34	51.82%
Gross Op. Exp.	124,451.11	51.23%	112,379.84	49.21%	1,372,697.90	48.34%	1,296,117.71	48.18%
Fixed Exp.	17,982.96	7.40%	29,217.00	12.79%	348,517.75	12.27%	412,532.00	15.33%
Income Before Debt	106,468.15	43.83%	83,162.84	36.41%	1,024,180.15	36.07%	883,585.71	32.84%
Debt Service	75,886.49	31.24%	48,000.00	21.02%	635,007.03	22.36%	576,000.00	21.41%
Net Income	30,581.66	12.59%	35,162.84	15.40%	389,173.12	13.71%	307,585.71	11.43%

Chart 4

Maui Oceanfront Inn

Income Summary December 31, 2006

	Current Period Actual	%	Current Period Budget	%	Year to Date Actual	%	Year to Date Budget	%
Revenue								
Rooms Department	206,519.38	88.02%	217,087.88	86.29%	2,899,911.12	87.70%	2,605,055.00	86.29%
Telephone	200.15	0.09%	391.00	0.16%	5,270.86	0.16%	4,692.00	0.16%
Other	27,901.51	11.89%	34,104.76	13.56%	401,589.12	12.14%	409,258.00	13.56%
Total Revenue	234,621.04	100.00%	251,583.64	100.00%	3,306,771.10	100.00%	3,019,005.00	100.00%
Operating Expenses								
Rooms Department	89,918.39	38.32%	62,644.75	24.90%	797,120.68	24.11%	751,737.00	24.90%
Telephone	1,569.26	0.67%	1,053.00	0.42%	13,449.36	0.41%	12,636.00	0.42%
Other	484.22	0.21%	1,001.76	0.40%	17,726.97	0.54%	12,022.00	0.40%
Admin. Gen	47,511.84	20.25%	28,900.63	11.49%	638,361.92	19.30%	359,608.00	11.91%
Adver.& Promotions	1,441.02	0.61%	3,052.89	1.21%	36,944.25	1.12%	36,636.00	1.21%
Property Op	21,680.20	9.24%	7,737.00	3.08%	139,846.21	4.23%	92,844.00	3.08%
Utilities Dept.	13,474.48	5.74%	13,088.00	5.20%	155,873.17	4.71%	157,056.00	5.20%
Franchise Fees	4,514.01	1.92%	5,500.00	2.19%	77,055.92	2.33%	66,000.00	2.19%
Total Oper. Exp	180,593.42	76.97%	122,978.03	48.88%	1,876,378.48	56.74%	1,488,539.00	49.31%
Gross Oper. Profit	54,027.62	23.03%	128,605.61	51.12%	1,430,392.62	43.26%	1,530,466.00	50.69%
Fixed Expenses	21,347.66	9.10%	26,166.63	10.40%	295,031.40	8.92%	409,200.00	13.55%
Income Before Debt	32,679.96	13.93%	102,438.98	40.72%	1,135,361.22	34.33%	1,121,266.00	37.14%
Debt Service	58,934.97	25.12%	50,000.00	19.87%	793,397.59	23.99%	600,000.00	19.87%
Net Income	-26,255.01	-11.19%	52,438.98	20.84%	341,963.63	10.34%	521,266.00	17.27%

Chart 3

Maui Oceanfront Inn

2007 Profit and Loss Statement

Income	
Misc. Rev	22,665.92
Rooms Rev	2,524,661.00
Sarento's Rent	398,434.91
Telephone Rev	11,084.00
Interest Inc.	47,194.00
Total Income	3,004,039.83
Expense	
Salaries and Wages	580,490.00
Repairs and Maintenance	42,757.00
Taxes and Licenses	457,297.00
Advertising	18,645.00
Employee Benefits	61,754.00
Other Expenses	383,183.00
Total Expenses	1,544,126.00
Net Income Before Debt	1,459,913.83
Debt Payment	
La Jolla Bank	1,002,330.90
La Jolla Loans Co.	75,000.00
Total Debt 2007	1,077,330.90
Net Income	382,582.93

Chart 2

Maui Oceanfront Inn

2008 Profit and Loss Statement

Income

Misc. Revenue	296,826.58
Rooms Revenue	2,435,945.85
Sarentos Rent	367,948.51
Telephone Revenue	7,341.01
Total Income	3,108,061.95

Expense

Salaries and Wages	480,134.68
Repairs and Maintenance	297,052.13
Taxes and Licenses	434,075.89
Advertising	25,384.55
Employee Benefits	85,634.99
Other Expenses	578,845.07
Total Expenses	1,901,127.31
Net Income Before Debt	1,206,934.64
Debt Payment	920,594.16
Total Debt	920,594.16
Net Income	286,340.48

Chart 1

Maui Oceanfront Inn

Pro Forma Income Statement Years 1, 2, 3, 4, 5

Revenue	Year 1	%	Year 2	%	Year 3	%	Year 4	%	Year 5	%
Rooms Dept	2,573,098.98	84.29%	$2,608,404.24	83.98%	$2,857,950.00	84.60%	$3,067,533.00	84.97%	$3,143,745.00	86.04%
Telephone	7,220.80	0.24%	$7,729.17	0.25%	$8,343.75	0.25%	$7,658.68	0.21%	$7,641.06	0.21%
Other	472,445.49	15.48%	$489,977.63	15.77%	$512,074.76	15.16%	$534,818.24	14.81%	$502,329.03	13.75%
Total Revenue	3,052,765.28	100.00%	$3,106,111.04	100.00%	$3,378,368.51	100.00%	$3,610,009.93	100.00%	$3,653,715.09	100.00%
Op. Expense										
Advertising	28,199.33	0.92%	$18,057.22	0.58%	$20,270.21	0.60%	$22,382.06	0.62%	$20,095.43	0.55%
Property Op	231,942.28	7.60%	$156,867.70	5.05%	$168,918.43	5.00%	$173,280.48	4.80%	$179,032.04	4.90%
Other	1,436,937.42	47.07%	$1,510,516.72	48.63%	$1,621,616.88	48.00%	$1,714,754.71	47.50%	$1,680,708.94	46.00%
Total Expense	1,697,079.03	55.59%	$1,685,441.64	54.26%	$1,810,805.52	53.60%	$1,910,417.25	52.92%	$1,879,836.42	51.45%
Net Income Before Debt	1,355,686.25	44.41%	$1,420,669.40	45.74%	$1,567,562.99	46.40%	$1,699,592.67	47.08%	$1,773,878.68	48.55%
Debt Service	575,600.00	18.86%	575,600.00	18.53%	575,600.00	17.04%	575,600.00	15.94%	$575,600.00	15.75%
Net Income	780,086.25	25.55%	$845,069.40	27.21%	$991,962.99	29.36%	$1,123,992.67	31.14%	$1,198,278.68	32.80%

Chart 5

What is the Value of the Property and Return on Investment

The Maui Oceanfront Inn was originally listed at $18.5 million. This price has since gone down to its current negotiated level of $11 million. The following are calculations to consider in the valuation of the property.

Using the income method, the value of the property will be determined. An average of future net operating income amounts will be assumed. The assumptions are based off of past performance and future economic conditions. The average of the net income before debt for the first five years is assumed to be $1,563,478.00. The capitalization rate is based off of a thirty year loan at 6%. According to the mortgage factor table (Chart 6) the factor is 5.996. This gives a percentage of 7.195%.

The purchase will be financed with 8 million dollars being funded by mortgage and 3 million by equity investors. Approximately 72.7% will be by mortgage with 27.3% by investors. The investors will receive 15% return on their investment. The weighted capital rate is .0932577.

Dividing the average net income before debt by the weighted capital rate, the value comes out to $16,764,722. (Chart 7)

The current purchase price of eleven million dollars is not over the estimated value of the business. Based off of the estimated value of the hotel, eleven million dollars is a reasonably positive price to pay.

Based on the current selling price of eight million, the return on equity for the investor would be 28.7% (Chart 7).

The current selling price of eleven million dollars reflects a purchase price below the calculated property value. The calculated value of the property based off of forecasted revenues for the next five years is in the range of sixteen million dollars. With the forecasted potential average income before debt the hotel could make, the return on investment for the equity investor would be 28.7%.

Interest Rate	30 Year	15 Year
4.125%	4.847	7.46
4.250%	4.919	7.523
4.375%	4.993	7.586
4.500%	5.067	7.649
4.625%	5.141	7.714
4.750%	5.216	7.778
4.875%	5.292	7.843
5.000%	5.368	7.908
5.125%	5.445	7.973
5.250%	5.522	8.039
5.375%	5.6	8.105
5.500%	5.678	8.171
5.625%	5.756	8.237
5.750%	5.736	8.304
5.875%	5.915	8.371
6.000%	5.996	8.439
6.125%	6.076	8.506
6.250%	6.157	8.574
6.375%	6.239	8.643
6.500%	6.321	8.711
6.625%	6.403	8.779
6.750%	6.486	8.849
6.875%	6.569	8.918
7.000%	6.653	8.988
7.125%	6.737	9.058
7.250%	6.821	9.128
7.375%	6.907	9.199
7.500%	6.992	9.27
7.625%	7.077	9.341
7.750%	7.164	9.412
7.875%	7.25	9.484
8.000%	7.337	9.556
8.125%	7.425	9.629
8.250%	7.513	9.701
8.375%	7.6	9.774
8.500%	7.689	9.847
8.625%	7.777	9.92
8.750%	7.867	9.994
8.875%	7.956	10.068
9.000%	8.046	10.142
9.125%	8.136	10.217
9.250%	8.226	10.291
9.375%	8.317	10.366

9.500%	8.408	10.442
9.625%	8.499	10.518
9.750%	8.591	10.594
9.875%	8.683	10.669
10.000%	8.776	10.746
10.125%	8.868	10.823

Chart 6

Property Value

Cap Rate

5.996x12= 71.95
71.952/1,000=.07195
.071952x100=7.1952

7.195

Weighted Cap

	Percent of Value	Return Required	Weighted Average
Mortgage	72.70%	7.1950%	0.05230765
Equity	27.30%	15.00%	0.04095
		Total	0.0932577

Purchase Value

1,563,478/.0932577
16764722

16,764,722

Return on Equity

Total Purchase Price	11,000,000
Debt Financing	8,000,000
Equity Financing	3,000,000
Total Average Net Income Before Debt	1,563,478
Allocated to mortgage amortization	575600
Available for Equity	860,922
Return on Equity	28.70%

Chart 7

Finance

The purchase of the Maui Oceanfront Inn will be financed through a mortgage and two investors. The mortgage will be a six percent thirty year mortgage provided by the participating bank. The mortgage will be for eight million dollars. The remaining three million will be split between the two investors, with investor one putting in one million and investor two putting in two million.

Investor one will be the primary owner of the hotel. Investor two will be a limited equity silent partner whose only risk is limited to the two million they invested.

The mortgage qualifies for USDA guarantee backing. The USDA will back 60% of the mortgage. Thus, the bank risks $3,200,000 of the $8,000,000. The bank's risk is 29% of loan to value.

The mortgage will be amortized for thirty years. For the first four years, the payment to the participating bank will be $575,600. After the bank is paid, investor two will be paid $500,000 for the first four years plus ten percent on the remainder of their investment. For example, investor two will receive ten percent on their two million in year one. Year two, investor two will receive ten percent on one million five hundred thousand, since five hundred thousand was paid off during year one (Chart 8).

The remainder will go to investor one. Investor two will be paid so they receive back their original two million within four years, and investor one will be get back their one million. After these four years are over, the $500,000 that was being dispersed to investor two to pay off their original investment will be paid to the bank to reduce the principle. This extra principle reduction would give investor two a 15% return on the increased equity. This extra payment amount will pay off the loan within approximately twelve years instead of thirty. After the payment to the bank is made, the remaining yearly income after debt service and principle reduction will be split between the two investors, with investor two receiving their guaranteed fifteen percent and investor one the remaining eighty five percent.

Finance

	Year 1	Year 2	Year 3	Year 4	Year 5
Income	1,355,686.25	1,420,669.40	1,567,562.99	1,699,592.67	1,773,878
Mortgage	575,600	575,600	575,600	575,600	575,600
Sub Total	780,086.25	845,069.40	991,962.99	1,123,992.67	1,198,278
Additional Mortgage	0.00	0.00	0.00	0.00	500,000
Sub Total	780,086.25	845,069.40	991,962.99	1,123,992.67	698,278
To Investor 2	700,000	650,000	600,000	550,000	104,741.70
To Investor 1	80,086.25	195,069.40	391,962.99	573,992.67	593,536.3
Total to Investor 2		1,350,000	1,950,000	2,500,000	2,604,741.7
Total to Investor 1		275,155.65	667,118.64	1,241,111.31	1,834,647.61

Chart 8

Conclusion

Based off of the available information, the Maui Oceanfront Inn has positives and negatives in regards to a possible purchase. The hotel is situated on beachfront land leased by the state of Hawaii. Sarentos Restaurant is located on property and pays fees to the hotel for use of the building it is housed in. The current franchise brand of the hotel is Days Inn. Renovations were done in 2001 and 2007. The Smith Travel Research report shows the hotel ranking low against the competitive set for ADR, RevPAR, and occupancy percentage, but the majority of these numbers must be looked at within the context of brands surrounding the Inn. The profit and loss statements show the hotel consistently makes a profit. The numbers are positive both before and after debt service for all four years – 2005, 2006, 2007, and 2008. The pro forma profit and loss statements show this trend continuing. The financing for the purchase of the hotel would include a thirty year mortgage for eight million dollars at six percent and two investors at three million dollars. The purchase price of the hotel is eleven million, which is below the income method valuation of the property.

With the information provided, the Maui Oceanfront Inn is a lower risk buy. However, more definitive information should be collected before a decision is fully made.

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