

### Annexure 1: Why Buy a Leasehold Motel?

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This is a question which we are being asked more often by people in the industry and people considering joining the industry.

The commercial answer to the question is that the net return on a leasehold property is much higher than that on a "freehold going concern" and the entry cost is comparatively low.

There is potential for capital growth with respect to leasehold properties, particularly where a new owner is able to increase turnover and therefore net profit of an operation. Rents generally speaking are not related to turnover and therefore an increase in net profit is enjoyed by the proprietor of the motel rather than the landlord.

An increase in net profit means that on disposal of the property (note the industry average for turnover is about 2½ years for each owner of a motel) will result in the vendor of a business enjoying an increase in the value of the goodwill for which he is able to sell the property.

This is particularly so where there are still a good number of years left to run on the lease. Because of the higher return in respect of these properties as compared to freehold going concerns, one must consider the time-honoured investment slogan "Risk equals return".

#### Suited to a lifestyle

Purchase of a leasehold property is becoming increasingly popular with people (usually husband and wife teams) entering the industry for the first time. Before the decision is taken, intending moteliers need to think very carefully whether they are suited to a life in a particularly demanding service industry.

If consideration of those lifestyle questions is favourably resolved then many new entrants into the motel industry choose to buy a leasehold property.

As a purchaser of a lease you are purchasing the goodwill and chattels of the operation, not the real estate and buildings attached thereto. The cost of purchase of a leasehold business is approximately one third of a freehold going concern, yet the returns are considerably higher.

## tip

**Remember that when you buy a motel lease, there are expenses, known in the industry as "ingoinings". These include:**

- bank fees
- solicitor's fees
- accountant's fees
- government stamp duty
- insurance.

**Work out exactly what these expenses are and don't leave yourself short.**

### **Consult with experienced adviser**

One of the most important keys to ensuring a safe investment in leasehold motel property is to engage consultants experienced in sale, purchase and operation of leasehold properties. It is also essential that the appropriate lease documentation, contract for purchase and industry formulas be applied to your transaction.

### **The Motel Lease**

The Motel Lease is an important asset which, if correctly structured, protects the value of the tenant's business and the value of the landlord's freehold investment. However, a Lease that does not reflect current industry standards will be a cross that both parties will have to bear for many years.

The purpose of the Lease is to set out the rules by which the tenant is able to occupy the motel. It will also set out the responsibilities of both the landlord and the tenant.

### **Understand the lease document**

It is important that potential Lessees understand that their occupation of the motel is controlled ultimately by the landlord through the Lease document. It is essential prior to purchase of the business, that the purchaser understands as much as possible about the Lease document and how it works.

Not only does this document affect his own activities in the motel business, but it is also an important part of the asset which is sold when the motelier decides to move on to another property.

The Lease document on the sale of the motel will be carefully scrutinised by an incoming purchaser and his solicitor to ensure that the new buyer is adequately protected. It is essential that the document be analysed by the purchaser and his consultants so that the motelier understands what costs he will be responsible for in relation to the property.

### **Term**

The length of a tenant's tenure and security will be derived from the Lease. This is extremely important in creating the maximum value in a motel business. Obviously, a business which has 5 years left to run under its lease is of far less value than one with a lease which has 20 years left.

Where a lease has a few years left to run, a tenant should seek advice as to the details of the formula recognised in the industry which applies to negotiations for lease extensions. A tenant will in effect buy more years to add to the term of the lease.

Enforcing the idea that short leases are of greatly reduced value is the fact that should a purchaser wish to buy a leasehold motel, obtaining finance will be particularly difficult when the remaining tenure of the lease is short.

Leases generally run for an initial 10-year term with two or three options of five years each, capable of being exercised by the Lessee of the property. The Lease should provide for the purchase of the chattels of the business by the landlord on expiry of the Lease.

### **Rent**

The Lease will set out the amount of the rent and how it is to be paid to the landlord. It is essential that anyone considering purchasing a motel lease has experienced consultants to consider the rent compared with industry standards. This is important when assessing whether there is any room for improvement in the profitability of the business and whether the business is readily saleable.

Rent under the lease is paid calendar monthly in advance and usually there is provision in most new lease documents for an increase in rent pursuant to the Consumer Price Index on an annual basis.

### **Repairs and Maintenance**

An important subject for any motel lease is repairs and maintenance. It is a feature of most well drawn Leases that responsibility for maintenance and upkeep of the motel is clearly set out. It is important that the Lease clearly specify who is responsible for the replacement of the fixtures and fittings when they come to the end of their working life.

It is a feature of most Leases that responsibility for maintenance and upkeep of the motel is left to the tenant. The rationale behind this is that the motelier does not want his business suffering whilst he waits for a tardy landlord to effect repairs to the property. It is far more desirable that the motelier be in control of the maintenance of his own building so that his business is not adversely effected.

The results of the analysis of the Lease in terms of cost to the tenant could be conveyed to the purchaser's accountant prior to any Contract for the purchase of a property becoming unconditional.

### **Landlord's consent? (Assignment of the Lease)**

Like many businesses, the sale of a motel lease is not simply a transaction between a vendor and a purchaser. In any business where the premises are leased, a landlord must give permission before the lease can be transferred.

There are no set rules for obtaining the consent of the landlord. In some cases, the landlord will wish to meet with the proposed purchaser, in others the landlord will simply want to see the references, resumes and financial information in respect of the proposed purchaser.

Any person looking at purchasing a motel leasehold business should ensure that they have their references and resumes ready to go. This will avoid any possible time delays during the transaction.

Generally, the landlord will ask the proposed purchaser to provide the following documents:

- a resume from the purchaser (or if the purchaser is a company the directors of the purchaser) the resume should highlight the previous business experience of the purchaser and in particular any experience that will prove that the purchaser has the qualities necessary to operate a motel
- two personal references (i.e. someone who knows the purchaser on a social basis should provide a short-written letter saying what a fine, outstanding member of the community the purchaser is)
- two business references (from two people who have known the purchaser on a business basis. These references should confirm in writing that the purchaser's dealings with them have been professional and that the purchaser has the qualities necessary to operate a motel)
- a statement of assets and liabilities (the landlord will want to be able to determine that the purchaser has some financial stability and will be able to continue to pay the rent)
- details of any borrowings by the purchaser (again the landlord will want to be able to determine that the purchaser will be able to continue to pay the rent. The landlord will also want to understand if there is anyone else (i.e. a bank) with an interest in the lease).

Generally, a landlord will want to satisfy themselves that you do not have any criminal convictions, you have a good character, your financial standing is sound and you will be competent at your job.

A landlord is not able to unreasonably withhold his consent to the transfer of the lease.