

## STRIKING THE BEST DEAL

*Start-ups or existing B&B owners looking for finance will often find the best route is via a specialist finance broker. Bill Lumley talks to Stewart Hindley & Partners senior partner Chris McDonagh for a fuller picture.*

There are plenty of reasons why new or existing luxury B&B owners may require an injection of capital.

McDonagh tells *Luxury Bed and Breakfast* magazine: "For high end and luxury B&Bs, the business needs to be refreshed on a regular basis, which might require £100,000 Capex to upgrade the infrastructure, for example with new wi-fi, electric charging points for motor vehicles and so forth."

Luuxury B&B owners might have an existing loan and find themselves in a position where they need more flexibility in terms of their loan repayments, such as seasonal repayments whereby they pay interest only in the quiet months and repayment with a higher payment schedule in the busy season.

"If there is an element of refurbishment and capex is required then that might be a good opportunity to look into refinancing in general, and to get a more competitive rate, and for some people it may be an opportunity for a bit of capital release as well. They might have run the B&B for 10 years for example and might now like to take some money out for, say, children's university fees. That could be wrapped up in a refinancing model."

Stewart Hindley & Partners is focusing mostly in the B&B market today on new-to-trade operators. "I'd say that 70% of our business is new-to-trade operators," says McDonagh. "They represent challenges in their own right, because banks are risk-averse, and they really prefer people with a proven track record in the hospitality sector. But if the applicants are of good commercial standing that will inevitably help the application."

The broker generally produces a positioning document that gives the bank the assurance it needs that the applicants for the debt will have the wherewithal to be able to take the business forward, he says.

"We'd generally suggest they go on a hospitality course before they actually engage with us and the bank. New-to-trade B&Bs in particular

present a challenge as they are generally attracted to businesses that are in decline.

"That's not to say that the product itself is in decline, just that people are in retirement mode and rather than working the business very hard they have let their foot off the pedal, so the trade has declined and as a consequence the trading profit has declined too, which is the driver to service the debt, and is therefore the number one factor."

Although there are cases of existing B&Bs that seek finance to upgrade to the luxury level, doing so can be difficult, he says. "One reason is that the majority of these owners generally live out of the business, so the net profit isn't necessarily a true reflection of the trade. Depending on lifestyle, that could be anything from £5,000 to £20,000 a year. It's important therefore if existing operators are looking to leverage debt that they position their trading information in the most effective way in order to produce the highest level of trading profit."

The reason for this he says is that although interest rates are generally at an all-time low, where typically a B&B might be looking at 3% gross for a refinance deal, trading profit has to

service the debt when it is stress-tested, and, generally banks will stress test at about 7.5% to 8% on a full repayment basis. The profit after owners' drawings therefore has to be able to meet that stress test.

So why would a new to trade operator be best off looking for a broker? McDonagh says: "The banks over recent years have cut back on staff, and that's the number one issue: it is very difficult to get to the right person. People often say they have a great relationship with their bank. They may well have, but it is a relationship, it is not a lending decision. Relationship managers don't often undertake lending but go to a separate lending manager. If you walk in off the street, the process is very elongated. It can take up to six months, and there is no guarantee that you would actually get a result at the end of the period," he says.

By contrast a broker, particularly one regulated by the FCA or the NACFB, should be able to get a B&B owner a decision within 48 hours without obligation. "That provides certainty," he says. "There are lots of issues that come into play - trading accounts, serviceability, room rate - all they key performance indicators that drive



the trading profit."

There is also the issue about valuation, with different banks using different panel valuers. "Panel valuers have their own interpretation of the trading profit and the multiplier," he says. "For a high-end B&B you might be looking at a multiple of eight times trading profit in terms of a notional value. A £100,000 trading profit would in theory equate to an £800,000 valuation. This isn't always strictly true, because B&Bs have good residential residual use as well. It is therefore a bit of a dark horse when it comes to value, not valued as a commercial hotel for example."

In addition the banks want you to undertake due diligence, he says. "If you go to a good broker they will do everything for you in this respect, but unless you are used to dealing with the bank day in day out for raising finance for hospitality it is unlikely to be positioned correctly to give you the best result. More importantly you would get the best rate by at least 2% if you actually go via a broker."

"This also provides absolute certainty: we wouldn't take on anything in our own right if we weren't 99% certain to get it over the line, because we get paid on a no-win no-fee basis," he adds.

There are a number of characteristics luxury B&B owners should look for in a broker, he says. "Firstly, the broker needs to specialise in the sector with a demonstrable track record. Case studies and testimonials are very important. They need to be fully accredited and STA approved and a member of a national body like the NACFB, and they have to have good customer satisfaction. From our own part we are always willing to provide references for cases we have actually completed," he says.

He stresses that his firm does not take on work that it cannot fulfil. "We would be very honest to people and say that yes, we agree it is a good opportunity, but that it is not going to work for them for reasons we would specify."

"We provide clarity and certainty, and we are highly regulated so there is no smoke and mirrors when it comes to the way in which the deal is structured. We offer industry advice and business advice when we are actually putting the case together. We might for instance say that this place you are looking at the moment isn't going to make it with the bank: you need to look at something else. In our firm they are all ex-hoteliere, so they all understand the business inside out."

That might be an example where McDonagh advises a B&B owner not to follow the finance

route. "It could be that this business is not going to make money, or that even if it does it is going to take four or five years for that to happen and within that period of time it is going to be projection led and the bank wouldn't like it," he explains. "We do protection-led lending, where the business case demonstrates it. We do things like looking at comparables so we are generally pretty adept at saying if a opportunity would make a good lending case. Not all of them do, because they just don't have the accounts. If it goes to projection-led lending it has to present a strong case to the bank, based on comparable valuation opinion and the credibility of the applicants. We generally refer them to a CV-writer to ensure they are presented in the best possible way," he adds.

Another reason for using a broker is that if you present anything to the bank they never forget it and it is on record and you can't then change your mind, he warns. "Once it has been presented, that is it. If an individual went rather than a broker and it was declined then we can't go back in there once it has been declined."

There are a minimal number of lenders in the UK that do specialise in hospitality, he says. "The big ones such as Lloyds, NatWest and Barclays, but if the individual goes in directly then we can't go back in and change the lending decision."

The key parameters a broker would use in determining the best lender are term of debt. The longer the term, the lower the repayments, so obviously they would be lower on a 15-year than a 20-year term.

McDonagh says: "Initially cash is king, so we would look for a 20-year term to give maximum benefit for cash flow coupled with a six or 12-month interest-only period while they establish and assimilate themselves with the trade."

"Clearly a competitive interest rate is going to be important to reduce the payments, and what we are also looking for is speed of process. We don't want a lending decision to take six months. Generally speaking we can get a deal from them walking through the door and formal instruction in about 10 weeks," he says.

#### FINANCIAL TRENDS

Interest rates are going to rise, he says, and the issue is when and by how much. "They will rise in the same way that they came down, by a quarter of a percent at a time over a period of time. My view

is that the Bank of England base rate may be at about 2% in the next five years. They are not going to put them up dramatically because wage growth is not currently in excess of inflation. If they put the rates up too quickly and too high then people won't be able to pay their mortgages, which is a no-no for any government."

He advises B&B owners that they need to be light of foot when it comes to managing their average daily rate on their website. "They need to be very fluid in the way they price their rooms, and they have to engage in social media and the like, but in terms of financial trends it is very difficult to project. There is a resurgence in the UK leisure market staycations that is without a doubt, the lower pound is encouraging more people from overseas to visit the UK and that is where it sits at the moment."

#### CONCLUSIONS

When people are considering purchasing a B&B ideally three years of trading accounts would have to be available. But McDonagh stresses: "As well as specialising in new-to-trade operators, we also specialise in projection-led lending, so even if the trading accounts are non-existent or it is a start-up of they are not producing enough trading profit, we can generally say we can be pretty confident in getting the bank debt based on a reasonably competent operator producing a fair maintainable trade," he concludes.

