

Helping Owners Strike a Fair Deal: 5 Milestones Marking The Road To Success For Hotel Management Agreements - By Jim Butler, author of www.HotelLawBlog.com

2007-03-20

In order to consummate any substantial business transaction, there are inevitably some 'challenges' to overcome. Hotel management agreements are no exception: in part because of their complexity, and in part because hotel management agreements typically transfer effective control over valuable assets for several decades, and their terms can easily enhance - or diminish - the value of hotel by a staggering amount.

We have often seen hotel values depressed by 50% or more from what the hotel would have been worth without the encumbrance of an onerous, long-term management agreement. In representing owners negotiating hundreds (or possibly thousands) of hotel management agreements over the past 15 years, the Global Hospitality Group(R) at Jeffer, Mangels, Butler & Marmaro LLP has compiled a comprehensive list of many milestones that mark the road to successful negotiation of a hotel management agreements. As in all journeys with high stakes, advance preparation including mapping out the most advantageous route and hiring guides that know the terrain, is critical to success. In this instance, before you ever get to the negotiating table.

This is especially true for those new to the hospitality industry. Recently, many sophisticated developers and investors have identified the rich potential that hotels offer - particularly in hotel mixed-use projects - and they are bringing new vitality to the marketplace. While not new to real estate development, these players are new to the norms, customs, practices and business considerations of hotels. The intertwining of single purpose real estate with an operating business presents unique issues and opportunities - opportunities that we have seen the uninitiated leave on the table, simply because they were none the wiser. Developers and owners new to the hotel arena can avoid an expensive and painful learning curve by retaining experienced advisors that know the value of each component in the management agreement from both sides.

Here are our top five pre-negotiation milestones for helping owners achieve success and strike a fair deal on a hotel management agreement:

1. Get the 'right brand' for your project

Every project is unique, and all appropriate brands, identities and market positionings should be considered - along with the appropriate operators who will enhance project value. The right operator to optimize value may not be the branded management company that puts its name on your hotel. And it is important to note that in the past few years, we have seen the emergence of new 'lifestyle brands' that can add great value to a project - 'brands' that are not owned by traditional hotel companies and which many pundits fail to recognize for the value they can bring. Some of the new lifestyle brands are sponsored by the traditional hotel companies such as Aloft by Starwood, and Indigo by InterContinental, but there are some very exciting new entrants such as the Valencia Group with their Santana Row and San Antonio Riverwalk projects or Miraval with their Miraval Living and Miraval Resorts. And they provide some interesting alternatives to other great lifestyle or boutique hotels such as the Kimpton Group, Joie de Vivre or Morgans.

Selecting the best brand and operator requires a careful business and legal analysis of the owner's needs, goals and resources - particularly for a hotel mixed-use project where the hotel is often the spark plug for the synergies of mixing uses. That's why we like to bring our knowledge and resources to the owner's team before the brand and operator candidates are even identified. We can help identify the right players, scope out areas of strength and weakness, and help our owner or developer client articulate and prioritize goals to be accomplished in a Request For Proposal (RFP) or a carefully-orchestrated interview process. This kind of preparation can enable an owner to better gauge the strengths and weaknesses of each potential brand, find the optimal terms that the brands and operators are willing to extend, and facilitate an informed decision and a smooth negotiation with reasonable expectations on all sides.

2. Look for common perspectives

Sometimes, we are brought in late on the hotel management agreement process - after the initial candidate consideration and selection and perhaps into the Letter of Intent or LOI stage. When this happens, we too often find that 'the table has not been properly set.' As deal terms and drafts begin to exchange, it can appear that owners and operators are contemplating two different projects ... because they are! The owner comes to the negotiating table with one set of financial projections and program elements, while the operator has its own. Set side by side, they would seem to describe different projects - different concepts for the hotel's target market segment and customers, its sources of revenues, costs of construction and maintenance, integration of the hotel with other project elements, and even the project's financial viability. If the owner believes the project is highly profitable and the operator does not, the natural (and reasonable) result will be for the operator to try to protect itself by demanding higher fees and incentives, which will create a chasm between the owner and the operator. If the operator believes that the project requires substantial amenities and the owner does not - or if they cannot agree on how hotel mixed-use project elements will be integrated - it is more likely that the owner and the operator will be unable to agree on key issues, such as the total cost of the project and owner's required investment. (Remember that selecting the "right" operator, based on objective data, makes a 'meeting of the minds' more probable.) The operator and owner must agree as to what the project will look like and what will drive its success.

3. Address the 'challenges' early

During negotiations, it may often make sense to defer certain tough issues for later resolution so that all the areas where agreement can be reached are understood, and the importance of the areas that require compromise are clear. However, there comes a time when the parties have to discuss 'the elephant in the room that they have been ignoring.' Talking about the elephant sooner, and more directly, may allow both sides to create global resolutions. And of course there may be situations where owners and operators will not fully resolve certain issues, either intentionally or unintentionally. While it's true that parties cannot be expected to resolve each and every issue that might come up during the term of a management agreement - that would require the ability to predict the future - failing to address known issues can be an 'expensive' way to reach 'agreement' because it leaves potentially messy disputes for the future.

4. Know what's 'market' and how it fits your goals

While both owners and operators usually seek to negotiate agreements with "market" terms, every hotel property is unique. And, there is really is no simple metric or checklist of market terms. There are ranges of what are considered 'market' terms for particular types of properties or projects and specific brands or operators. For example, the terms for branding or operating a 2,000-room convention hotel are quite different than a 200-room full service urban hotel or a 120-room extended stay. And 'market' is also defined by the competition for a particular set of brands or operators, which will vary depending on how desirable a specific hotel project is, and how important that location or property may be for the strategic and business needs of a brand or operator (e.g. to fill in a critical 'hole' in its distribution system, maintain a presence in a key market, etc.)

These factors make it very valuable for an owner to have an experienced team who may know better what market is than the brand or operator - and will at least know what the operator has done in 6 recent deals and what their 3 closest competitors are likely to offer on a sticky economic or business point. There are also a lot of trade offs that make up a 'market' package. In other words, it is a little like going to a smorgasbord buffet with \$100 worth of tickets, and you have to know the price of each item if you are going to get the meal you want. If you spend all your money on the caviar and dessert, you won't have any left for the main dish or the beverage. All items on the buffet are not of equal cost or value.

So, while there are some commonly accepted ranges for business and legal parameters for hotel management agreements, an owner needs to recognize that they can be broad and owners may need to be flexible to accomplish their goals in a particular situation.

5. Bring the right team to the table

Negotiations don't occur between companies; they transpire between the people representing those companies - and it is essential to have a team with the comprehensive set of experience and skills to negotiate and document a successful hotel management agreement. Hotel management companies usually have a strong bench of experienced lawyers, dealmakers, financial experts and others who understand fully their goals and needs, because they are actually in the business of sourcing and negotiating management contracts and franchise agreements. Owners typically have not experienced the frequency or volume of hotel management agreement negotiations that operators have, and should retain experienced lawyers and advisors in order to level the playing field. But more than just arming oneself in negotiations, retaining experienced professionals will make the negotiations more productive for both sides.

Owners will want to draw on professionals who have had direct experience with the operator, as well as broad-based experience in the industry. A hotel lawyer and consultant who knows what a particular operator has done in other deals as well as what that operator's competition has done (and is likely to do again) is able to bring great value to the owner's side of the discussions.

Finally, it is essential that **owners understand the critical importance of their own active participation** in the hotel management agreement negotiations. While it may be expedient to leave the discussions to the professionals (and there are certainly portions of the discussions which can and should be handled by attorneys or consultants), there are always a lot of issues that will ultimately be won or lost by the passion and conviction of the owner. 'I am just not going to do that,' goes a long way toward convincing the operator that a specific issue is too important to be compromised.

That is one of the reasons that we spend so much time with owners - particularly first time hotel owners and developers - to help them understand the real practical significance of management agreement provisions. It isn't rocket science, but it is understanding the business implications of hotel management agreement terms on the owner's goals and plans, and seeing what should be accomplishable that makes a difference.

Preparation to successfully negotiate a hotel management agreement starts early. It starts before you ever identify potential candidates and way before you ever start talking terms. The roadmap you establish - along with the practical experience of the professional team members you line up to structure and guide the process - can make a substantial difference in the outcome and long-term success of your entire project.

About the Author



Jim Butler is recognized as one of the top hotel lawyers in the world. He devotes 100% of his practice to hospitality, representing hotel owners, developers and lenders. Jim leads JMBM's Global Hospitality Group(R) -- a team of 50 seasoned professionals with more than \$40 billion of hotel transactional experience, involving more than 1,000 properties located around the globe. In the last 5 years alone, they have brought their practical advice to more than 80 "hotel-enhanced

mixed-use" projects, a term Jim coined to fill a void in industry lexicon. This term describes one of the hottest developments in real estate-where hotels work together with shopping center, residential, office, retail, spa and sports facility components to mutually enhance the entire project's excitement and success.

Jim and his team are more than "just" great hotel lawyers. They are also hospitality consultants and business advisors. They are deal makers. They can help find the right operator or capital provider. They know who to call and how to reach them. They are a major gateway of hotel finance, facilitating the flow of capital with their legal skill, hospitality industry knowledge and ability to find the right "fit" for all parts of the capital stack. Because they are part of the very fabric of the hotel industry, they are able to help clients identify key business goals, assemble the right team, strategize the approach to optimize value and then get the deal done.

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This article comes from Hotel News Resource

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