

INVESTMENT TODAY



SHIELDING AGAINST INCOMPETENCE

In many distressed hotels, the blame lies with inept hotel management companies. Incompetence can take on a variety of forms, including an inability to: (1) maximize revenue while controlling expenses, (2) achieve an occupancy level that represents at least an average market share, (3) achieve operating expense ratios that at least equal national averages and (4) attract quality personnel.

If a hotel management company falls short in any of these areas, the owner faces the chance of deteriorating profits and possible economic losses. Continued management incompetence can eventually lead to mortgage default and loss of the property.

Prevention is the best hedge against an incompetent hotel management company. An owner must first thoroughly investigate potential management companies to avoid contracting with an undesirable operator. Second, the owner must negotiate a management agreement that allows the owner to intervene in the hotel's operations and to expedite removal of the management company as soon as any incompetence becomes apparent.

In selecting a management company, owners should keep the following points in mind:

- The operator should have experience managing hotels with a similar market orientation and niche. Visit some of these hotels and evaluate their operation.
- The financial performance of the operator's hotels should be evaluated to determine management's ability to maximize revenues while controlling expenses. A management company's reluctance to fully document its financial operating expertise should be considered a danger sign.
- Survey existing and past owners who have worked with the management company. Determine why owners terminated their contracts.
- Investigate the management company's expansion plans. Does it have the experienced personnel to accomplish these goals? Will these plans benefit or adversely affect your property?

Once you have chosen a management company, you can take a number of steps to protect your property. Hotel owners should not passively stand by while their hotels are incompetently managed. The owner can main-

tain a degree of control by establishing a set of approval criteria in the management agreement. For example:

- The owner should approve all operating budgets and capital expenditures, and the operator should adhere to them.
- The marketing and engineering plan should require ownership approval prior to becoming effective.
- The owner should be involved in selecting or transferring the general manager and other top-level personnel.
- The owner should review and approve all significant management policies that could affect the hotel's financial performance.

A management contract should also establish some performance standards and leave the door open for the owner:

- The management contract should enumerate performance criteria for the operator. Performance based on profits tied to debt service gives an owner the best protection.
- Management termination through a buyout provision allows the owner to replace management quickly. This provides immediate protection from an incompetent operator and enables the owner to sell the property unencumbered by a management contract. A buyout can usually be structured based on a multiple of two to three times the previous 12 months' management fees.
- In today's environment of mergers and acquisitions, the management company an owner starts with might be radically transformed if sold or merged with another company. Owners should negotiate for an option to terminate the contract in the event that the restructured organization is less desirable in any way.
- Negotiate a management contract that calls for a short initial term and gives the owner extension options.

Quick action is essential when faced with undesirable management. The financial liability of an inefficient operator can multiply rapidly. Owners who carefully monitor their investment will be able to recognize warning signals such as substandard occupancy, average room rate and operating expense ratios; an inordinate number of negative comments from the guest response cards; or excessive employee turnover, particularly among management personnel. **LH**

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