Third party management companies: Key trends and issues

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Introduction

There are five main business models within the hotel industry, with a number of permutations within each of these models, they are as follows: property fully owned and operated by the hotel brand; property leased by a hotel brand, which pays rent for the "walls"; property owned by a third party and managed by a hotel chain; property owned by a third party and managed by a "non-branded" specialist management company; property owned by a third party, with a franchise agreement with a hotel chain. This report concentrates on the increasing popularity of the hotels owned by a third party and managed by a non-branded management company.

The report aims to answer questions such as what has brought the growing interest in third party management companies? Who are the major players in third party management? How is the industry evolving on a regional level? And what are the major trends and issues impacting this particular sector of the hospitality industry?

Advantages of using a management company as opposed to individual manager[10]

Historically, hotel owners have either hired individual on-site managers to operate their properties or have engaged the services of professional hotel companies through hotel operating agreements such as property leases or management contracts. The employment of individual managers is the less expensive approach, but there are serious drawbacks to such arrangements. In terms of supervision of staff, overall management skill, and effective operational methods, management companies are frequently superior to individual managers.

Supervision
All the employees of a lodging facility should be supervised to ensure that the integrity of the facility's financial control system is maintained. An individual general manager often cannot provide the necessary level of direct supervision, whereas the structure of a hotel management company generally provides several layers of control over this aspect of the business. A hotel management company, can provide the back-up staff, logistical support, and uninterrupted supervision that is essential for a 24-hour-a-day, 365-day-a- year business. Unless ownership can assume total operational responsibility for the hotel on short notice and for extended periods, an individual general manager is often not a viable alternative for property management.

Expertise
Many professional hotel management companies offer a range of expertise and experience that individual general managers cannot match. Management companies can assist hotel owners with property development, acquisition, and operation by providing such services as national advertising and reservation systems, interior decorating, and property engineering. Management companies are often also able to provide counselling and representation for labour negotiations, permit and license applications, and zoning and property tax proceedings.

Verifiable past performance
A successful hotel management company should be able to document its past performance and provide references regarding its operations currently under contract. Verifiable information of this kind provides hotel operators with a basis for selecting a qualified operator. Individual managers, on the other hand, generally cannot document the effect of their management on a particular hotel.

Established methods and procedures
The major advantage in hiring a management company is that it can provide established, functional methods and procedures that constitute a complete system capable of handling the complex job of operating a lodging facility. In instances in which a takeover must be made rapidly, established management companies can bring in top-level management staff from other properties to train local personnel and implement proper operating systems and controls. For new hotels, management companies can often provide valuable advice in the layout and design of the physical plant, and once the facility is completed, can institute their mode of operation and quickly bring on- line a fully functioning lodging facility. This experience and expertise saves time and reduces costly mistakes.

Most hotel management companies have developed procedure manuals and training programs that cover all of the aspects of lodging facility operations. When nothing is left to chance and set methods are established for handling all foreseeable problems, the element of human error is greatly reduced and hotel guests receive a consistently high level of service.

The benefits of retaining a professional hotel management company usually far outweigh the alternative of employing an individual general manager, particularly when a hotel owner does not have the ability or desire to provide a high level of supervision, As a result of many investors reaching this conclusion, the number of hotel properties managed by third-party operators has grown significantly over the past twenty-five years. This trend is further substantiated by hotel lenders, underwriters, and rating agencies, who typically require that a competent hotel company be included in the project team.

10 HVS – Property Management

Evolution of the concept – the US

Third party management companies are far more established in the US than in other parts of the world, due to the maturity of its hotel industry, where franchising is far more the norm, and the change in hotel ownership has led to owners looking for expertise in hotel management.

Leading third party management companies in the US (2014)

Rank	Company	Third-party managed rooms at end 2013	Third-party managed hotels at end 2013	Total revenues for third-party managed hotels (USD000s)
1	Interstate Hotels & Resorts	58,134	291	2,600,000
2	White Lodging Services Corp	22,383	155	869,796
3	Pillar Hotels & Resorts	21,074	222	577,589
4	GF Management	19,911	130	620,000
5	Crescent Hotels & Resorts	18,652	74	720,000
6	TPG Hospitality	18,040	63	740,000
7	Remington	15,681	79	679,100
8	HHM	15,470	125	Na
9	Aimbridge Hospitality	15,131	186	Na
10	Rim Hospitality	13,062	84	425,000

Source: 2014 Hotel Management Survey

Moving into Europe

The concept of third-party management has become more popular in Europe due to the expansion of the franchise model there. And as the gap between ownership and operational management becomes wider, asset management too is becoming more accepted in Europe.

The emergence and increasing popularity of third party management companies have led to brands making strategic decisions to expand via franchises as they know third party management companies can manage the hotels efficiently.

The franchise and third party management contract complement one another: the franchisor provides the brand name and marketing platform and the third party management company provides the expertise and know-how to manage the day-to-day operation on the hotel. The franchisor, third party management company and owner work together to manage the property effectively.

The partnership is mutually beneficial. Particularly in Europe, owing to the diverse market, as franchisors and management companies cannot typically be the masters of all things in all markets across the region. Although various brands are well established in many markets, this combined method is increasingly useful when operators are in the process of establishing presence in new markets and require the combination of an internationally recognised brand and local knowledge and know-how.

Obviously, implementing a franchise agreement and a management agreement with a third party management company means double fees for the hotel; however, HVS noted in a 2014 report on Hotel Franchising in Europe that third party management fees are typically more competitive than those of the brands. There are several other benefits, such as:

- Owing to their close relationships with franchisors, third party management companies are often able to help owners negotiate more competitive franchise fees.
- Cash flows are typically run at tighter level with marketing costs (which are covered by the franchise agreement) usually lower.
- The term of management agreement is characteristically much shorter (starting at a minimum lock in of five to ten years) and exit options are typically more flexible.

HVS concludes that third party management companies encourage expansion both for the franchisor and the owner[13].

13 HVS International, Hotel Franchising in Europe - 2014

Leading European third party hotel management companies			
Company	Hotels	Brands	Geography
Grand City	120 (13,000 rooms)	Wyndham, Tryp, Radisson Blu, Best Western, Mercure and Holiday Inn	Germany & Europe
Bespoke	100	Operate under independent local names	UK
Interstate (Europe)	83 (12,500 rooms)	Marriott, Four Points by Sheraton, Holiday Inn Express, Hilton, Holiday Inn, Renaissance	Global
Redefine BDL	60	Crowne Plaza, Holiday Inn, holiday Inn Express, Ramada	UK & Ireland, Africa
Hospitality Alliance	58 hotels	Ramada, Treff, H_2 Hotels	Germany, Switzerland
PREM Group	37	Leopold, Aspect, Premier Apartments, Holiday Inn, Ramada, Crowne Plaza	UK, Ireland, Europe
Focus Hotels	27 (3,700 rooms)	Doubletree by Hilton, Ramada, Mercure, Clarion by Choice, Comfort Inn, Best Western	UK & Ireland
Sophos	24 (12 under devlp)	Wyndham, Marriott, Days Hotels, IHG, Ramada	Central & Eastern Europe
Kew Green Hotels	30	Crowne Plaza, Holiday Inn, Holiday Inn Express, Days Inn, Ramada, Courtyard by Marriott	UK
Hamilton Hotel Partners	8	Holiday Inn, Leading Hotels, Small Luxury Hotels, Preferred	UK, Europe

Source: McKenney Research

And the Middle East and Asia Pacific…

Owners and operators in the Middle East disagree on whether the market is ready for third party operators to take over the running of hotels.

At the recent Arabian Hotel Investment Conference 2014, when the subject was discussed, CEO of IFA Investments Joe Sita said that although there had been talk about franchising licensing, the model was not very prevalent in the Middle East.

However, Sita strongly advocated for third-party operators who are more focused on the bottom line, saying: "I think the US model actually works best where brands focus on the brand and the delivery of the business and the positioning of the brand, and delivering the customer. And then you use third party operators who are more specialised and focused on the bottom line to actually manage the business and they work across a range of brands and properties."

"It's worked with properties we have acquired in the US and I found there's a much better alignment of interests when you do that. So to me that's a model that needs to develop here. I think there is room for getting people to focus on what they're good at," he explained.

Hilton Worldwide president Middle East & Africa Rudi Jagersbacher, however, argued the Middle East was not ready for franchise and third-party agreements to be the norm.

"The franchise model I think would certainly work with the right product in the right location. I don't think we are necessarily ready for that in the Middle East or Africa. I think it's an emerging market, we want to be in control of the brand, we want to make sure that we are successful, we want to make sure our brand standards are fully implemented. And I think it's really important to show our investors that before you go into a franchise agreement, you want to see what is happening with the local market, how are the brands operating within the local market," he said[17].

The profitability of a franchising model in the Middle East as well as maintaining the brand's reputation are also key factors of concern for hoteliers.

"It is actually quite difficult to make money from the franchise model unless you can develop critical mass and that really does bring you to the big markets in the region, potentially the kingdoms of this world, and other markets where you can actually build and leverage some significant infrastructure for yourself as a franchisor and for your franchisee," said Alex Kyriakidis, president and managing director Middle East and Africa, Marriott International, Inc.

"If you go down that road, I think the critical element is who the operating partner is. Who is going to protect your brand integrity? That is actually the key question," explained Joe Sita, president, IFA Hotel Investments.

Pascal Gauvin, CEO of IHG, India, Middle East and Africa, which has 22 franchise contracts in the Middle East believes it depends on the maturity of the region or market.

"We need a bit of sophisticated market, a mature market. It needs to be the right partner, making sure the infrastructure is right because what is important to us is our brand, and all brands have to perform so it could be through a managed contract or through a franchised contract," said Pascal.

"I think it's a matter of time," agreed Kyriakidis. "I believe it's a matter of the markets here developing operating expertise over time so that you then have qualified franchisees come forward and then we both as partners have comfort in working with each other, partnering with each other to go down the path of a franchise model."[18]

17 http://www.hoteliermiddleeast.com/20455-owners-and-operators-split-on-franchising-in-me/
18 http://www.hoteliermiddleeast.com/17263-hotel-chains-unlikely-to-franchise-brands-in-mena/

Trends and issues

Creating chains out of distressed assets

Key UK hotel management companies are jostling for position, with growth plans that could see them taking over a string of hotels from weaker managers. And, with banks now keener to do deals on indebted hotel companies currently under their control, 2014 looks to be the year the managers get their big opportunity to bolt on portfolio additions.

Among the assets that may be of interest to UK management companies such as Kew Green and BDL Redefine are More Than and Somerston Hotels. More Than Hotels is a franchise operator of 12 Holiday Inn Express hotels around the UK and has substantial debts with RBS, but might attract up to GBP50m from a buyer. Somerston is indebted to the Irish Bank Resolution Corporation, with a portfolio of 32 Holiday Inn Expresses and one Hampton by Hilton[30].

INDUSTRY INSIGHT by Katherine Doggrell: while they [management companies] bide their time and wait for the juicy pickings of More Than and Somerston are happy to play manager, many of them to banks eager to push for stronger business in the hope of getting a better price when it comes to a sale.

Throughout the downturn, the message in the regions has been that size and distribution matter. Last year's deals and the likely imminent flurry are expected to lead to a few dominant regional players and then further consolidation between them. One message that is coming in loud from these flag-less managers is that the flight to the safety of a brand is not necessarily the best response when times toughen.

Source: Hotel Analyst Perspective, Issue 1, January 2014

Another example of this is when the Royal Bank of Scotland announced in late 2013, an experiment that will see a number of their loan customers come together under a new Irish hotel brand. At least 25 hotels are expected to be rebranded initially under the as yet formally named new brand, which will set out to create a chain of distinctive Irish hospitality and present customers with the country's largest chain.

RBS has teamed up with hotel management company, Michels & Taylor, headed by former Hilton executive Sir David Michels, and the pair have branded the arrangement a joint venture that will see both commit equity; a figure of around EUR600,000 is understood to have been committed initially.

The as-yet unnamed brand will allow hotels to still feature their individual names ahead of it, but will promise a combined marketing and distribution system, along with other operational efficiencies. Existing owners and operators will remain in place and the working title at present is The Collection.

INDUSTRY INSIGHT: The RBS creation of what is tipped to be called The Collection is an interesting exercise in rescuing value. While the 25 hotels are notionally independent they are effectively controlled by RBS.

RBS has installed Michels & Taylor as asset managers with day-to-day running still carried on by the hotel owners. The fascinating aspect though is the nature of the agreements underpinning the JV deal between RBS and M&T, and how both parties will seek to exit.

Clearly, the pair sees an opportunity to create a brand that has value. But how will RBS realise this value? Will it wrench control of its portfolio from the existing owners and then trade it (building a sizeable portfolio is the only way to attract the big private equity players for example)? Or will it keep the JV brand distinct and seek to either sell-off individual assets to new owners or refinance the existing owners? It is a difficult balancing act for the bank and one that it would surely be far more wary of within its domestic UK market.

Source: Hotel Analyst Perspective, Issue 20, October 2013

Another company taking advantage of the economic downturn was Prem Group which established HAMS (Hotel Asset Management Services), a wholly owned subsidiary specialising in managing distressed properties for asset owners and Receivers. Tulfarris Hotel and Golf Resort in Co. Wicklow was HAMS first appointment in 2009. Later appointments included the Clanree Hotel, Conference & Leisure Centre in Letterkenny which, after 2.5 years of careful stewardship, was successfully sold in summer 2013 for above asking price.

30 Hotel Analyst Perspective, Issue 1, January 2014