Hotel&Motel Management

Management Agreements Adapt to Economic Climate

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By Chris Crowell

Money, or the lack thereof, has a way of creating tension. And with the industry working its way out of the downturn, this tension may be felt during management contract negotiations.

"Not long ago, when there were so many transactions, it was easier for operators to stick to a standard agreement and not waiver from that," said Michael Medzigian, chairman and managing partner for Watermark Capital Partners LLC. "It's more difficult to do that today, but it's a challenged industry now and they have to work together closely to make a deal."

Medzigian
WATERMARK

At the Americas Lodging Investment Summit, Medzigian and others will discuss these issues in a session titled "Management agreements—How has the agreement changed in this new environment? What are the key deal points for both parties."

The panel will discuss a variety of sticking points, including contract length, fees, performance structure and participation by brands, but Jim Anhut, chief development officer of the Americas for InterContinental Hotels Group, said contract terms will be greatly affected by the year's transaction activity.

"Let's say there's a huge reset, lots of assets come to market, that [creates] lots of opportunities, especially for management companies willing to invest and bring equity to the table," Anhut said. "If that doesn't happen, and there's more back-room renegotiation of deals, maybe there's a little less opportunity for management companies, but maybe more opportunity to be consultative."

He noted that special servicers can't hold a property for more than two or three years, so in this new environment, with so many properties ending up in special servicing, these deals may be the best route for management companies.

In conventional management agreements with an owner, Michael Kosmas, leader of global hospitality/leisure practice for Squire Sanders & Dempsey LLP, said the leverage is shifting away from the management companies.

"The reason is brands have to grow, especially public companies, and there are fewer deals available to do, and you only can grow with the more limited number of deals," Kosmas said.

Kosmas
SSD

Performance metrics

Kosmas said a bigger area of focus in this new environment is performance testing. With owners in dire need of revenue, return on investment and other performance stipulations stated in the deal framework will be monitored more closely.

“In good years, no one can tell you how [performance tests] work,” Kosmas said. “I think next year is the first year you’ll see a whole lot of performance test failures trigger.”
He pointed out that the last prosperous year in lodging was 2007, so with year-over-year comparisons dipping for so long and becoming easier to meet, owners are looking for results.

A flurry of performance test failures would indicate owners are going to become more hands-on in this environment.

There are “so many distressed hotels and so many situations where properties go back to lenders—and the reality after the fact is not in line with the expectations on the front end and people are more focused on what happens when things go wrong,” Medzigian said.

Contracts
One way owners will gain this control is in negotiating contract length. It’s in this area that management companies will need to be more lenient, as owners and lenders are looking for shorter deals, according to Kosmas.

Anhut
IHG

“Owners and lenders want more control over the destiny of assets,” he said. “They are less willing to give long-term [deals].”

Management companies that succeed in getting the most favorable deals will be the companies that are flexible, adept at working when budgets are tight and have a well-established track record.

“The worst thing an owner can do is pick a low-cost producer and get a low-cost result [at a time like this]. You don’t want to drive the asset further down,” Anhut said. When an owner is in need of a very quick turnaround, a veteran management company could have “good leverage” in those negotiations, Anhut said

“Back in the ’90s [financial crisis], the third-party management companies helped many reluctant owners work through those restructuring events, and it will [happen again],” Anhut said.

Another discussion point could be non-disturbance agreements, which Medzigian said are becoming a bigger trend. These NDAs require the financier of the property to only act in a manner that is consistent with the management agreement because otherwise they are not obligated to do so. These often are beneficial to operators, and the more popular these become, the longer the negotiation processes will take this year.

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