



HOTEL PARTNERS
AFRICA

ON TOP OF AFRICA

10 **More** Myths of Hospitality Development in Africa





- Hotel Valuations
- Market and Financial Feasibility Studies
- Operator Selection and Negotiation
- Development Management
- Sourcing of Debt and Equity
- Financial & Technical Due Diligence
- Design Review & Technical Services
- Procurement of FFE and OS&E
- Installation and Commissioning Services
- Asset Management
- Acquisitions and Disposals
- Recruitment
- Training

10 MORE MYTHS OF THE AFRICAN HOTEL INDUSTRY

There's a lot happening in Africa!

Welcome to the second edition of Hotel Partners Africa's "Myths". The first edition was published in 2014 and launched at the Africa Hotel Investment Forum (AHIF) in Addis Ababa. This second edition was also launched at AHIF, in 2015 the fifth anniversary of this highly successful investment conference.

Earlier this year, a survey by W Hospitality Group, one of the founding partners of Hotel Partners Africa, counted 270 hotels in the chains' development pipelines, with almost 50,000 rooms. That's 20 per cent more than in 2014, huge growth in the fastest growing continent.

We're proud to have been involved in several of these deals. But in addition to our advisory services, helping deals to get done, and hotels to get built, we find ourselves more and more as educators, helping our clients to understand how the global hotel industry works, and in particular the global chains' business model.

Over the course of a year Hotel Partners Africa receives hundreds of enquiries from prospective hotel owners, seeking our advice on how to enter the industry - or in some cases, what they should have done before jumping in feet first! Many of Africa's hotel developers are first-timers, developing their first hotel, and are eager to learn about this unique industry.

This little publication is here to help, by describing ten more of the misunderstandings, or "myths", that we come across, and our explanation of how it really happens on ground, and how to get it right.

We hope you find it useful! The first edition can still be found at:

www.HotelPartnersAfrica.com

The Hotel Partners Africa Team

Myth #1:

Dear David, my hotel is almost ready to open and I have been speaking with some potential operators about them managing it on my behalf. However they are not prepared to put any “skin into the game”, and have all these unrealistic demands on how the hotel should look. In addition they charge far too much money for their services and I think my brother could manage it just as well.

It is true that hotel management companies do not always add value to the hotel real estate in every instance. However, it is safe to say that in most emerging markets they help tremendously, enhancing the market perception of the hotel, generating bookings, ensuring the property is managed efficiently and keeping the quality of the hotel up to standard. Our experience has been that in most markets in Africa there is a real increase in the value of a hotel through engaging the best management company to operate it.

Putting “skin into the game” is something that the hotel companies usually do only in an indirect way. Paying “key money” to enhance the FF&E, or offering guarantees on returns may happen in exceptional circumstances, but most of the investment into a project a hotel company makes is in ensuring its brand, central reservations system, loyalty program and staff training are all able to generate the highest trading and profits at your hotel.

Trying to save costs on management is only sensible if it does not impact on how well the hotel trades. Agreeing a fair incentive fee, based on the owner’s return, means that the operator and the owner earn more money if the hotel is a success.

Putting in a poor management team will inevitably have a negative impact on the returns to the owner and to the property value.

Myth #2:

Dear David, I have almost finished building my new hotel and I would like to sell it now. I understand that the Royal Hotel across the road sold for US\$400,000 a room, so can you please sell my hotel for the same.

I would very much like to, but in most cases this is unlikely to happen! It is just not that simple to sell a non-operational hotel at full value.

When a hotel is sold people buy it based upon its trading potential and then apply a multiplication factor to the profit. If the property earns US\$1 million profit and the market multiplication factor is 10, then the purchaser would look at a value in the region of US\$10 million. If the property has an established track record then buyers are more comfortable with the projected future trading cash flow and a better price is usually obtainable, as the multiplication factor is higher.

When a hotel does not have an established trading record there is more doubt and the value tends to be lower as a lower multiple is applied. In addition, if the hotel is not trading, it usually takes a number of years for the trading to get to a stabilised level, which also has a depressing impact on the sale price.

The same is true for a trading hotel when full access to the trading records is not granted to the potential purchaser. They will have concerns regarding the actual trading results, and will not pay the full multiplication factor on projected earnings, as they will perceive that there is a greater risk attached.

If as a developer you wish to sell your hotel at the best price, it is usually best to wait 3 to 4 years after opening, when it has a trading record and has established itself in the market.

Myth #3:

Dear David, the Grand Hotel sold for US\$75 million and it has 200 rooms. My budget hotel has 400 rooms so can you value my hotel for US\$150 million using this as a comparable.

Comparable evidence is incredibly important when it comes to assessing hotel values, but it is not just as simple as calculating a price per room and applying that to calculate the value. If two identical hotels, with identical legal interests, in identical condition, with identical facilities and locations, where trading was the same and they were both being sold at the same time, then comparable evidence of this kind “might” be appropriate. However that is extremely rare and I cannot remember a single example in the last twenty years where that was applicable.

The appropriate use of comparable evidence is to compare how the subject hotel relates to the local market, to build up both its projected cash-flow and its multiplication factor. If similar hotels generate a RevPAR of US\$150, how does the property sit in relation to these? Does it have a better location or less appeal to the general market; in short is US\$150 an appropriate RevPAR to apply to the projected accounts? The same is true for all other revenue streams, and all operating costs until an appropriate net operating profit is calculated.

The property must then be reviewed in terms of other sales to determine the most appropriate multiplication factor. If one hotel sold off an 8 times multiple and another off a 10 times multiple, where does the subject property sit in relation to these two sales? Will similar buyers be interested in the property? Have there been any changes to the market since these sales occurred?

Comparable evidence is useful, but to be effective it needs to be used selectively.



Myth #4:

Dear Trevor, I'm going to build the tallest, most luxury hotel in town, no, in Africa – it's a sure fire winner!

Well, maybe, just maybe that's right. But have you really thought this through?

Tall can be the best use of a limited but well-located site in the centre of a city where land prices are high – look at New York or Chicago! But tall also means expensive, in terms of the cost of construction. Will that extra cost be recovered through higher prices charged to the hotel's guests?

And does the town need another luxury hotel? In my experience, it tends to be the higher end of the market that gets developed first, and is sometimes the market sector that becomes oversupplied first. The luxury segment is rarely the deepest segment, and in times of a downturn in demand, can be the worst affected. Don't get me wrong, there are still opportunities for developing deluxe hotels in Africa, but have you done the research, looked at drivers of demand, and the future new hotels planned or under construction?

Africa is littered with unfinished hotels, started by owners with unproven dreams, who then run out of money because the project is costing more than the (unrealistic) budget. The resultant delays in completion, sometimes years later than the anticipated opening date, mean that the markets have moved on, external events have changed the dynamics of the market, and the need for the tallest, most luxury hotel in town, if there ever was one, is no longer there.

Myth #5:

Dear Trevor, I am OK hiring a hotel chain to manage my hotel, and I want you to negotiate a contract for me that gives me the right to get rid of them whenever I want.

A typical management contract in Africa is for a term of 20 to 25 years, sometimes with options for renewal at the end of the initial term. A management company wants the longest (reasonable) term, because a signed operating agreement becomes, for them, an asset that increases the value of the hotel chain. There is a level of certainty about a future earnings stream (the fees that they will earn over the life of the agreement), which is looked on favourably by analysts who value public companies. If they can be terminated at will, then the value of the future earnings is much less.

So for the management company, termination “at will” is never acceptable. One reason is that they are vulnerable to having put a lot of work into building the business in the three to four year ramp-up period after opening, and want to enjoy the benefits (higher fees) thereafter, not to be fired when the owner has tired of them.

From the owner’s point of view, what is needed is a mechanism to terminate the agreement if the hotel is not performing well. Terminating at will is not the answer, as removal of a management team, and the brand, will almost certainly result in reduced revenues, due to the loss of confidence on the part of guests, and the loss of the reservation and distribution systems of the brand.

Expert advisers can ensure that the agreement contains provisions that protect the owner if the management company is not delivering.

Myth #6:

Dear Trevor, the Grand Hotel charges US\$600, why are you projecting only US\$300 for my project? I can do better than them!

I think that, when you say “charges”, what you actually mean is that the Grand Hotel has a published price of US\$600, it’s on the board behind the reception desk as the price for a standard room, right?

That’s actually a part of the marketing activity at that hotel, a piece of information that tells people that the hotel is really expensive, and therefore must be, well, Grand. Let’s look beyond the marketing puff to the reality.

For starters, when we make our projections, they are net of tax and service charge, which in some places can total more than 20%, so US\$600 becomes US\$500 that the Grand actually receives.

Then there are the discounts that are offered. Very few people actually pay the published price. Go on-line, and look at the different prices offered on the different websites, both third-party and the hotel’s own – nearly always less than the published price.

In addition to this variability of rates to the general public, hotels contract with companies, airlines, the military and many other organisations, offering a discount to anyone who will “bulk buy”, i.e. book a large number of rooms during the year. That’s like any industry – buy a fleet of five cars from a dealer, and you’ll get a deal, buy 10 or more tickets from an airline, and you’ll get a group rate.

So the reality is that the Grand Hotel has a variety of different prices available, and the average room rate that they achieve is nowhere near that US\$600!



Myth #7:

Dear Mark, I don't need a Project Manager, my brother's an architect!

The surest way of killing a project is to try to save on or, for other reasons, employ the wrong professional team. An experienced and qualified team is critical to the successful execution of any hotel project.

The past experience of each member of the professional team must be checked. Being a qualified architect or engineer, or designer, does not automatically qualify a professional consultant for a hotel project.

It is important to understand the details of what is to be designed, budgeted for, constructed, fitted out and commissioned. Coordination with the hotel operator is critical, as any changes required by them later will invariably cause additional costs and delays to the project.

If you decide to employ the services of an foreign architectural firm, you can still find a role for your brother. In most jurisdictions, local planning and consent submissions have to be submitted by a local architect, and he can fill this role as well as establishing and advising on local building codes, labour regulations, local bye-laws etc.

There is an important role to be filled locally, but to start with the wrong architect with insufficient experience means there is no way the design is going to incorporate all the requirements of a modern, branded hotel.

Myth #8:

Dear Mark, don't worry about the furniture and equipment for the hotel, we'll go and buy it cheaply in China.

Well, if I had US\$10 for every time I heard that, I wouldn't need to work. Yes, there is decent equipment and manufactured products coming out of China, but as is abundantly clear on the African continent, there is a flood of inferior products.

Trying to save money up front and committing to procuring inferior products is going to cost you a lot more in the future. The greatest challenge is availability of spare parts and qualified technicians and artisans to be able to repair damaged or faulty equipment. This invariably causes delays and if it is the central boiler, chiller plant, sewage system or water pumps, this can shut down the hotel for days until it can be repaired or replaced.

Likewise furnishings or other hotel equipment. While defects might not shut down the hotel, you may have to place a room out of order, the laundry service is not as efficient or menu items may become unavailable. It all comes down to additional cost and delays.

The biggest challenge with China is Africa is perceived as a “cheap” market and therefore, automatically you will be presented with the most economical range of products. You are not a professional hotel procurement agent who is knowledgeable on the requirements of hotel FFE, OS&E and plant equipment. All furniture and equipment should be contract grade with relevant fire and life safety specification and importantly, should be able to survive the “useful life period” of that asset. Hotel renovations are expensive and need to be planned and budgeted for and clearly you do not want to have to replace all the furniture and equipment in under 5 years.

Buy cheap, spend often

Myth #9:

Dear Mark, there is a great uncompleted hotel structure in Kwamarra State in the south of the country. I know the governor well and will be able to get a 30-year lease on the property. The State government will book at least half of the hotel. Can you help me to complete it?

Well, to begin with, how long has the structure been abandoned and what is the exposure of the structural members? It has been said and proven some times that to demolish and rebuild a structure is the best and faster route. The existing structure must be the subject of a full structural audit in order to ensure it is still structurally sound. Ascertain if there are reliable and accurate “as-built” drawings of the structure, as the design will need to be completed and full MEP services designed and made provision for within the building design. If MEP installations have been completed, a full audit of those will need to take place. Pipes must be pressure tested and checked for any corrosion. Ducts, hangers, louvres and fans must all be checked. Fire equipment must be inspected and certified, amongst others.

Do you intend to get a hotel brand to manage the hotel? If so, we need to check if the existing design and structure complies with their requirements.

How do you intend to fund the project, and with elections coming up in three years’ time, how secure is the proposed lease on the property, and the State’s promise of patronisation?

As you can see, there are a number of questions to be asked and various tests and examinations to complete. A hotel development is never a quick and cheap venture, and while it seems you have been presented with a great opportunity, some serious due diligence must be done in order to establish how viable the project is likely to be.

Myth #10:

Dear Petra, I feel that utilising the services of a recruitment firm to recruit our hotel's executive team is expensive and we don't see the merit in spending that money when we can do it ourselves.

Professional recruitment firms are experienced in sourcing, background checking and suitably identifying candidates with specific experience to add the most value to their client, as each property has a unique set of requirements, type of guest, culture, dynamics and challenges, especially on the African continent. Experienced firms are able to put forward candidates whom they can professionally recommend based on a rigorous screening process, and offer guarantees to the client for those placements.

Appointing a firm on a retained basis for senior level staff provides the client with the peace of mind that the business has a dedicated resource taking care of the recruitment aspects of the business in line with a professional methodology and approach, whereby suitable candidates are identified or "headhunted" in confidence to determine their interest in the particular opportunity. Their skills, qualifications and suitability are assessed and in so doing the candidate's interest and eagerness for a particular opportunity is established. Retained firms work closely with their clients to provide them with a shortlist of recommend and suitable candidates from which to choose from. A long term relationship is often established as the retained firm understands the client's requirements, culture and expectations of its staff, which enables long term successful placements and business value add.

"If you think it's expensive to hire a professional, just wait until you hire an amateur". Red Adaire

At Hotel Partners Africa, we provide advisory services to clients throughout Africa, clients who are already in the industry, and those entering it for the first time.

Talk to us to about:

- *Hotel Valuations*
- *Market & Financial Feasibility Studies*
- *Operator Selection and Negotiation*
- *Development Management*
- *Sourcing of Debt and Equity*
- *Financial & Technical Due Diligence*
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