Management Company Corporate Billables

Maintaining Alignment Between the Management Company and Owner

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CHMWarnick
Objectives

• Why awareness of management company billables and programs are essential to success
• Mandatory vs. Optional programs
• Methods of cost analysis
• Approaches to challenge costs and programs providing assurances to Owners
• Managers fiduciary responsibilities
CHMWarnick at-a-Glance

• Globally-recognized for 20 years as the leading hotel asset management and owner advisory services firm
• 100% focused on hospitality real estate
• More than 70 hotels/29,000 guest rooms/$15 billion in client investments under asset management
• Advising on $2 billion in hotel development and extensive repositioning projects
• Senior team of over 40 hospitality professionals; one-third of the individuals on our team have more than 30 years hospitality experience
• Diversified experience (400+ hotels) including every major hotel brand and independent properties
• Global client base: sovereign wealth funds, Fortune 500, private equity, public/municipal agencies, lending institutions, and family offices
The Situation

- Management companies include in the HMA provisions for reimbursement of “Centralized Services” and “Corporate Billables”
- Centralized Services and Corporate Billables typically can represent benefits, services, and facilities generally made available by Operator at substantially all other properties managed by Operator
- Centralized Services generally may or may not include Operator central or regional office overhead or general office or administrative expenses; these costs are normally described in far greater detail within or on an exhibit attached to the HMA
- In addition to the standard services, management companies frequently introduce new initiatives intended to improve efficiencies and ultimately increase market share at the operations in their portfolios
The Situation

• As reported by CBRE in July 2017, management fees have steadily risen since 2010 at a pace greater than the average of all other costs and revenues between 2010 and 2015.

• In 2001, Hotels/HVS reported fees averaged during the prior 10 years on room revenue alone as low as 2.1% up to 11.3%; HVS reported in 2014 fees ranging between 3.3% and 14.7% of rooms revenues with slightly higher percentages in their 2015/2016 analysis.

• In an analysis by CHMWarnick, prior to 2017 management company collected fees and billables averaged between 4% and 8% of total revenues; in recent years, fees and billables are aggregating annually higher than 9% and as high as 15% of the total operations revenues.

• During recent years, the percentage of hotel ownership by management companies has rapidly declined; this shift has impacted the earnings of many management companies.

• In an effort to improve local operations efficiencies and taking advantage of new technology, management companies have created shared, complex, cluster, or central services programs.
Observations

• Payments to the management company has made this one of the operations highest paid vendors
• Corporate services monthly and reoccurring billables documentation is frequently limited, confusing explanations, and unique allocation sharing
• When new initiatives are rolled out, “most” HMA's specify that the Owner is required to engage in “brand” programs to maintain compliance; but most agreements also provide Owner protection that the Operator is required to maintain costs within the annual approved budget
  – Therefore, one of the first stages of controlling corporate costs is for the Operator to be provided with details on the new program and overview that with the Owner
  – The Owner has the right to request additional information and challenge
• Many corporate offices automatically debit the business each month for fees thereby restricting the review and audit of corporate billables
Observations

• New and existing shared or Centralized services programs can provide reductions in cost or labor at the property level, they can be offset by higher corporate support costs
• The difference between Corporate Billables and costs part of standard management fees becomes more and more difficult to differentiate as management companies may stretch the definitions of what is part of standard fees vs. central services billables
• Management companies continue to explore ways to increase revenue streams
• Rarely is analysis completed or provided comparing the prior local costs vs. the new shared services costs
• The roll-out conversion of decentralized processes to centralized experiences frustrations, errors, delays, and after-the-fact cost allocations and charges
• After new programs are in place, a variety of unresolved frustrations occur and delaying the transition into the new standard methods
• Operators are responsible for ensuring all vendor payments are correct and accurate.

• While the Operator is responsible for insuring the management company is paid for the services they provide, like any vendor, the local Operator has a fiduciary responsibility to the Owner to ensure that the billings are accurate, include support, challenged if necessary, within budget, and in compliance with the HMA.

• Operators audit billings from vendors, and should audit the Corporate billables in the same manner.
Owner Expectations of the Operator

Operators should ensure that brand/management company-mandated programs are aligned with the Owner’s investment objectives

• Which services do I need and why?
• Which services are mandatory vs. optional and what is the process to opt out?
• What is the expected ROI and how will I receive proof that this new program will produce more value?
• Is my share of the cost appropriate and what is the basis for calculating?
• What documentation will be provided in support of the shared cost?
• Why are these costs not covered by management or other existing fees?
Support for Corporate Billables

• In most instances the Operator cannot hold back payment if Owner is questioning a charge
  – Be sure to document the question and follow up realizing that the billing has been or will be paid and track for collection of future credits
  – Credits can take months to process
• Audit monthly and ask for as much support as you would normally ask from any vendor
• Pay from an invoice and not a statement
• If the charge is an allocation, ask for the list of whom is included in the allocation and clarify the allocation method
Should the Business/Owner Be Charged?

- Review your HMA to insure the items billed are those that you should pay
- Should the charges be part of other fees such as marketing, accounting, or management fees
- Did you really use the service?
- Do you need the service?
- Did you agree to the service?
- Is the allocation method fair? Available rooms, total rounds, total members, total revenues?
- Ask yourself, if I was the Owner, would I want to pay this?
- Ask internal leaders, regional, or corporate for clarification
Confirm - Can or Should be Paid by Operator?

- Labor, benefits, and bonuses
- Travel costs exceeding your standard policies
- Meetings of corporate support staff
- Corporate overhead
- Advertising overhead
- Contract or temp labor

- Overtime
- Business entertainment
- Equipment
- Non-brand related expenses
- Advertising tear sheets and copies of invoices
- Office supplies
Unique Items to “Monitor”

- Reservations system fees, per reservation, and monthly participation fees
- Commission credits on reservations fees that were cancelled
- Credit Card commission fees
- Frequent guest program stay costs
- Travel agent or group commissions processed by corporate office
- Corporate events: Manager conference and related participants
- Guest award redemption program fees
- Procurement program fees
- Banking fees
- Credits and refunds
- Items referred to as “processing” or “participation” fee
Operator’s Obligations to Ensure Reasonable Billables

• Review the terms of your HMA for Centralized Services and Corporate Billables
• Was it budgeted and is the cost within the budget guidelines?
• Is the charge competitively priced and, if not, obtain explanation on why or bid out on your own
Analyze New Programs

- Request proof of value and results
- Prepare a monthly mini P&L to share the program ROI with Owner
- If a program was unsuccessful, challenge the corporate contact for a credit
- Fiduciary responsibility to your Owner
Be Cautious Of...

- Yes, you work for the Management Company, but you have a fiduciary responsibility to your Owner
- Is the billable something that is not in the budget; if so, determine if you need or wanted to participate
- Monitor corporate statements to ensure payments are accurately applied
- Pay from invoices with support
- Follow up
- Don’t raise concerns to your Owner until you have all the documentation
Save Your Records

• Build a report to track corporate fees monthly by category
  – Monthly show Owner the value of your management company and highlight the total amount of payments compared to revenues
  – Include savings where programs have contributed cost reductions, calculate the net impact

• Retain the support
• Monitor for trends to research unusual variances
• Have available for year-end external audits
• Share your report with Owner to demonstrate your focus on this sensitive area
Keep Eye on Compliance with HMA

- Review your HMA to confirm exactly what the operation can be charged from your management company
  - Is the billable in compliance with the HMA?
  - Is the billable including any profit to the management company?
- Could you have secured this program at a lower cost?
  - Ask for proof of value to your operation; if its something that really didn’t fit, as
  - If you didn’t budget to participate in this program, are you really obligated to be charged?
- Does the HMA require Owner approval to participate and has that been secured?

As hard as this is to believe, accounting departments do, on occasion, make mistakes; you might be billed for something in error or the allocation method could be erroneous.
What is the Risk?

- Management contracts can be terminated
- Failure to work together can inadvertently transition into ugly, costly potential legal disputes
- There will be an economic downturn whether locally, nationally, or internationally; a strong relationship will work together to get through the storm
Who Should Monitor Corporate Billings?

General Manager and Finance Leader
Why Now?

- Fewer management companies have equity positions
  - Corporate programs and billed costs to the local level don’t seem to carry the same focus as when the management company was an Owner
  - Management companies are pressured to create additional revenue streams

- Associated with the continued increase in management company programs to improve efficiencies that often result in increased corporate revenue streams, Operator has an obligation and fiduciary responsibly to Owner to ensure that the items they’re paying for are in compliance with the HMA but are also reasonable and appropriate

- If the new program isn’t working or is costing more than if you arranged on your own, ask for an explanation that could result in a adjustment or credit

- The management company wants to retain the HMA for the life of the contract and desires to maintain positive relations with Owner
  - Disputes are not healthy for any relationship; rather, compliments and success stories strengthen relations
While the local leaders most involved with corporate expenses are employees of the management company, ultimately the Operator’s role is to protect and increase the value of the asset and the investment of the Owner.
Questions?

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