

Hotel Development - From Inception to Operation

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Glamour and luxury.....

Images of an elegant and luxurious hotel, glimmering in the sun on a white sandy beach, surrounded by palm trees gently swaying in the warm breeze evokes in most, if not all of us, dreamy thoughts of glamour, relaxation, pampering and absolute delight.

Those in the industry know very well that whilst this is the experience, the hotel personnel strive hard to provide for their guests, achieving this requires extreme hard work and dedication by the operator and hotel staff.

But this hard work doesn't start and end there - this is the public face of the hotel.

The 'private' life of the hotel starts long before the first guest checks in. In many respects, the development process (which commences with identification of a development opportunity and ends with completion of the finished product), is equally as difficult and demanding.

The hotel industry, whether you are an owner, developer or operator, is certainly not for the faint-hearted.

In this article, (to be produced in 2 parts), I have sought to outline the private life of the hotel - from inception through to its unveiling as the shiny finished article. This journey is in fact far from simple, and the development process will take many twists and turns before it is completed.

However, in my experience as a legal adviser within the hotel industry, I believe it is beneficial to be knowledgeable of all the issues and steps involved, together with the required timing for these, so that the bigger picture is always to hand (and can therefore be better managed).

Both an operator and an owner will each go through a similar process, this article focuses on the development process from an owner's perspective. I have chosen to do this because not all owners will have the same level of knowledge and experience of development or the hotel industry. This article therefore seeks to show, simplistically, just how complex the development process is and how important it is to get it right. Hotel development is too expensive a business to get wrong!

The Beginning - an Opportunity.....

An opportunity presents itself. Whether this is by way of a development site, an existing building under construction (or already constructed), or an operational hotel, the process starts.

Below/overleaf I have prepared a diagram outlining in basic form the various stages of a hotel development, together with identification of what's involved at each stage. This diagram cannot capture all the issues that may need to be dealt with, (for this a lengthy book would be required), but hopefully provides an informative overview.

The structure that I have commented on also assumes a stand-alone hotel. In the event the hotel is part of a mixed-use development, or forms part of a building which also includes residential and/or commercial components (which will not form part of the hotel and therefore will not be managed by the hotel operator), the structure necessarily becomes more complex. Additional issues and considerations will be involved in these circumstances.

Due diligence.....

The next step is to undertake a thorough due diligence exercise.

This will require the involvement of various professionals, including hospitality consultants, lawyers, surveyors, architects, accountants, insurers, government liaison representatives and potentially hotel operators.

The due diligence process forms the foundation upon which the project will evolve and the hotel will be built. It is a vital part of the process and sufficient time, resources and effort should be given to it.

The due diligence process can be broken down into separate components, comprising the following:

- Market research covering the geographical location of the project, competition of the proposed hotel, demographic information, potential customer analysis, the political and economical environment of the region, financial analysis of existing hotels in the vicinity of the proposed project, together with trading and employment framework etc
- Land and ownership investigation, to discover whether there are any potential problems with the land (survey and environmental issues), restrictions on the title or 3rd party interests etc, which may affect the development
- Investigation into development issues such as planning, access, utilities and licensing requirements – to understand what will be required, hurdles to be overcome and whether it will be possible to build the hotel as required
- Corporate structuring considerations : how does the acquisition impact on the owner's corporate structure, is the project located in a different country, is a local company required, do property ownership restrictions apply to the owner, what corporate governance requirements need to be complied with internally?
- Financial due diligence and planning : what is the tax regime in the location of the project, how does this impact the owner's existing operations and corporate structure, can profits be repatriated, does a foreign investment regime apply to the owner's investment, what duties will be payable where goods/materials/services are imported, what are the estimated development and construction costs, can workers and materials be procured locally or do they need to be imported, what borrowing requirements does the owner have, what security will a lender require, and general consideration of lending arrangements to be agreed
- Business plan and risk analysis (summarising all aspects of the due diligence)
- (For non-operational assets), hotel operator expressions of interest : it is always beneficial to involve the hotel operator at the earliest stage possible, to obtain their feedback and opinion of the proposed project and the location, together with confirmation of their interest to manage the hotel (subject to agreement of terms).

Where the asset proposed for acquisition is an operational hotel, the due diligence process as outlined above will be required to a large extent. Additionally, detailed analysis of the hotel operation and management itself is required as follows:

- Review of existing hotel management agreements and consideration of whether sale of the asset will trigger termination of these, or whether the agreement (and thereby the operator) may be assigned to the owner, does the operator have a first right of refusal to purchase the hotel?
- Consideration of the commercial terms of the operator's appointment, including fees, exclusivity arrangements, the existence of a performance test, freedom to dispose of or grant security over the hotel etc
- Review of the existing hotel management team and performance of the hotel to date
- Review of financial records and audited accounts to establish the trading history of the hotel, income and expense levels and resulting profitability for the owner
- Inspection and survey of the hotel itself : what is the condition of the rooms and common areas, is a refurbishment required?

- Is the back of house in good order?
- What is the quality of the FF&E: is there a need for large scale replacement?
- What is the age and quality of the infrastructure and plant – have these been maintained properly, what are the likely costs where replacement and/or repair are required, what warranties over the plant and equipment will be transferred to the owner?
- HR and employees : does a trade union exist, how does is the employment legislation regime of the country in which the hotel is located impact operation, what are the likely owner's costs associated with employment of the hotel staff (ie. pension and insurance contributions etc), are there any pending legal actions or tribunals against the hotel/existing owner?
- Review of all supplier and service agreements entered into by the hotel : what are the obligations and liabilities?
- Review of the hotel's insurances and claim history
- A detailed analysis of whether the hotel or existing owner is (or is likely to be) a defendant in any legal action, what are the existing and potential legal liabilities of the hotel?

On the assumption that all due diligence investigations, surveys, business plan, financial forecasting and risk analysis are acceptable, then acquisition of the asset can take place and the process will then move into a more detailed development stage.

Development stage

The development stage brings in further specialisms and professionals. During this part of the process, involvement will be required from hotel operators, architect and design consultants, a project manager and cost consultant, and potentially other consultants as may be required subject to how the development team is to be structured.

The development stage will also depend on the type of asset that has been purchased.

(a) Development Site

If acquisition of bare land for development has occurred, then the development stage will necessarily involve:

- Appointment of the hotel operator, which ideally should be undertaken pursuant to a detailed RFP and selection process
- Obtaining the various development licences and planning permissions, and non-objections from local tourism authorities
- Commencement of concept design of the hotel, with involvement of the appointed operator to ensure that the hotel will, in all respects, comply with the operator's brand standards
- Preliminary development cost projections
- Preliminary design and construction programme

(b) Existing building (whether partially or fully completed)

The development stage, where the asset acquired is an existing building, will follow the requirements of a development site for the most part, particularly with regard to hotel operator appointment and the design process (where the building is partially complete, or only completed to a shell and core finish).

In both cases (acquisition of a development site or an existing building), it is important that selection and appointment of the hotel operator occurs as early as possible. Such an early appointment will facilitate the design programme of the hotel, with the owner being able to obtain input, guidance and approvals from the operator in line with the programme (thereby preventing any costly delays). It will also ensure that the hotel is designed and built in accordance with the operator's brand standards, and allows the owner to draw on the experience of the operator with regard to market positioning and optimising the marketability of the hotel.

Late appointment of an operator may cause additional pressure and stress to the design and construction programme, and is likely to push up development costs, particularly if design needs to be re-worked to accommodate the operator's requirements.

(c) Operational hotel

The development stage may or may not apply where the acquisition is of an operational hotel. This will depend upon whether the existing hotel management agreement is transferred to the owner and operation remains unaffected, whether renovation/refurbishment is required, or whether the hotel management agreement terminates and a new operator needs to be appointed, with a major renovation.

In the event that the development stage does apply, then it will follow a similar path as per (a) and (b) above. Additional complexity will arise in the event of partial renovation or refurbishment of the hotel, which is to be undertaken without closing the hotel. This will need to be carefully considered, with the operator's views and approval obtained, before the renovation budget and programme can be finalised.

Renovation of a hotel whilst it remains operational, is one of the most sensitive and difficult scenarios for owner and operator alike. Both parties will try to balance the need for a facelift to the hotel (to hopefully improve revenue) against the requirement for minimal impact on available room inventory, common areas, provision of services, and the guest experience generally. Time is of the essence, and the works programme needs to take these issues into account, which adds further management issues. This is an extremely difficult balancing act to achieve.

Construction and beyond

In the second part of this article, I shall focus on the construction, pre-opening and opening stages, at which point the hotel is then handed over to the hotel operator (and the owner can hopefully take a deep breath and more of a back seat!).

Part 1 of this article was written for Hotelier Middle East Magazine, March 2011 edition.

[Chart for Hotel Development Article](#)