

Apartment Hotels – Are the owners in the picture!

The allure of an expensively decorated apartment, situated in a resort location, offering multiple lifestyle facilities, independent management, a recurring income, the prospect of capital gain together with a right of use, has proved compelling to many thousands of Australian investors.

The consequence is that of recent years the Apartment Hotel has comprised the largest single component of new rooms inventory in many of Australia's resort locations.

This has been accompanied by the emergence, and apparent significant growth, of a number of specialist Management entities who hold generally long term contracts with the individual Owners of the Apartments.

In many cases these contractual entitlements have been acquired from the original developers of the Apartments who typically no longer participate in their operation having sold the rights to manage to a third party. All sounds good, however property and hospitality specialist Savills, say it is vital that specific expertise is required by potential investors to understand the investment they are considering.

Generally the entities that manage the Apartments are contractually entitled to receive, from the revenues derived, various and differing streams of remuneration including fixed charges, together with other charges calculated by reference to gross revenue and gross profit.

Typically the greater part of this remuneration is determined and paid without regard to any underlying profit derived by the operation of the Apartment Hotel and of the returns received by individual Owners.

The Owners of the individual apartments may have been paid, for a limited term, a guaranteed return on their investment, but its ultimate success will, as with any investment, be determined by the level and stability of the continuing income return that the Operator provides over time.

The recent volatility of the domestic markets has meant that across individual Australian accommodation markets there are many properties trading as Apartment Hotels that have not been able to deliver to owners levels of income that are consistent with the suggestions that were made to Owners at the time of their commitment. This compounds in the circumstances where the levels of debt in many cases has been established by reference to the cash returns originally suggested as being capable of being received from the trading of the potential purchase – the Apartment!

Savills comment that relying on the best efforts of the Body Corporate is not enough to provide individual owners with the capacity to challenge the operators of the Management contract, and the services of 'Owners Representatives' are essential.

An Investment or Dream.

Owning a piece of paradise is always compelling and as many owner investors are finding expensive.

It may not have been understood that, for example, in many circumstances the:

- Right of the Owner to utilize room nights in the Apartment Hotel may be subject to the provision of time defined notice periods, subject to availability or is restricted during certain periods of the year.
- Ability to sell a unit may be restricted by the obligation to procure an incoming purchaser to accept an assignment of the contractual relationships that exists between the Owner and the Manager.
- Owner may have little, if any, right to question, supervise and restrict the commitment and incurrence of expenditures by the Manager and which are practically funded by the revenues derived from the Owners apartment.
- Right of the Manger to market, price and position the Apartment Hotel in whatever manner it desires.
- The Manager may have an unrestricted right to manage or own other Apartment Hotel properties that adjoin, are in close proximity, and are competitive to the facility within which the Ownwers unit is situated.
- Entitlement of the Manager to manage ,may not be terminated or will require a costly legal battle.
- Limited, if any, ability of the Body Corporate representing Owners to influence or exercise any level of executive authority over the Manager.

Know What Is On Offer

Typically the documentation between a Manager and Owner will be complex and often comprised of a number of separate contracts addressing, amongst other things, the right of the Manager to sell the room nights available at a rate they set, promote and market the Hotel without consultation, manage the body corporate or community organisation that administers the collective of units that comprise the hotel, and commit Owners funds at its discretion.

Generally the contracts will establish an irrevocable long term commercial and trading relationship between the parties with the Manager typically receiving a right to manage the investment unit without any obligation to provide a minimum level of occupancy and income return. The accountability of an Operator which is theoretically to the Body Corporate in fact does not exist.

However in most circumstances the Manager is, regardless of its performance, contractually entitled to receive a stream of income from the operation of the Apartment Hotel in preference to the payment of any return to the Owner.

Savills research suggests that in some cases Owners may not have fully appreciated the long term and contractual nature of the trading risks they have accepted by virtue of their signing the agreement to commit the custody and management of their investment unit to the Manager of an Apartment Hotel.

Know what is on offer as the documentation that normally evidences the relationship with a Manager is typically, complex, voluminous, and to the uninitiated, obscure as to the rights, obligations and entitlements of the contracting parties. Savills advice is, to understand the full ramifications of these Management Contract by obtaining specialist advice on the subject.

Further, and following purchase, in many cases the ongoing liaison and communication between the Manager and the Owner is completed by way of a third party relationship managed through a Body Corporate structure with the Manager holding a responsibility to only report to and be accountable to an elected body of representatives of Owners.

The members of the elected body of representatives will normally be Owners who have only limited time, capacity and experience to be able to address the complexity of the ongoing requirements of the trading outcomes and the complexities of the tourism and hospitality sector.

Savills experience suggests that the Body Corporate will clearly be at a disadvantage in any enquiry of the Manager and the completion of analysis of data provided relating to the

performance and prospects of the Apartment Hotel including the complexities of the tourism and hospitality sector.

Savills view is that all Management contracts will need to include accountability of the operator and it is important for all Body Corporate to obtain the advice of a professional 'Owners Representative'. The return on investment for the Apartment owner and the integrity of their investment are the criteria for a successful investment in an Apartment Hotel.

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