



HOTEL RISKS

‘UNDER CONSTRUCTION’ IN AFRICA

THE CONTINENT OF AFRICA IS CURRENTLY THE MOST UNDERDEVELOPED CONTINENT IN THE WORLD. WITH THE PROJECTED SHORTAGE OF RESOURCES GLOBALLY IN THE NEAR FUTURE, MANY COUNTRIES HAVE SET THEIR SIGHTS ON AFRICA TO SUPPLY THEIR EVER-INCREASING DEMAND. MULTINATIONAL COMPANIES IN THE MINING, OIL AND GAS, ICT AND SERVICES SECTORS, IN PARTICULAR, ARE IN A RACE TO ACQUIRE CONTRACTS AND BUSINESS PARTNERS ACROSS AFRICA, AND THEY ALL NEED A PLACE TO STAY...

MARK MARTINOVIC, CEO of Hotel Spec, hotel development experts with experience of more than 80 hotel projects in 21 African countries, speaks to us about hotel risks in Africa.

Africa and its growing cities are still wracked by challenges; electricity is intermittent, corruption soaks up development funding, political instability and tyrannical governments undermine confidence, and kidnapping of foreigners is rife. Or, at least that's been the stereotypical image of African countries until recently for many foreign investors.

Analysts say the rate of return on foreign investment in Africa is higher than in any other developing region. According to the IMF World Economic Outlook, 10 out of 20 of the world's fastest growing economies (highest projected compounded annual growth rate (CAGR) from 2013 to 2017), are in sub-Saharan Africa.

As a result, Africa now has the fastest-growing middle class in the world. Some 313 million people, 34 per cent of Africa's population, spend US\$2.20 a day, a 100 per cent rise in less than 20 years, according to the African Development Bank.

Along with this 'rush' to Africa, comes the need for new hotels. Traditionally, Africa has come off a very low base, and international hotel chains and brands have set Africa, as a continent in general, as a high-value destination for their brands.

PITFALLS IN HOTEL DEVELOPMENT IN AFRICA:

In order to succeed in the development of a hotel project, one needs to understand the various risks associated with hotel developments in Africa. The most common of these concerns should focus primarily on:

- **Registration of land ownership and title deeds.**

Land ownership in many African countries is still an issue, and unless clear and unencumbered title to the property can be proved, no financial institution will consider providing any funding for the project.

- **Capacity of the professional team.**

Having stayed in many hotels around the world does not qualify an owner or a designer of being a hotel expert. Employing the design and consultant team with relevant experience and capacity to execute the project are of the utmost importance.

- **Availability of resources for the construction as well as long-lead items such as plant and equipment.**

Availability of construction materials locally will impact on the overall cost of the project, but skilled labour is equally important. Consideration prior to construction should be given to all plant and equipment that needs

to be imported. Some countries have particularly prohibitive importation procedures that will have a direct bearing on cost and time while ports, rail and road networks are mostly underdeveloped.

- **Availability and cost of funding.**

Debt funding for hotel projects, while still being available, is not easy to secure. Most financial institutions do not like the cyclical and uncertain nature of projecting hotel revenues and profit. This ultimately results in the cost of finance sometimes being unaffordable in the project's business plan.

- **Experience, capacity and ability of the contractor to complete the project.**

Too often, clients tend to consider the cheapest tender for the construction works, and this can lead to disaster. Prospective hotel developers should inspect the contractor's previous relevant projects as well as do a full background due diligence on their contractor. The form of contract to be entered into should be appropriate to the project and provide sufficient security to the client with regard to performance guarantee, advance payment, insurance, retentions, completion and defects liability.

- **Contract documentation.**

The form of contract to be entered into is vitally important as that is the document that states the required performance and expectation of the completed project, while dealing with all aspects of the design, construction and completion of the project. It also clearly sets out the timing for the project, all payments, insurances, allocation of risk and remedies in the event of any default by either party.

- **Infrastructure.**

One of the biggest challenges in Africa is the availability of electricity, portable water and sewage insofar as hotel developments are concerned. Hotels consume a large amount of electricity and water and produce a huge amount of sewage and wastewater. As opposed to their Western counterparts, hotels built in many African countries have to provide all of this themselves, in the form of diesel generators, boreholes and water treatment plants, sewage treatment plants, etc. This all adds to the cost of construction, additional equipment and then the cost of running and maintenance.



HOTEL BRAND

Each hotel brand has its own set of guidelines and brand standards as well as detailed requirements for the finishes, facilities (both front and back of house), Fire and Life Safety (FLS), amongst others. More International Management Agreements than not, have specific clauses requiring the owner/developer to comply with all of the Brand Standards for the specific hotel brand they have selected. This is a contractual requirement (in terms of a signed management contract), whereby the owner has to produce a fully equipped and furnished hotel to the standards required by the operator.

Where a hotel developer has decided to go ahead with his development prior to appointing a hotel operator and then selects an operator and brand during construction, there is a very high risk of having to make a number of changes to the design, specification of plant, equipment or furnishing, or spatial planning. For example, an operator may require more than one service elevator for a hotel larger than 100 rooms and if only one was planned for, then structurally and architecturally, this will have major implications to the cost. In addition, there will be time delays for the design work to be completed and then additional works to be affected on site. The result of this would be the contractor being able to submit an extension of time claim, there will be additional costs for design and then the purchase of the additional elevator, which in itself is a long lead and expensive item in any building. Along with the extension of time claim from the contractor, he will be permitted to add P&G (overhead) costs

to each day of extension and will be entitled to reasonable profit on the addition to his scope of work. Even in a fixed price, lump sum contract, this late adjustment to the design and/or the addition of equipment or built-up area, will result in additional cost and time to the employer.

Hospitality projects, by their nature, carry a higher financial risk than most other types of developments. So creating designs that are not too extravagant is important. Architects and designers should understand that the design needs to be appealing, while reinforcing the brand identity, providing safety and security and should maximise the revenue potential of the hotel.

CLIENT/EMPLOYER

The employer needs to ensure that they have secured funding for the entire project as delays in payment to the contractor can have a severe impact on the project. A contract for construction will require an advance payment, normally 50 per cent of the total contract value.

Thereafter, there are monthly payments to be made. Some clients are under the impression that once 50 per cent of the contract sum has been advanced, that they do not need to pay again until the development is 50 per cent completed. This is not the case, and the contractor will submit regular claims according to an agreed schedule of payments. These payments will have deducted from them: the retention amount as well as 50 per cent of each claim (the amount of the advance payment), however, they will still have amounts owing to the contractor which must be paid.



Failure to pay the contractor on time will entitle the contractor to compound interest on the outstanding amount. The risks here are the increased interest charged by the contractor to the employer, adding to the project costs but also, where a smaller contractor has been employed, this may put financial pressure on the contractor and inhibit his ability to perform according to the contract. In addition to the interest charges, the contractor may suspend works due to non-payment or he may have to delay ordering certain equipment that requires upfront payment from him, thereby delaying the contract to which he would be entitled to a claim for extension of time.

CHANGE IN LEGISLATION

Where certain changes have come about as a result of a change in import procedures or delays by authorities and the contractor can prove that he had diligently followed the procedures laid down by the relevant legally constituted public authority in the country of the project, then again, the client will suffer cost and time implications.

CLIENT SUPPLIED ITEMS

In many hotel projects in Africa with private individual owners, the owner elects to procure and supply certain items to the contractor. Alternatively, the parties could negotiate that the client will select the supplier of a product and the contractor will have to import the specified product from that supplier at his cost, which will be itemised in the bill.

The biggest risk here is that many hotel developers in Africa believe that they can procure items cheaper from China. In most cases, the client is not a specialist in that particular product and since it is a client supplied item, the contractor will not accept responsibility for the performance of those items and will not cover the warranty.

A further risk is the ability of the employer to ensure that all free issue materials are delivered to site on time in accordance with the programme of works. If the delivery is late, partial, or items are damaged, causing a delay to the programme, the contractor will be entitled to claim for extension of time. Where the items arrive too early, they will need to be securely stored in an environmentally appropriate (rain, humidity, dust) warehouse, of which cost should be considered.

LONG LEAD ITEMS

Unfortunately in Africa, most plant and machinery items are long lead items, meaning it takes a long time to get them to site. Before they can be ordered, they must also be designed, specified and agreed to by the hotel operator. The ordering, supply, logistics and local clearing and delivery to site must be carefully coordinated in order not to cause any delays to the project's programme.

Other issues could be problems in port, international exchange rate exposure, customs procedures, availability of transport vehicles, and the state of the roads and infrastructure. In addition, availability of local specialist installers and availability of spare parts and service personnel.