

AUSTRALIA

Hotel Management Agreements



Introduction



One cannot discuss the evolution of hotel management agreements (HMAs) without first talking about the separation of hotel ownership and hotel operations; a transformation of the major chains' business models, more commonly known as an "asset light" strategy. Today the form taken by hotel operators in HMAs is an important factor in the effective working of the market in hotel investment. DLA Piper's Hospitality and Leisure Sector Group has negotiated HMAs for a myriad of different clients across the H&L landscape (owners, investors, operators (both branded and white label) and lenders) in all of the world's key jurisdictions.

Many consider hotel management agreements to be borne out of a modified lease for the Hong Kong Hilton back in 1963, and the main terms included in it underpin most HMAs to this day. All major chains today have, to one degree or another, expanded nationally and internationally through a combination of franchise and management, and all have their own "form" or template agreements. In summary, over the last few years, we have found that trends that started as a result of the financial crisis of the last decade have continued to develop. In many markets the advent of recession made operators more risk averse. Traditionally HMAs were a means to limit operators' exposure to fixed rental payments when revenues were dropping. In less developed markets, even with a degree of economic recovery, operators have continued to use HMAs in this way. In more developed markets, such as Spain and the United Kingdom, we have seen increased complexity in agreements, a symptom of owners becoming more knowledgeable and seeking more control and input on the operation of their hotel, although owners continue to take the lion's share of commercial risk in developments.

Another important factor, as with any real estate investment, is the attitude of those who are providing the money, be it equity or debt. Leases were the traditional mainstay of hotel developments and indeed Germany remains a country where hotel deals are commonly based around leases. However, as investors have started to see the increased returns from ownership, the boom in arrangements like ground leases and other market changes is essential to have an understanding of investors and be able to work with them in a scenario of increasingly complex legal arrangements.

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Australia

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General

Are Hotel Management Agreements (HMAs) common in the jurisdiction?

Yes. HMAs are a common owner/operator structure used in Australia.

If not HMAs, what are the alternatives / what is commonly used?

Other alternative approaches are:

- **Franchise agreements** – operators enter into franchise agreements with well-known domestic or international hotel chains under which the chain provides a business system, services and licenses the use of the brand and other IP of the hotel chain. The property at which the hotel is operated may be owned by the operator or another party (which may be an entity related to the franchisor). The fee structures may vary and may be made up of a number of components, including royalties for the use of IP, other fixed charges, fees for services and/or fees based on revenue/performance of the hotel business.
- **Leases** – owners lease the underlying asset to an operator on a long-term basis (under which a fixed lease payment is payable), and the operator operates the hotel business autonomously, or occupies the hotel under the lease, with the HMA regulating the operation of the Hotel.

Is it common or usual for the HMA to be governed by (i) local laws; (ii) the laws of one of the parties' country of incorporation; or (iii) an alternative jurisdiction?

HMAs are typically governed by Australian law. Australia is regarded as a relatively stable legal jurisdiction, such that the sovereign risk and legal risks associated with use of Australia law are limited.

Are there any significant or unusual points to note in respect of tax on HMA payments in the jurisdiction?

HMA payments made to the operator by the owner, and/or any rental payments under a lease of the Hotel property are subject to the Australian Goods and Services Tax (GST).

Term and termination

Is there a standard contract period of an HMA?

The duration of HMAs depends in part on the bargaining position of the operator – for major operators, terms of 20+ years are not uncommon. The duration also depends on the nature of the assets, with landmark assets often attracting longer terms.

Is the term usually fixed? Are early exit or similar options included (contractual or implied)?

The term is usually fixed.

It is increasingly common to integrate early exit mechanisms where operators underperform for a sustained period. This is in addition to standard early termination rights, such as for an insolvency event (eg liquidation, receivership, statutory winding up) or where a third party brings any claim or commences proceeding relating to the owner's title to the hotel or land.

Is it usual to include fees / liquidated damages for early termination?

Exit fees for early termination for convenience (ie without cause) or on sale of the property by the owner, and excluding termination in the case of manager default, are common. The level of termination fees/liquidated can vary depending on a number of commercial factors (eg location, type of hotel, market position of brand) and the reason for early termination (ie for convenience vs where the property is sold).

What is the usual position in respect of renewal?

It is common to have renewal periods that are subject to agreement between the parties; options that are exercisable unilaterally are less common. Renewal periods vary depending on the operator and are driven by their own operational needs. Renewal periods as part of an HMA are often negotiated as part of any agreed future capital improvement program for the hotel asset.

Fees

Is there a standard fee structure for HMAs (eg base + incentive)?

HMA fee structures typically comprise a percentage of gross annual revenue (base fees), and a sliding scale percentage of the adjusted gross operating profit, where the operator meets profitability thresholds (incentive fee). The fee structure will depend on various factors including the extent to which the operator or the hotel owner contribute to capital and operational costs of the hotel over the term of the HMA.

What other fees and charges are there (such as royalties, accounting, marketing, license fees, etc.)?

Depending on the parties and type of hotel, marketing contributions and/or fees for use of services such as accounting, software, reservation networks or intellectual property (including branding) may be payable.

Are owners typically required to set aside funds for fixtures and fittings?

Yes. Owners are typically required to make furniture, fitting and equipment (FF&E) contributions for general repairs and maintenance of the hotel, and any other budgeted capital expenditures.

Performance and operations

What is the usual standard imposed on an operator in respect of the operation of the hotel?

Commonly, the standard imposed on the operator is that the operator will use the skill, effort, care and expertise reasonably expected of a prudent operator of hotels with regard to the brand and brand standards of the hotel operator. KPIs and other prescriptive standards are less common, although the inclusion of such standards varies depending on the operator and the consequences flowing from failures to achieve such standards, the operator and the asset.

What performance measures are commonly used in the jurisdiction?

Common performance measures are generally related to performance against an agreed budget and/or Revenue Per Available Room (RevPAR) relative to a set of similar competitors.

These measures are often linked to termination rights for failures to meet these standards.

Is an operator or owner guarantee common in the jurisdiction?

The inclusion of guarantees depends on the identity and structure of operator and owner, including the financial position and assets held by them.

What is the usual position in respect of employees? With whom does the liability for the employees sit?

Commonly, the owner of the hotel employs the employees and the employees take directions under the supervision of the operator. In these circumstances, the hotel owner is liable with respect to:

- minimum wage obligations, work, health and safety (WHS) and discrimination law compliance;
- any penalties, damages, compensation or other order arising of unfair dismissal; and
- vicariously liability for the acts and omissions of employees.

For everyday management, owners usually give operators permission to direct and control its employees.

In some cases, the general manager, and possibly other key employees (eg executive chef), will be employed by the hotel operator.

Is it usual to have a non-compete clause, eg that no other property with that brand can open within a certain radius?

Yes, based on a geographic radius.

Who is responsible for insurance?

The owner is typically responsible for obtaining insurance for:

- the property;
- business interruption;
- workers compensation for employees employed by the owner; and
- items owned by the owner or people other than the operator.

The operator is typically responsible for the following insurances:

- public liability;
- workers compensation for employees employed by the operator;
- motor vehicle;
- employee fidelity; and
- other operating risks it is customary to insure against in the operation of hotels.

Does the HMA give rights in real estate in the jurisdiction?

No, provided that the HMA does not operate as a lease or give rise to a leasehold interest.

Does the HMA need to be recorded against the property, if this is possible in the jurisdiction?

No.

However, where an HMA is not recorded against the property (for example, via a caveatable interest and caveat registered against the title to the property), operators will need to ensure they properly secure their operating rights in the event the hotel property is sold.

Where financing is taken, is it standard to obtain a Non-Disturbance Agreement (NDA) as part of a management or lease agreement?

Yes. The terms of NDAs vary depending on the parties.

What other agreements usually sit alongside an HMA in the jurisdiction?

There may be other associated agreements depending on the operator, which can include:

- IP licensing agreements;

- services agreements for the provision of services (eg accounting, software licensing, access to reservation networks);
- individual employment contracts for the general manager of the operator;
- supply agreements; and
- mortgagee step-in right deeds (on behalf of the owner).

Transfers and assignments

What are the standard rights / restrictions in respect of transfer / sale of the hotel?

The rights and restrictions applicable to the transfer/sale of the hotel depend on the operator and the asset. For major operators and/or landmark assets, the consent of the operator is commonly required for the hotel to be sold or transferred. Otherwise, the owner is usually permitted to transfer or sell the hotel without the consent of the operator.

When a managed hotel is sold (either asset or share deal), is it usual in the jurisdiction that either the Operator's consent is required for the sale, or that the hotel may only be sold if the HMA transfers with the hotel?

Both. In relation to the requirement for the consent of the operator, see above – it depends on the operator and the asset; however, commonly with marquee hotels operated by international hotel operators, their consent is usually required, and commonly provided if the purchaser agrees to be bound by the HMA following the sale of the hotel.

Whether this is the case with other operators, or if the owner can sell the hotel property with vacant possession will depend on the terms of the HMA.

For taxation reasons, hotels are commonly sold with the HMAs in place, even if these can be terminated after settlement. Taxation advice should be sought as part of any hotel acquisition or disposal.

Do HMAs commonly include a right of first refusal for the operator to purchase the hotel?

It depends on the operator and the asset. Some operators also own hotels and therefore like to have a first right of refusal, while other organizations that are simply operators do not seek such a right.

Is it usual to include provisions which enable the sale of the property with vacant possession ie without the brand?

As above, these depends on the terms of the HMA and the operator. There are different tax consequences arising if the hotel property is sold with vacant possession and taxation advice should be sought as part of any hotel disposal.

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