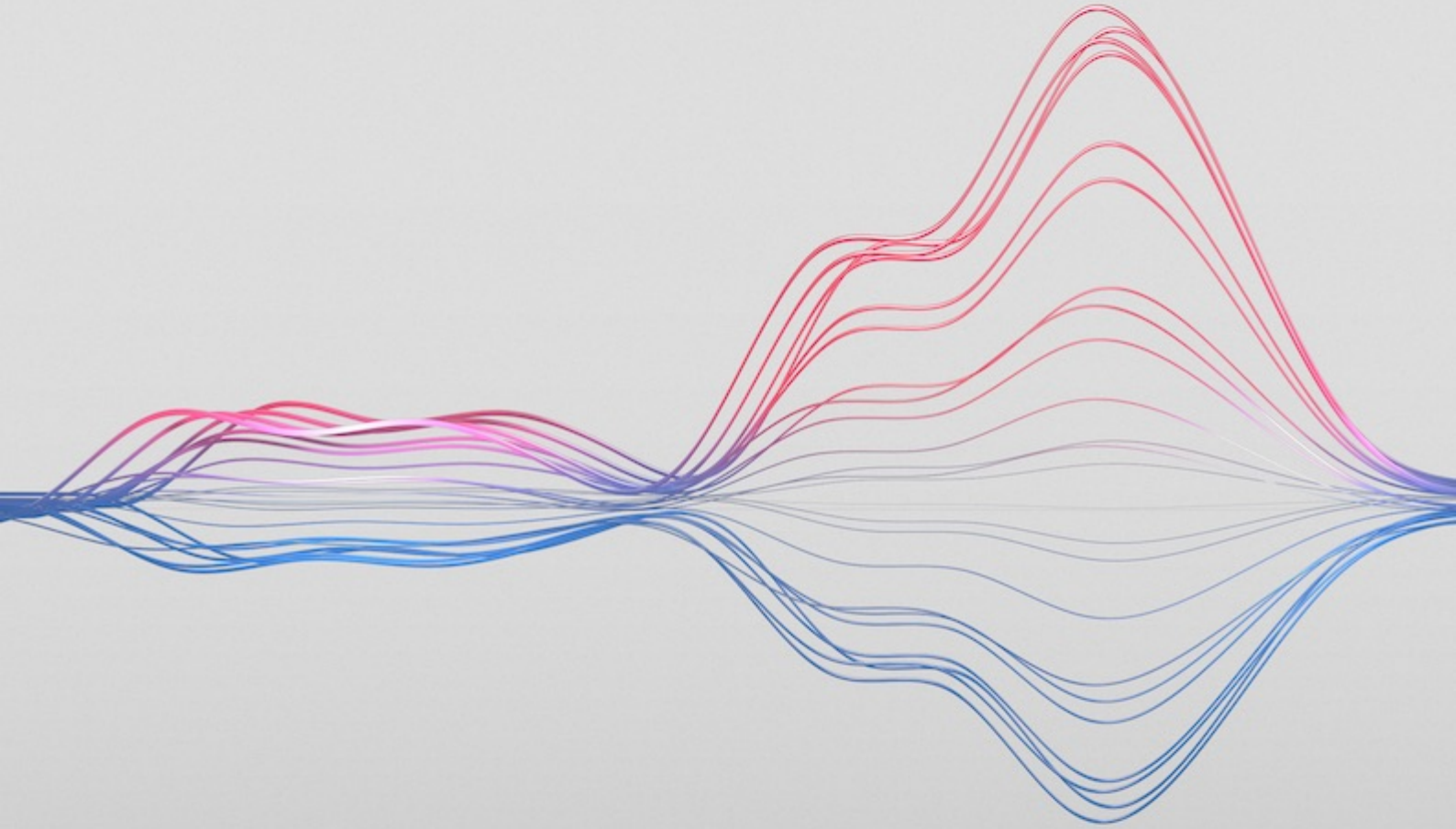
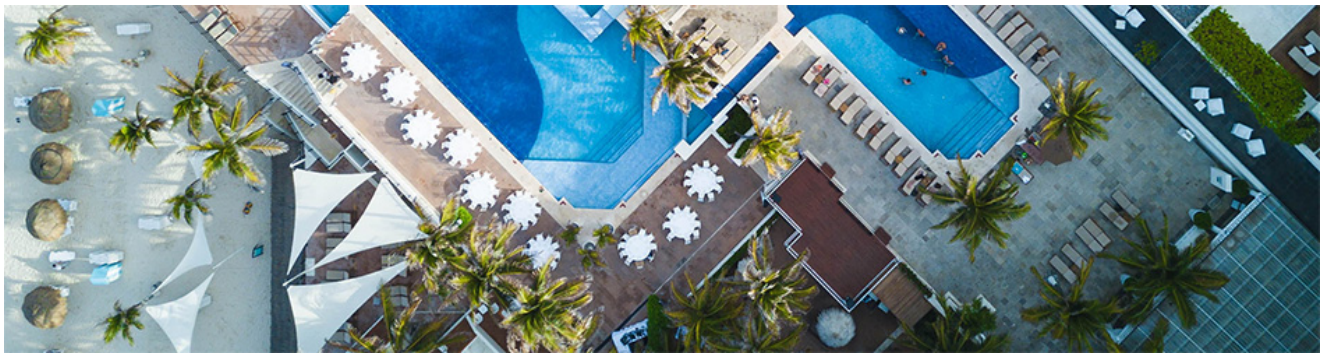
UNITED KINGDOM

# 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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# United Kingdom

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## General

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

HMA's are widely used across the UK and indeed English law is commonly used as the governing law for HMA's across the world. Branded operators commonly utilise HMA's for upscale brands.

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

Lease is the obvious alternative. Most hotel operators resist taking a real estate interest and the growth of corporate owners (and investment into them) with internal operating capacity has seen a growth in franchised hotels.

### 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 in the UK will commonly be governed by English law, it would be unusual for any other jurisdiction's laws to be used as the governing law.

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

It largely depends on corporate structures. At a simplistic level there should not be, but as Brexit progresses, both owners and operators will be aware of VAT and withholding issues on payments and the application (which will change) of taxation treaties.

## Term and termination

### Is there a standard contract period of an HMA?

HMAs for branded operators tend to be longer in duration (20 years +) whereas white label managers will usually be for shorter periods.

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

The norm is for an HMA term to be fixed. Where early termination or, for example, flip to franchise is negotiated it is usually subject to exit fees. Under English law it is unlikely a HMA could have implied early termination (for convenience) rights. The issue appears to have stemmed from US law where an agency relationship may be considered to exist; agency is not viewed in the same way under English law. Only those termination rights contained within the HMA are likely to be enforceable under English law.

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

Exit fees for early termination other than due to operator default are common. The level of fees can vary widely depending on a number of issues (e.g. location, brand, scale, etc.).

### What is the usual position in respect of renewal?

This varies widely between different operators. Usually HMAs will be extendable in tranches of say 5 or 10 years. This can be mutually agreed or at the operator's discretion.

## Fees

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

Fee structures vary between operators. The standard is a base fee calculated on revenues and an incentive fee based on profits. Some branded operators may intersperse this with royalty fees.

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

As above, branded operators may require royalty fees and most require marketing contributions and other fees for certain centralized services, which may or may not be optional (e.g. accounting services etc.). Where a project includes condominiums or branded residences there will likely be further fees applied.

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

An FF&E Reserve is very common in the UK. Contributions and how it is operated can vary widely depending on practical matters associated with the hotel(s) (e.g. is the hotel part of a portfolio, the hotel's age, standing, etc.). It is common for contributions in early years to be lower and for these to increase over time (e.g. 2% of revenues in Years 1-2, 3% in years 3, 4% in year 4 and 5% in year 5 onwards).

## Performance and operations

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

Contractual performance standards vary between operators, type of hotel etc. Generally speaking, HMAs do not usually contain KPIs, SLAs or specific standards as fee structures often mean owner and operator's interests are aligned.

### What performance measures are commonly used in the jurisdiction?

A performance test is fairly standard (together with a termination right for failure to meet such test) but the type and nature can vary depending on the operator, nature of the hotel, location, etc. A standard performance test would consider achievement against budget and/or RevPAR against a competitive set of local or similar hotels.

### Is an operator or owner guarantee common in the jurisdiction?

For branded operators, an operator guarantee would be unusual. Regarding owner guarantors it will depend on the owner vehicle, if it owns the hotel (ie are there are Propco/Opco structures in place, etc.).

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

The owner will be the employer, except potentially for the General Manager and, depending on the nature of the hotel, certain other senior staff.

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

Non-competes are common and usually negotiated.

### Who is responsible for insurance?

The owner is responsible for the cost of property insurance (even if sourced by the operator) and the operator may put operational insurances in place (albeit this would be an operating expense). Recent updates to the Uniform System of Accounts have sought to make certain insurances an owner cost.

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

Not in itself. However, where key money is granted or rights of first refusal on a sale etc, restrictions can be registered on the title of the hotel.

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

Not the HMA itself but rights under the HMA may be per the above.

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

This depends on the bank and the operator. Traditionally, NDAs have always been required where there is finance and a management agreement.

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

There could be a number of different agreements depending on the operator, these include:

- (Brand) License Agreement
- Central Services Agreement
- Technical Services Agreement – on a new build or redevelopment
- Central Reservation Services Agreement.
- Property owner agreement (where operating an Opco/Propco structure)

## Transfers and assignments

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

Transfer rights under HMAs can vary widely. Commonly, operators will require consent to any change in ownership of the hotel. There may be restrictions on transfers to competitors, restrictions in relation to financial covenant strength and "reputation" tests.

### 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?

Yes.

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

Traditionally this has been common in the UK.

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

More recently this has been sought by owners. A standard HMA will not provide for this and if it is ever given there is usually an exit fee. Some brands are willing to offer a one-time right after a fixed period to exit with low or no fees.

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