

IRELAND

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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General

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

HMAs for hotels managed by the international hotel brands are unusual in this jurisdiction but there are some well-known examples for certain upscale brands and hotel properties.

HMAs for white label management companies are far more common in our jurisdiction and contain many of the same characteristics as the branded HMAs.

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

There are a number of different operating models here.

For branded hotels, leases and franchise agreements are 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.

It is not uncommon for boutique or smaller hotels to operate by a third party manager pursuant to a white label management agreement.

Leases are seen here, particularly for operators/tenants from jurisdictions where the leasing model is more prevalent (e.g. Germany).

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?

We see some different approaches in practice. Although Irish law is common and frequently used, it is not uncommon to see HMAs, or indeed franchise agreements, governed by English law as that would be the traditional preferred choice of governing law of international hotel brands who quite often enter into these contracts using companies incorporated in England.

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

This largely depends on corporate structures. At a simplistic level there should not be, but both owners and operators will need to be aware of VAT and withholding issues on payments and the application of taxation treaties (particularly in the post-Brexit environment where a UK counterparty is a party to the agreement).

Term and termination

Is there a standard contract period of an HMA?

From what we have seen, the term for HMAs for branded operators tends to align with the standard international position i.e. a fixed term of 20+ years or 20 years with two renewal options (e.g. for a further 5 + 5 years). Terms for 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 the HMA term to be fixed.

Early exits can always be commercially agreed and subject to exit fees.

Similar to English law, it is unlikely that Irish law would allow an HMA to include implied rights for early termination (for convenience). Only the termination rights explicitly stated within the HMA are likely to be enforceable. However, if explicitly agreed upon commercially, these rights can include termination for convenience.

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

Yes. While it would be a matter of commercial negotiation, there is nothing under Irish law to prevent this.

What is the usual position in respect of renewal?

The HMA typically includes one or more renewal terms of five years. These renewals can either be mutually agreed upon by both parties or take the form of renewal options that benefit only the operator. In either case, these renewal rights are subject to standard prior notification periods.

Fees

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

Yes, although fee structures vary between operators, they typically include a base fee calculated on revenue combined with an incentive fee when certain profit hurdles are met. In some scenarios, there may only be a base fee.

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

While fee structures vary between operators, the position in Ireland would follow the usual set of fees as described in question 9 and above. Other fees that can arise are reservation fees, centralised services and FF&E contributions. Technical services fees arise for newly developed hotels if input from the operator's technical team is required on the design and fit-out of the hotel.

Sometimes fees can be prescribed as optional and owners would pay additional fees if they opt in to avail of those services or based on usage.

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

Yes, it is common to see a fixtures and fittings reserve that is typically funded by the owner based on a percentage of the annual revenue of the hotel. The contribution typically increases over the term of the HMA, i.e. it may be 1% in year one and gradually increase over a number of years to 4% of annual revenue. Some owners look to create a "notional FF&E Reserve" to avoid the cash flow impact of funds being placed in a reserve account.

Performance and operations

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

This would depend on the standard of the hotel. For higher-end hotels, owners may look to impose an objective standard of operation to be adhered by the operator so that performance is benchmarked to that expected from an international operator of a 5-star hotel. It is not uncommon for HMAs not to include that objective standard.

What performance measures are commonly used in the jurisdiction?

A performance test is the standard approach and it operates in much the same way as other jurisdictions when it is applied i.e. an assessment of the performance of the hotel against budget and/or the RevPAR of a competitive set of local or similar hotels which would usually be identified in the HMA but subject to change over the term. It can be challenging to compile a competitive set of hotels in Ireland due to a relatively small number of brand managed hotels being in operation.

Failure to meet the performance test can result in a termination right. Typically, this occurs when performance metrics are not met over consecutive years. However, a cure right, which allows the operator to make up for the shortfall through payment, is usually agreed upon as a method to avoid termination.

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 there is a PropCo/OpCo structure in place, a property owner's agreement may be put in place or both PropCo and OpCo would be party to the HMA as covenants from the freehold owner of the property may be required.

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

Generally, the owner is the employer of all employees and liability rests with the owner.

It is not usual to provide for employees of the operator to be seconded to the hotel to fulfil a key personnel position and, during that period, the costs would be an operating expense of the hotel.

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

Yes. This is common and usually negotiated. Given that the majority of branded hotels in Ireland are in Dublin, consideration would need to be given to the geographical factors given that it is a relatively small city.

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).

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

No (although a case-by-case analysis would be required in case there are any property specific covenants arising that are potentially registrable e.g. via a caution on the owner's folio).

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

No, this is not possible in Ireland.

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

Yes, NDAs or comfort letters are 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)
- Non-Disturbance Agreement

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?

This would not be standard but it is something that operators sometimes look to include in a HMA and there is nothing under Irish law to prevent it.

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

This would need to be commercially agreed and would be subject to exit fees payable to the operator. For the most part, the sale of the hotel with a branded operator in situ is seen as the method of achieving a better return upon the sale of the hotel.

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