

ITALY

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 are commonly used for luxury hotels managed under known brands.

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

In transactions concerning a hotel business, the following structures are generally taken into consideration:

- **Property Lease Structure:** the property is leased by the owner to (the OpCo, incorporated, held and managed by) the manager /tenant, on the basis of a property lease agreement. The manager/tenant is responsible for (incorporating the OpCo), obtaining the licenses and hiring the employees necessary to carry out the business activity within the property. Certain activities can be lease to or operated by third parties, on the basis of business branch leases entered into with the manager/tenant (the Third-Party Lease).
- **Business Lease Structure:** the property is leased by the owner to the OpCo, incorporated and held by the same owner. The licenses are obtained by the owner. The business going concern carried out by OpCo in the property is leased by owner to the manager on the basis of a business lease agreement. Employees working for the OpCo are hired by the owner or the manager. Certain activities can be leased to or operated by third parties, on the basis of Third Party Lease(s) entered into with the client.
- **Pure Management Structure:** the property is leased by the owner to the OpCo, incorporated and held by the owner. The licenses are obtained by the owner. The business carried out by the OpCo in the property is managed by the manager on the basis of a management agreement. Employees working for the OpCo are hired by the owner but can be selected/coordinated by the manager. Any Third-Party Leases are entered into by the owner with third-party operators, and the relevant activities can be supervised by the manager.

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 concerning hotel businesses in Italy are usually governed by Italian law.

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

There are no unusual points.

Term and termination

Is there a standard contract period of an HMA?

A duration of 20 years is usually negotiated in HMAs for branded operators. A duration of 15 years may be provided, renewable for one or two further 5-year periods.

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

The term is usually fixed. Specific termination rights could be agreed by the parties depending on the specific situation or event or breach of the obligations. Usually a termination right is granted if specific revenue targets are not met.

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

Liquidated damages may be discussed and agreed upon by the parties, depending on the transaction.

What is the usual position in respect of renewal?

See **Standard contract period**, but it depends on the transaction and negotiations between the parties.

Fees

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

Usually a base fee is calculated on revenues and an incentive fee is based on profits. Royalty fees are also provided for branded operators.

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

Usually the royalty fees, marketing contributions and other fees for certain centralized services are requested on the basis of specific agreements entered into simultaneously with the HMAs.

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

Contribution and FF&E reserve are usually requested.

Performance and operations

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

The standard depends on the level of the hotel. Branded operators usually provide their own standards.

What performance measures are commonly used in the jurisdiction?

The performance tests are based on the negotiations between the parties. Usually the tests are based on achievement against budget and/or Weighted Average RevPAR against a competitive set of local or similar hotels.

Is an operator or owner guarantee common in the jurisdiction?

Branded operators usually ask the owner to release a parent company guarantee, if it is a special purpose vehicle.

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. That said, the employees can be selected/coordinated by the manager.

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 and the operator may put operational insurances in place.

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

The HMA does not give rights in real estate.

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

According to Italian law, it is not possible to record (trascrivere) an HMA in the Italian Real Estate Register.

That said, pursuant to section 6 of the Presidential Decree no. 131/1986, the HMA is subject to registration at the Italian Tax Agency in case of use. Registration in case of use shall be applied when a deed has to be filed with the judicial registries in the performance of administrative activities or with the public administrations or territorial public bodies and their respective control bodies, unless the filing is made for the fulfilment of an obligation of the administrations bodies or entities or is compulsory by law or regulation.

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

Branded operators usually request non-disturbance agreements which shall be negotiated from time to time and are not likely to be released by banks or third parties.

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

Usually license agreements, centralized services agreements, design review agreements, technical service advisory agreements, facility agreements and key money are included in the set of documents to be entered into.

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?

Usually the operator requests the insertion of these specific clauses into HMAs.

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

Yes.

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

Such a clause should be expressly negotiated and would imply an early termination clause of the HMA.

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