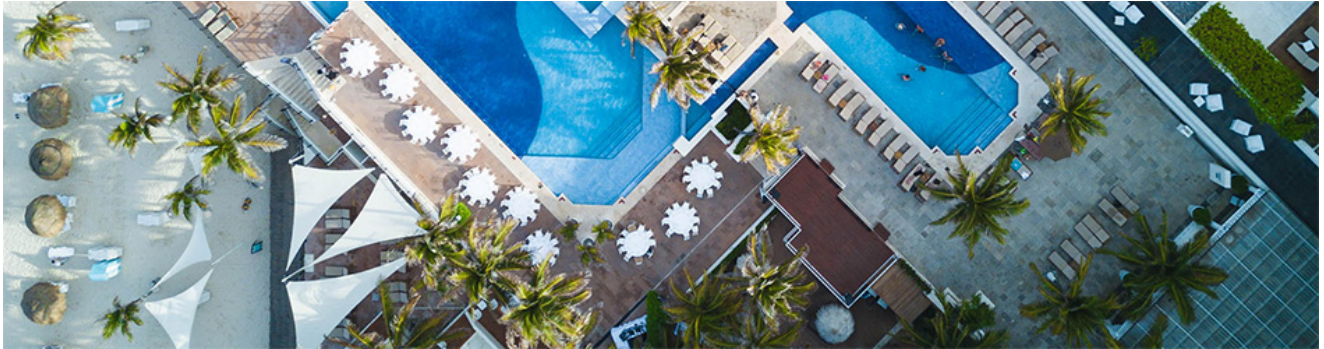


MEXICO

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.

Key contacts



Matt Duncombe

Partner, Global Co-Chair,
Hospitality and Leisure

DLA Piper UK LLP

T +44 113 369 2948

matt.duncombe@dlapiper.com

[View bio](#)



Jo Owen

Partner, Global Co-Chair,
Hospitality and Leisure

DLA Piper UK LLP

T +44 207 796 6293

jo.owen@dlapiper.com

[View bio](#)



Harriet Lipkin

US Co-Chair, Hospitality and
Leisure

DLA Piper LLP (US)

T +1 202 799 4250

harriet.lipkin@dlapiper.com

[View bio](#)



Bradley Levy

US Co-Chair, Hospitality and
Leisure

DLA Piper LLP (US)

T +1 312 368 4093

bradley.levy@dlapiper.com

[View bio](#)



Mexico

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General

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

Yes. Major international brands always use an HMA. International brands generally use their own form of HMA applicable to all jurisdictions and they are adapted to the local jurisdiction if necessary.

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

The alternative is to have a lease. There are some situations where there is a combination of a commercial lease and an HMA in order to have the commercial lease registered in the Public Registry of Commerce. Depending on the location, when the term of the lease is longer than a certain period of time (eg in the State of Jalisco it is six years), the lease has to be registered. This option is not generally accepted by international operators due to the fact that (i) commercial leases may not exceed a certain term (ie the State of Jalisco, the term is 20 years or the State of Quintana Roo the term is 15 years) and (ii) rent will have to be paid to owner by the operator.

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?

Subject to negotiation. US-based hotel operators typically push for Maryland law, which is favourable to Hotel operators, as the applicable law. Often the compromise is to have the above-property service agreements governed by US law and the property level operating agreements governed by Mexico law.

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

With US-based hotel operators, tax withholding and "gross-ups" can be significant modifiers of management fees. Most hotel operators require the hotel owner to pay for any withholding or similar taxes (including VAT) which apply to the fees to be paid to the operator under the HMA and related agreements. This is done by "grossing up" the fees paid to the operator so the brand gets the same economic benefit from the negotiated deal as if no such taxes applied.

Term and termination

Is there a standard contract period of an HMA?

Generally from 20 to 30 years.

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

The term is generally a fixed term and extension options are established. HMAs may be terminated early in the case of breach by the parties, which may include low performance or other criteria negotiated by the parties.

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

In the case of early termination due to a breach by any party, a conventional penalty (ie liquidated damages) may be negotiated in favor of the non-defaulting party.

What is the usual position in respect of renewal?

Renewal options are generally included in HMAs and it is subject to mutual agreement of the parties.

Fees

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

The standard includes a base fee calculated on revenues and an incentive fee based on profits.

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

Operators normally have license agreements, trademark license agreements etc.

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

FF&E reserves are very common.

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 hotels, etc.

What performance measures are commonly used in the jurisdiction?

Performance measures vary depending on the form of Hotel Management Agreement (HMA) used by the operator and is subject to negotiation of the parties. As mentioned above, international operators tend to use their own forms applicable to all jurisdictions.

Is an operator or owner guarantee common in the jurisdiction?

Guarantees on both sides tend to be usual.

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

The owner employs all the employees, except top management, who are generally employed by the operator. However, the operator has the right to select employees even though they are ultimately hired by the owner.

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

Yes. Non-compete clauses are common and may include a radius subject to city size and type of brand.

Who is responsible for insurance?

Insurance of the property will be at the owner's cost.

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

No.

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

No.

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

Yes; however, this may be a hard discussion with financial institutions especially in the case of breach of the loan.

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

Depending on the operator, the following agreements may also be executed:

- Technical Services Agreement
- Trademark License Agreement
- Pre-opening Services Agreement

Transfers and assignments

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

Changes in ownership of hotel or change of control of the owner will often be subject to the operator's prior approval.

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?

No.

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

No.

Key contacts



María Eugenia Ríos

Partner

DLA Piper Gallastegui y Lozano

T +52 55 5261 1805

maria.rios@dlapiper.com

[View bio](#)

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