

THAILAND

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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Thailand

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General

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

Yes. Internationally managed hotels tend to be concentrated in Bangkok and resort destinations, as expansion into second tier Thai cities has been slow.

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

Use of franchise agreements, particularly between operators and owners with strong track records, is increasing and sometimes preceded by a management arrangement (ie a managed hotel converts into a franchised hotel if certain criteria are satisfied). Leases are less common and used mostly by upstart operators.

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?

Thai law is most common in HMAs. There are instances where Singapore, Hong Kong or English law may be used and/or preferred by operators, depending on the transaction structure.

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

No. Although international operators normally have the right to manage hotels in Thailand by a local or an offshore entity, and this decision may be driven by tax considerations (ie the different withholdings rates on payments to the operator).

Term and termination

Is there a standard contract period of an HMA?

No, but a rule of thumb is 20 or more years for luxury/upscale brands and 10-15 years for midscale/economy brands or white labels.

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

Yes, the term is fixed. Early exit options for breach or underperformance are normally negotiated in the HMA. Termination on sale provisions in favor of the owner may be agreed, although exit payments normally are required. Implied termination is unusual in the HMA context.

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

Yes. Although the methodology to calculate fees/damages will depend on the governing law of the HMA.

What is the usual position in respect of renewal?

Agreement between the parties.

Fees

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

The fee structure will depend on the operator and the brand, but in most cases will be calculated as a base management fees (against total revenue) and incentive fee (a sliding scale against (adjusted) profit).

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

License fees, centralized services fees, and marketing service fees are the most common, and additional fees will vary widely among operators and their a-la-carte services. Condotels and hotels with branded residence components are common in Thailand and there may be additional fees involved in these type of structures (eg fees for condominium association management, branded residence marketing fee).

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

Yes. The funds take the form of an FF&E Reserve that is calculated as a percentage of total revenue, taking into account the hotel's positioning. Accounting for these funds as a notional book entry may be agreed.

Performance and operations

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

The standard is usually negotiated in the HMA, but generally will be to operate to the standard of comparable hotels in the market and with the aim to maximize profits, while taking into account other factors.

What performance measures are commonly used in the jurisdiction?

The GOP test, where the performance of the hotel is measured against the profit estimated in the annual budget, is the common measure. Depending on the strength of the parties, and the hotel segmentation, the RevPAR test, where the revenue per available room generated by the hotel is benchmarked against similarly positioned hotels, is a second test that may be used. In either case the operator normally has a right to cure before the owner can exercise a termination right of the HMA for underperformance.

Is an operator or owner guarantee common in the jurisdiction?

Parent guarantees of the owner are common if the owner is an SPV granted land use rights by way of a lease. Operator guarantees are rare.

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

The owner is almost always the employer and the liable party for the hotel employees.

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

Yes.

Who is responsible for insurance?

The owner. Some operators may seek to carry operational insurance in their name and to list the owner as an additional insured.

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?

No, but operators typically require owners to use best efforts to obtain an NDA.

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

This depends on the operator and whether it uses one agreement for its HMA or splits its agreements, and if split, there is usually a technical service agreement, license agreement, centralized services agreement and various side letters personal to the owner with key commercial terms on which the operator has agreed to deviate from its standard position.

Transfers and assignments

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

Operators will require consent to any change in the ownership structure, and consent can be withheld for a number of reasons, including if the owner fails the operator's compliance checks or is deemed a competitor.

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, unless the operator is a Thai-based hotel operator or already has real property assets in Thailand.

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

No, but if agreed, the operator would likely require a termination fee.

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