Hotel investment in Africa - the 'big five' legal issues

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By: Sean Cope

Safari enthusiasts typically focus on spotting the big five game animals.

For potential investors into the African hotel sector, we discuss in this article the big five legal issues to spot.

Africa is a vast continent comprising 54 legal systems, so robust local law advice for each country within the continent is a necessity. This article is intended to highlight headline issues to prospective investors and should not be considered exhaustive.

Land ownership

An international hotel developer will quickly need to establish the types of land ownership it is entitled to hold under local law. Foreign ownership restrictions are common in Africa with international investors often restricted to holding leasehold interests or other kinds of interests limited in time. For example, in Nigeria and Ethiopia all land is state-owned and foreign ownership is restricted to 99-year leases. In Angola, only Angola's citizens may hold freehold title, however foreigners are permitted to hold long-term leases of up to 60 years in designated areas, subject to the proviso that they must then hold the interest for at least five years before disposal.

Due diligence challenges, including lack of property registration, remain a barrier to investment. However, there are examples of steps being taken in some countries to address this. For instance, in Kenya land rights were enshrined in the 2010 Constitution and the Unified Land Acts of 2012 while Botswana, Zambia and Ethiopia recently featured in Jones Lang LaSalle's "global top 10 improvers' list" for real estate transparency. As land due diligence is essential to any real estate investment, potential investors should be aware of any constraints on this. Although markets and land registration systems continue to mature, accessibility of title information and an absence of state guarantees may delay or frustrate title investigations, particularly in the less developed African jurisdictions.

Local partner

The majority of hotel owners in Africa are local or regional investors. International hotel investment has typically been deterred by the perceived risk, and international investors have also encountered difficulties with developing scale in Africa. In contrast, local or regional investors often concentrate on developing a single hotel for diversification of already successful businesses. Moreover, local or regional investors have benefited from being able to price risk lower than international investors and have been willing to develop a hotel at a lower return than their international competitors.

The importance of strong local relationships must therefore not be underestimated. However, it is imperative that investors and operators demonstrate a robust compliance framework in accordance with Know Your Client (KYC) and anti-money laundering regulatory requirements, at both local and global levels. This is particularly true for investors and operators subject to extra-territorial laws of their home state such as those from the US or EU member states. A lack of transparency about the identity of contracting parties should be resolved at the outset with continuous monitoring systems put in place alongside suitable contractual protections.

Tax and exchange rate risk

A degree of tax certainty may be gained by investing from a location which has a Double Tax Agreement (DTA) with the hotel jurisdiction. Mauritius and South Africa have attractive DTA networks and have historically been popular holding countries for investment into Sub-Saharan Africa. For example, both nations have concluded DTAs with numerous states including Rwanda and Uganda. In addition, Mauritius has concluded DTAs with Namibia and Senegal, and South Africa has DTAs with Ethiopia and Nigeria. However, in a bid to attract more capital from investors, a coordinated approach to taxation has also been on the agenda for the East African Community (EAC) following the introduction of the EA Common Markets in July 2010. Once ratified, the EAC's DTA is intended to lower corporate taxes and increase crossborder investments between the member states (namely, the Republics of Kenya, Uganda, Burundi, Rwanda and the United Republic of Tanzania).

International operators often denominate management fees in US dollars. This may cause complications for owners where, as often happens in volatile commodity exporting economies, the state wishes to reinforce the primacy of its domestic currency. Risks associated with foreign exchange restrictions therefore require careful consideration. For example, earlier this year the Tanzanian Government declared it unlawful to price goods and services for Tanzanians in US dollars. There is also a history of nations taking measures to prohibit all transactions in US dollars; with recent examples including Zambia and Ghana (though both prohibitions have since been lifted).

Devaluation of local currency is a primary concern for owners required to make US dollar-denominated payments to operators. Where hotels generate earnings in local currency, owners will be exposed to exchange rate gap risk where the local currency depreciates against the US dollar. Contractually, it is important that a particular exchange rate is specified and provisions are included for the use of an alternative exchange rate if the selected one ceases to exist. Commercially, financial institutions are becoming more skilled in providing hedging solutions; which, when coupled with a longer term view in assessing the impact of foreign exchange rates, can reduce, but not eliminate, the perceived currency risks. Furthermore, hotels can provide a natural hedge against currency fluctuation where revenues are in US dollars but operational costs are in the local currency.

Dispute resolution

Concerns regarding, amongst other things, the ability of local courts to resolve complex commercial issues in a timely and cost-effective manner, together with the relative ease of enforcement of arbitral awards internationally under the New York Convention (of which more than half of African states are signatories), have made arbitration the preferred dispute resolution method for international parties in Africa. A number of African states have made efforts to support arbitration in a bid to attract investment. For example, a Uniform Act on Arbitration Law, enacted in the OHADA grouping of 17 mainly francophone states in West and Central Africa, provides a single commonly applicable law governing the recognition and enforcement of awards. In addition, a number of African states, including Nigeria, Rwanda and Uganda, have adopted legislation incorporating the UNCITRAL Model Arbitration Law.

Nevertheless, arbitration should not be viewed as straightforward and consideration of a number of practical matters is required. Due diligence must be undertaken to identify the location of a counterparty's assets, including an assessment of the availability of measures to enforce an award against such assets. Consideration should also to be given to the relative merits of selecting an African jurisdiction as the seat of arbitration versus the traditional hubs of London or Paris or emerging locations such as the Dubai International Finance Centre or Abu Dhabi Global Markets.

Extra-territorial laws

Failure to comply with anti-corruption laws or trade sanctions could result in significant liabilities including civil and criminal penalties and reputational damage. International operations and investments of US companies are subject to restrictions imposed by the US Foreign Corrupt Practices Act. Anticorruption laws and regulations of other countries also have extra-territorial reach, such as the UK Bribery Act and UK Modern Slavery Act. Anti-corruption laws and regulations generally prohibit companies and their intermediaries from making improper payments to government officials or other persons (eg to secure development rights in violation of public procurement rules or unlawful facilitation payments). Liability can even extend to a failure to put in place adequate procedures designed to prevent business partners, contractors or agents from acting in ways prohibited by these laws and regulations. The consequences of non-compliance render effective risk management procedures; contractual protections; KYC checks and an understanding of how to respond to allegations, a necessary cost of doing business.

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AUTHORS

Sean Cope
Senior Associate
Dubai | T: +971 4 438 6100
