



Kingdom of Saudi Arabia (KSA) - Hotel Management Agreements

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By:

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General

1. Are Hotel Management Agreements (HMAs) common in your jurisdiction?

Yes, this is the method by which most of the intentionally branded hotels are operated.

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

In recent years, we are starting to see more international operators becoming increasingly willing to enter into Franchise Agreements. This is as a result of having an increasing number of hotel owners that are appropriate partners for a franchise arrangement and an increasing use of asset managers in the hotel sector.

3. 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?

In deals with international operators, HMAs will be governed by the laws of an alternative jurisdiction, e.g. English law.

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

No, other than as of 1 January 2018, VAT of 5 percent was introduced in KSA.

Term and Termination

5. Is there a standard contract period of an HMA?

Between 15 and 25 years for the initial term with up to two renewals of 5 or 10 year terms.

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

Fixed term.

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

Whilst it is not typical, it is sometimes possible.

8. What is the usual position in respect of renewal?

Renewal upon the mutual agreement of the parties.

Fees

9. Is there a standard fee structure for HMAs (e.g. base + incentive)?

Base fee (as a percentage of total revenue) and incentive fee (as a percentage of gross operating profit).

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

There is usually a licence fee (as a percentage of total revenue), a centralised services fee (usually based on the services used at the hotel) and a marketing fee (which is often a percentage of room revenue).

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

Yes, a separate fixtures and fittings account must be contributed to each month.

Performance and Operations

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

A standard usually needs to be negotiated into the HMA – it may be possible to negotiate that of a similar operator of, e.g. luxury hotels in the country.

13. What performance measures are commonly used in your jurisdiction?

A performance test commonly has two limbs – one is a test against the RevPAR of the Hotel compared to a competitive set of hotels and the other is a comparison against actual total revenue compared to the budgeted total revenue. Failure of the test is if the Hotel has a RevPAR of less than 80 – 90 percent of the Competitive Set and if the actual total revenue is less than 80-90 percent of the budgeted total revenue.

For an operator to fail the test, typically it must fail both limbs of the test for two consecutive year. The HMA may allow the operator to 'cure' a failure of the performance test by making a payment. HMAs that provide a 'cure right' for the operator usually limit how many times such a cure right can be used by an operator (often no more than twice during the initial term).

14. Is an operator or owner guarantee common in your jurisdiction?

Not at all.

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

Due to KSA law and regulations, it is always the hotel owner who employs the hotel employees.

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

This is often negotiated as part of the deal.

17. Who is responsible for insurance?

The owner is responsible for 'property' insurances and the operator may procure the operational insurances in order to ensure they are in place and meet their requirements.

18. Does the HMA give rights in real estate in your jurisdiction?

No.

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

No.

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

Whilst not yet standard practice, it slowly becoming more common.

21. What other agreements usually sit alongside an HMA in your jurisdiction?

Technical Services Agreement, Licence Agreement and Centralised Services Agreement.

Transfers and Assignments

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

An owner typically cannot transfer without the consent of the operator. The operator will seek to prohibit transfer to a competitor (often broadly defined) or anyone subject to sanctions etc.

23. When a managed hotel is sold (either asset or share deal), is it usual in your 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, definitely.

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

This is less relevant in KSA due to the restrictions on foreign ownership of real estate. However, the wording is often still included in HMAs.

25. Is it usual to include provisions which enable the sale of the property with vacant possession i.e. without the brand?

Only if this is negotiated, and such a provision would include liquidated damages to be paid to the operator.

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