United States (US) - Hotel Management Agreements

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General

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

Yes. HMAs are used across the US, mostly for upscale and luxury tier hotels operated under a major hotel brand. As franchised brands have increased across the US in recent years, third-party managers operating under a brand franchise have increased. Third-party management agreements and brand management agreements are very different in both form and terms. The focus of this guide is brand-managed HMAs.

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

The alternative is to have a lease. Widely used in Europe, the lease structure has been slow to debut in the US, and is used primarily with foreign investors and in the franchise context. Upscale and luxury hotels which are managed are rarely subject to leases and most always managed under a branded HMA. A lease agreement is consummated through a sale-leaseback, where the hotel owner sells an asset to a new owner, which leases the property back to the seller, who self-manages, as an operator itself, or more typically, through a third-party operator. Most branded hotel operators in the US will not take on a real estate interest as their expertise is management, not ownership and its attendant risks.

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?

Hotel managers operating in the US will typically push for Maryland law as the applicable law in the HMA due to the benefits of Maryland law, as applied to hotel operators. Conversely, hotel owners usually prefer the laws of the local jurisdiction, or more owner-favorable jurisdictions such as New York or Florida. New York or London are typical compromise jurisdictions in the HMA with respect to above-property service disputes for foreign hotel companies operating in the US, to the extent applicable law is bifurcated.

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

No. The US does not charge VAT, so tax withholdings and corresponding "gross up" of management fees is not an

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issue in HMAs for US-based hotel operators, as it can be in foreign jurisdictions.

Term and Termination

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

Initial terms for branded hotel operators range from 20 to 30 years, with extension terms (at the election of the operator) adding up to an additional 20-50 years. Non-branded management terms are shorter, and range from 10-20 years.

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

Terms are typically fixed, with extension options at the discretion of the operator. HMAs typically do not provide for early exit other than termination due to breach or failure of the performance test. Sometimes owners are able to negotiate the ability to terminate on sale after a specified holding period (for example 10 years), upon payment of a negotiated termination penalty, which is calculated based on lost management fees. In such instances, the operator is usually granted a right of first refusal to purchase on sale, allowing the operator to prevent termination of the HMA by purchasing the hotel. Outside of the contractual terms of the HMA, case law in select US jurisdictions has evolved in the past 10 years to allow the owner to terminate the HMA in a non-default scenario in violation of the HMA terms, based on agency principles, although such termination will not insulate the owner from resulting damages. As noted above, Maryland, where many hotel companies are headquartered, by statute requires adherence to the terms of the HMA, disallowing termination based on agency principles. Hence, most hotel companies require Maryland law as choice of law in the HMA.

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

When an owner is able to negotiate the right to terminate on sale, owners typically must pay the operator a termination penalty (i.e. liquidated damages) of an amount equal to a multiple of prior years' management fees, for which the multiple can span the remaining initial term of the HMA.

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

In addition to the initial terms, HMAs typically include renewal terms at the expiration of the initial term, which are automatic unless operator provides notice not to renew. Renewal terms for branded operators can, collectively, range from 20-50 years. Renewal terms are less common for non-branded operators. Branded operators will seek to secure multiple automatic renewal terms and owners will seek to make renewal terms subject to a performance metric such as receipt by owner of its priority return.

Fees

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

The standard fee structure includes a base fee calculated on gross revenues and an incentive fee based on profits. Base fees range from 2-3 percent for non-branded third-party management to 2.5-4 percent for branded management. Base fees tend to have a negative correlation to the initial term (i.e., the shorter the term the higher the base fee and vice versa). Incentive fees vary, but typically are based on some percentage of GOP, AGOP or NOI, and are often subordinated to an owner’s priority return on investment.

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

Additional operator fees may include reservation, marketing and loyalty program fees, as well as technical services and pre-opening fees.

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

Virtually all HMAs require FF&E reserves, for which percentages typically vary from 2-4 percent, with an occasional 5 percent for ultra-luxury brands. With new or refurbished hotels, the FF&E may start low and ramp up.

Performance and Operations

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12. 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., but are typically fairly general, such as "acting as a reasonable and prudent operator," "with a view toward maximizing long-term profitability and value of the hotel," "operation and management as a world class luxury hotel," etc.

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

Performance measures are typically set through a two-prong performance test, which is some form of (i) a percentage of budgeted GOP, and (ii) a percentage of RevPAR of a defined competitive set hotels. Percentages of GOP and RevPAR vary, depending on the age of the hotel, the market and other factors, but typically range from 80-95 percent. If both performance tests are failed during an established performance test period, then the owner has the right to terminate the HMA. Operators often negotiate cure rights in order to avoid termination, and the tests are excused for things like force majeure events.

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

Guarantees are not a standard HMA requirement. The existence of guarantees depends on the bargaining strength of the parties and the particular hotel and market.

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

Most often the operator employs all of the employees; however, the owner has the right to approve certain key management employees such as the general manager, director of finance, director of F&B and sales director. This notwithstanding, employee liability rests with the owner, other than to the extent of the gross negligence or willful misconduct of the manager in hiring or overseeing the 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?

Yes. Non-compete clauses are common and may include a radius restriction which varies, depending on the market and brand.

17. Who is responsible for insurance?

All hotel insurance (property, liability and operational) is obtained by the owner, or the operator on its behalf, at the cost of the owner. Some brands offer optional insurance programs for owners to cover the insurance needs of the hotel.

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

If properly drafted, and to the extent the HMA or a memorandum thereof is recorded, the HMA can be considered a covenant running with the land, but is not considered a real estate interest.

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

This is not required, as most operators like to keep the HMA confidential. However, often a Memorandum of HMA is recorded in the local real estate records.

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

Yes, and typically the agreement includes subordination, as well as non-disturbance (SNDA). SNDAs are highly negotiated between the lender and the operator, and vary depending on the strength of the lender, the owner and the brand. Key issues tend to revolve around lender exercise of remedies upon loan default, control of accounts under the operating agreement and transfer provisions.

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

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

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- Technical Services and Pre-Opening Agreement
- Trademark License Agreement (if not contained in the HMA)
- Sales and Marketing License Agreement (if there are also branded residences)
- Residential Management Agreement (if there are also branded residences)

Transfers and Assignments

22. 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 hotel owner are typically subject to prior approval of the operator, with certain carve-outs for affiliate transactions. However, with institutional or strong owners, transfer to third parties which meet certain criteria, such as (i) having adequate financial resources to perform under the HMA, (ii) not being competitor, and (iiii) not being a specially designated national or blocked person, is often allowed.

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?

Typically, the hotel may be sold subject to the HMA without the consent of the operator as long as the transferee (i) has the financial resources to perform under the HMA, (ii) is not a competitor, and (iiii) is not a specially designated national or blocked person.

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

No, unless the owner has the right to terminate the HMA on sale.

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

The ability of the owner to terminate the HMA on sale is a non-standard negotiated right. If negotiated, there is typically a termination penalty that is required, calculated based on lost management fees for the remainder of the term of the HMA. Termination on sale rights also typically do not kick in until after an initial management period (e.g. 10 years), and are often coupled with a ROFO in favor of the operator, to allow the operator to avoid termination by acquiring the hotel itself.

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