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Hotels and leisure

Key terms for hotel management agreements – Issue 1 – The term

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This is the first in a series of short briefing notes identifying key issues for discussion when agreeing the terms of a hotel management agreement (the HMA). We briefly identify the typical position adopted by each interested party and further issues for consideration when negotiating from such a position.

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Issue for consideration – the Term

One of the key terms to be agreed between the parties will be the length of term that the operator will be engaged for under the HMA. When negotiating the term, the parties will also need to consider whether the operator or the owner will have any rights to extend/renew the HMA.

The operator's position

Operators, particularly branded operators, will typically prefer a long initial term under the HMA and unilateral rights to renew the HMA for additional periods, citing the investment made by the operator in establishing the reputation of the hotel and the need to ensure that their brand reputation and income flow is not compromised if replaced within a short period of time.

The owner's position

Owners typically prefer to avoid being bound by the HMA for the long term, particularly as it is unusual for owners to be entitled to terminate an HMA at its discretion without paying a significant compensation amount to operator. Owners will also not want the operator to have specific renewal rights, or for any rights of renewal being subject to certain performance conditions, on the basis that if the hotel is a success, renewal will be in both parties' interests.

The lender's position

Lenders will be keen to understand whether income is protected during the term of the loan. As such, lenders will want to ensure that the HMA will not expire prior to the satisfaction of the loan and will need to take into account when negotiating the terms of any financing (including the relevant periods of repayment) any operating period in an HMA allowing the Operator to terminate.

Negotiation considerations

Various additional commercial arrangements can be agreed to balance the interests of the parties. These include:

Owners concerned about being tied to an HMA with an under-performing operator may seek to impose termination rights for the owner based on a performance test under which the owner may terminate should the hotel fail to perform at a particular standard (performance tests will be looked at in more detail in a subsequent briefing note). Owners may also seek to link the payment of fees to the operator to the performance of hotel using incentive fees.

Rights of termination will often be entrenched (with caveats) within clauses relating to damage/destruction of the hotel. Careful review of the HMA is required to ensure that the parties fully understand how and when this might be applicable and how these may lead to the earlier termination of the HMA. In this context, lenders and operators will often having competing requirements as to how any insurance proceeds will be paid in by insurers on a total loss event.

The parties may agree termination rights for the Owner based on the payment of a liquidated sum to the Owner (for example a number of years' worth of fees), however, negotiation of the compensation amount can be protracted.

Where an operator is to manage a mixed-use development which includes both a hotel and a branded residential component, owners may be more open to extended terms given the additional appeal and security this may give to those investing in the branded residential component.

Did you know ...

Though often included in HMAs, rights to renew based on 'mutual agreement of the parties' are of no legal effect under English law and will not require either party to renew an HMA. This does not prevent such language being prevalent in many HMAs and term sheets.

For more information

Our global legal practice is highly experienced in all aspects of the hotel and leisure industry and advised hotel owners, developers, lenders and many of the world's top hotel and leisure operators on all aspects of their operations. Through our extensive global platform of lawyers we are able to provide a co-ordinated legal service catering to all aspects of our clients' legal needs – from a single project boutique hotel development, to a multi-jurisdictional hotel portfolio acquisition. Our previous track record in the hotel and leisure sector has not only given us insight into the often complex legal requirements of the industry, but has also enabled us to build an in-depth understanding of the commercial and practical aspects of our clients' business. Our global offices can offer you the skills and experience required in this growing and diversified sector.

If you would like further information please contact Nick Clayson or Louisa Lynch or your local Norton Rose Fulbright contact.

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