
Hotels and leisure

Key terms for hotel management agreements Issue 2 – Hotel financing

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This is the second in a series of short briefing notes identifying key issues for discussion when agreeing commercial terms for 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. Issue 1 covered “the Term” and can be found [here](#).

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Hotel financing

Hotel developers will often look for debt financing to assist in the construction of new hotels. It is not uncommon for owners to seek to appoint an operator prior to obtaining construction financing (especially as a strong brand can increase the likelihood of obtaining favourable finance terms) and accordingly an HMA may have been negotiated and signed in advance of procuring financing and the commencement of construction. Given the often competing requirements of lenders and operators, when negotiating the HMA, owners need to keep in mind the position of both from an early stage.



The operator’s position

Operators will typically require the owner to obtain an acceptable form of non-disturbance agreement from any lender to whom a mortgage or other security interest is granted as part of the financing of the hotel. The non-disturbance agreement is intended to protect the operator by requiring the lender to recognise the HMA, and the operator’s tenure under it, in the event of enforcement by the lender against the owner. This may also include restrictions on loan to value ratios and a requirement that any incoming purchaser of the hotel following an enforcement event will also continue to be bound by the HMA.



The owner’s position

While an owner may wish to appoint an operator for a new hotel to assist in securing financing, compliance with the obligation to procure a non-disturbance agreement under an HMA can cause difficulties for owners if a lender is subsequently unwilling to agree to the terms of non-disturbance required by the operator. This may be due to an inability of the lender to agree to continue provide funds on the default of an owner or a wish to ensure that the hotel can be sold unencumbered by the HMA on enforcement (particularly if the hotel is not performing well). This raises the unwelcome prospect of either a potential material breach by the owner of the HMA or the unavailability of financing.



The lender's position

While lenders are keen to ensure a hotel is being operated efficiently and generating revenue to repay a debt, a lender will not always be willing to agree that their absolute rights of security over a hotel will be subject to the rights of the operator to continue operation. From a risk perspective lenders may also be wary of being required to step into the shoes of an owner during enforcement, particularly in jurisdictions where the enforcement process may be drawn out over a significant period of time.



Negotiation considerations

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

The lender will typically require the operator to subordinate certain rights and interests under the operating agreement to the lender's security. One example of this is in relation to the incentive fee where the lender will normally seek to defer any payment of the incentive fee in circumstances where it would reduce available cash in the hotel operating account below the level required to meet the on-going operating costs.

The operator will want to ensure that neither the occurrence of any event of default under the loan agreement nor the enforcement of the lender's security shall of itself give the lender the right to terminate the hotel operating agreement or to interfere with the operator's right to freely operate the hotel or to receive any payments due to it under the hotel operating agreement.

The NDA will normally provide that where the owner is unable to service the loan and the lender exercises its security, the operator will agree to the lender and its successors assuming (jointly and severally with owner) the rights and obligations of the owner under the hotel operating agreement. However lenders will need to consider whether such risk can be accepted and whether this forms part of the credit committee approval received for the financing.



Did you know...

Careful consideration needs to be given to the way in which any security is taken over bank accounts and any reserve accounts which relate to the preservation of the on-going business as a hotel. The operating account will typically be in the owner's name but would usually solely utilised by the operator. It may not be appropriate for such accounts to be charged / swept by a lender.



For more information

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If you would like further information please contact [Nick Clayton](#) or [Louisa Lynch](#) or your local Norton Rose Fulbright contact.

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