



Hotel Financing Series, Part 5: Hotel Management Arrangements and Related Issues



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In the previous installment of our hotel financing series, we examined some of the key issues regarding franchise agreements and non-disturbance agreements. In this Part 5 of the series, we look at hotel management agreements and related issues.

Hotel management comes in two scenarios. In the first scenario, a hotel operates under a franchise model, with the hotel owner employing a professional hotel manager to manage the day-to-day operations of the hotel, as discussed in the previous installment. In the second scenario, which we will examine more closely below, some hotels are run under a hotel management model under which the owner of the brand runs the hotel for the owner. This is slightly less common, but some of the international hotel chains continue to run some hotels under their own management. In the latter scenario, because the hotel manager is also the person who owns the brand, the responsibility to adhere to brand standards rests with the hotel manager.

Hotel management agreements

The hotel management agreement (“HMA”) sets out the duties undertaken by the hotel manager, as well as the obligations and rights of the hotel owner. As the hotel manager runs the day-to-day operations of the hotel, it is of prime importance that the hotel manager has the requisite experience and capability to run the particular hotel, and, if there is a separate franchise agreement in place, be able to adhere to any requirements prescribed by the franchisor.

The arrangements with the hotel manager and the HMA are key elements of a lender's due diligence. In conducting its analysis, some of the questions the lender may want to ask may include:

1. What is the experience and track record of the hotel manager?

2. With regard to termination rights of the hotel owner if the hotel manager is not capable, is there a long period of notice or are there issues with fees upon termination?
3. Does the hotel manager provide frequent and detailed updates on key hotel information, such as vacancy rates, guest rating, operating plans, marketing plans, expenditure, hiring staff, etc.? And does the hotel owner have a say in these matters?
4. What are the key performance indicators set on the hotel manager?
5. What is the remuneration structure? Is there a performance incentive?
6. In terms of cashflow structure, whereas usually the hotel manager would have access to the hotel operating accounts, does the hotel owner also have access? Or does the hotel manager run the accounts and then make distributions to the owner? And at which stage does the hotel management fee get deducted?
7. How competent is the hotel manager in dealing with the franchisor's requirements? And does the hotel manager provide reports which adhere to the reporting requirements under the franchise agreement?

Duty of care agreement

It is common for the lender to enter into a duty of care agreement with the hotel manager. The agreement covers a number of key areas, including:

1. Acknowledgement of lender's security. The hotel manager acknowledges that the hotel owner has obtained finance and grant security over its assets (including the rights to the HMA) to the lender. To the extent that there are competing interests over owner's assets (for example, any collateral provided with respect to hotel manager's fees), the priority is agreed in this document.
2. Termination. This document may alter the termination procedure in the HMA. For example, if the hotel owner is in breach and the lender wants to keep the HMA in place, the duty of care may provide that the hotel manager must first notify the lender, and the lender may wish to cure the default. Separately, if the hotel owner is in breach under the facility, the lender may terminate the HMA in exercising its enforcement rights.
3. Amendments. Material amendments to the HMA will generally require lender's prior consent.
4. Access to documents. Where the lender takes enforcement action and appoints a new hotel manager, the hotel manager agrees to assist with the transfer of documents and information.
5. Direction upon enforcement. When the HMA has mechanics which prescribe how the cash profit is to be deposited, the lender may direct the hotel manager to send the cash profit of the hotel to an account specified by the lender where the lender exercises its enforcement rights.

In the next – and final – part of our hotel financing series, we will look at cash controls that are typical for hotel financing.