

Are management agreements encumbrances?



Hotel owners negotiating management agreements will invariably find a provision in the operator's standard form of management agreement restricting the sale of the hotel unless the management agreement is also transferred to the purchaser. This means that the owner cannot sell his property unencumbered or with vacant possession.

Prior to agreeing such a provision, owners should consider the effects of this both on the marketability of the hotel and also its value.

Restrictions

In many countries, this restriction can be registered on the title document of the hotel. The main implications of this restriction are as follows.

- It is unlikely that the hotel will be bought by a competitor of the operator. Once upon a time, it was clear who competitors are and will be but with the recent metamorphosis of Blackstone, for example, from the industry's favourite investor to a competitor, can anyone with any certainty anticipate what companies will be the competitors of the brand at the moment in the future that the hotel is to be sold.
- The hotel may not be bought by a purchaser who wishes to attach a different brand to the hotel or who wishes to debrand the hotel since such a decision will incur penalty charge which will ultimately be payable by the purchaser from an increased expectation by the seller.
- The hotel will not be bought by a purchaser who wishes to change the use of the property e.g. for residential use or as a hospital since this will also trigger a higher exit expectation from the seller who will be burdened with a penalty charge payable to the operator.

Location

Location is frequently a key factor in considering the importance of this restriction. If, for example, the hotel is located in developing country, a restriction on the sale of the hotel unencumbered is likely to be less significant.

Indeed, the attachment of a brand to the hotel may well add value to it, particularly if there are few branded hotels in the locality.

Encumbrance

If, however, the hotel is located in the centre of a large international city, the encumbrance of a management agreement is far more likely to be a liability to a seller.

Most operators will be prepared to negotiate on this issue but the extent to which an operator will be prepared to compromise will, as usual, depend on the negotiating strength of the owner.

Most international operators are unlikely to allow owners to sell the hotel free of the management agreement during the operating term without compensation to the operator. Typically, the compensation is a multiple of the management fees received by the operator for the previous year with the multiple decreasing as the residue of the operating term decreases.

Hotel owners should consider whether a long-term management agreement is likely to add value to their hotels. If not, negotiate a right of sale unencumbered. Hotel operators should

consider whether seeking such a charge on the owner is in the interests of the brand in respect of the owner / developer concerned and /or in the location under consideration.

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