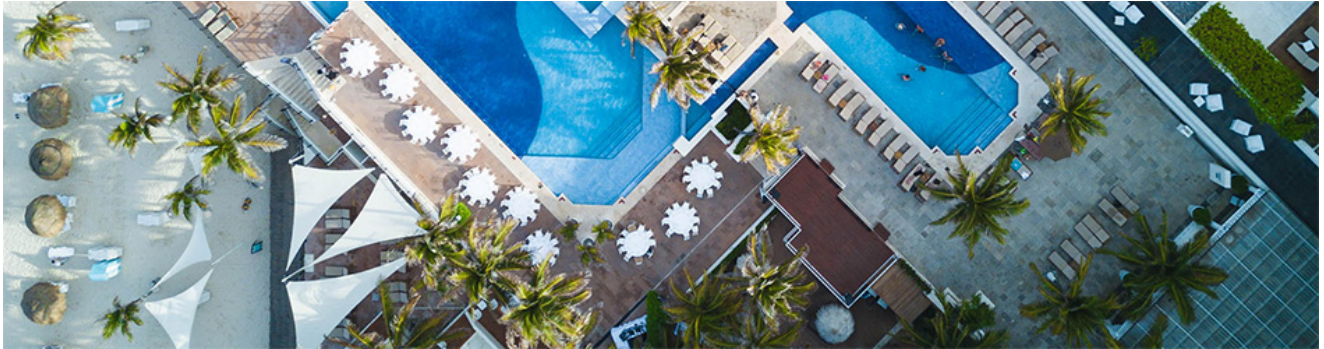


CANADA

Hotel Management Agreements



Introduction



One cannot discuss the evolution of hotel management agreements (HMAs) without first talking about the separation of hotel ownership and hotel operations; a transformation of the major chains' business models, more commonly known as an "asset light" strategy. Today the form taken by hotel operators in HMAs is an important factor in the effective working of the market in hotel investment. DLA Piper's Hospitality and Leisure Sector Group has negotiated HMAs for a myriad of different clients across the H&L landscape (owners, investors, operators (both branded and white label) and lenders) in all of the world's key jurisdictions.

Many consider hotel management agreements to be borne out of a modified lease for the Hong Kong Hilton back in 1963, and the main terms included in it underpin most HMAs to this day. All major chains today have, to one degree or another, expanded nationally and internationally through a combination of franchise and management, and all have their own "form" or template agreements. In summary, over the last few years, we have found that trends that started as a result of the financial crisis of the last decade have continued to develop. In many markets the advent of recession made operators more risk averse. Traditionally HMAs were a means to limit operators' exposure to fixed rental payments when revenues were dropping. In less developed markets, even with a degree of economic recovery, operators have continued to use HMAs in this way. In more developed markets, such as Spain and the United Kingdom, we have seen increased complexity in agreements, a symptom of owners becoming more knowledgeable and seeking more control and input on the operation of their hotel, although owners continue to take the lion's share of commercial risk in developments.

Another important factor, as with any real estate investment, is the attitude of those who are providing the money, be it equity or debt. Leases were the traditional mainstay of hotel developments and indeed Germany remains a country where hotel deals are commonly based around leases. However, as investors have started to see the increased returns from ownership, the boom in arrangements like ground leases and other market changes is essential to have an understanding of investors and be able to work with them in a scenario of increasingly complex legal arrangements.

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Canada

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General

Are Hotel Management Agreements (HMAs) common in the jurisdiction?

Yes. HMAs are often used for upper-tier or city center hotels and resorts under brands in Canada.

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

Commercial lease agreements and franchise agreements are possible but less common given that few operators take a real estate interest.

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?

HMAs in Canada are generally governed by Canadian law and the law of the province in which the hotel is located.

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

The VAT in Canada is the Goods and Services Tax (GST). Tax rates vary by province. Withholding issues are possible where non-Canadian entities are involved, but HMAs are typically structured to avoid this.

Term and termination

Is there a standard contract period of an HMA?

Contract periods vary as negotiated by the parties, often ranging from 10-30 years.

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

Yes, the term is usually fixed. Contractual exit options are common in the event of hotel or party insolvency, owner default on payments or funding obligations, hotel profits falling below a stipulated threshold, and unreasonable owner interference with hotel operations. Implied early termination rights for convenience are unusual and exit fees would likely apply.

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

This depends on the circumstances of the termination. Owners may be subject to a termination fee if termination is due to their own default or sale of the hotel. If operator default is the cause, an early termination fee will likely not apply. Termination fees vary by agreement and may be based on a percentage of revenue, management fees owed for the previous fiscal term, or a pre-determined lump sum.

What is the usual position in respect of renewal?

Renewal options depend on the parties' agreement but may include automatically recurring renewals until one party gives notice, renewal on a year-to-year basis, or an operator having a set number of renewals, such as two five-year renewal options, after the initial term.

Fees

Is there a standard fee structure for HMAs (eg base + incentive)?

Fee structures vary between operators. Usually a base management fee is paid, calculated on gross operating revenue (often between 1-3.5%). Incentive management fees may also be paid, calculated on operating profits (often between 2.5-10%, with increased amounts in later fiscal periods and when profits exceed higher thresholds).

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

Usually, owners bear most costs and taxes. Fees paid by owners may include centralized systems fees, administrative and consulting fees, pre- and post-opening marketing fees, IP license fees, frequent guest fees, royalty fees, working capital, travel and accommodation fees, and training fees. Sometimes, operators pay key money to owners.

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

Yes, owners must generally provide, maintain, and insure furniture, fixtures and equipment. HMAs commonly require owners to maintain FF&E reserves by setting aside a percentage of gross revenues (often between 1-5%, increasing each fiscal period up to a maximum) annually. Sometimes, operators may be tasked with setting aside FF&E funds.

Performance and operations

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 hotel, etc. HMAs may require operators to run hotels consistent with appropriate class standards (such as first class or tourist class), comparably to similar hotels in the area, and/or to the physical, operational, service, quality levels of other operator-managed hotels under the brand. Generally, HMAs don't contain KPIs, SLAs, or specific standards because fee structures align owner and operator interests. Financial standards are often based on operating profits versus a threshold or compared to a competitive set of similar hotels. HMAs may also require operators to exercise reasonable care, skill, diligence, use their best efforts, and/or comply with local laws.

What performance measures are commonly used in the jurisdiction?

Common performance tests are whether, for two or more consecutive years, net profits fall below forecasted profits, a certain percentage of gross operating profits, or a certain percentage of a competitive hotel set's RevPAR. Failing a performance test is often cause for owner termination without an exit fee. However, curative provisions may allow operators to pay shortfalls for a couple of periods to delay termination.

Is an operator or owner guarantee common in the jurisdiction?

Operator guarantees are unusual for major brands. Owner guarantees may be used depending on the circumstances.

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

The owner generally employs all staff, including executives and GMs. Some HMAs may state that the operator is the employer as the owner's agent.

Is it usual to have a non-compete clause, eg that no other property with that brand can open within a certain radius?

Yes. Operators and their affiliates are often restricted from operating or owning interests in similar or competing hotels or resorts in certain metropolitan areas or within a certain radius. Restrictions can apply for part of or the whole term and may be waivable with the owner's written consent.

Who is responsible for insurance?

Usually, the owner is responsible for all insurance. Sometimes the owner obtains property and liability insurance, while the operator obtains operational insurance. Generally, if an operator is required to obtain insurance, it will be in their capacity as a managing agent or as the owner's agent.

Does the HMA give rights in real estate in the jurisdiction?

No.

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

HMAs do not need to be recorded and this is not possible in Canada. However, other encumbrances provided for in the HMA may be registrable, such as statutory rights of way, easements, undersurface rights and rights of first refusal.

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

NDAs are common where there is financing, but this depends on the bank, owner and operator.

What other agreements usually sit alongside an HMA in the jurisdiction?

Brand and IP license agreements, centralized services agreements, confidentiality agreements, arbitration agreements, owner use and booking agreements.

Transfers and assignments

What are the standard rights / restrictions in respect of transfer / sale of the hotel?

This varies as negotiated. Generally, owners need operator consent to transfer or sell to third parties. HMAs often provide that where the proposed purchaser is of good financial standing and reputation and is not a competitor or affiliated with a competitor, operators cannot unreasonably withhold consent. HMAs may permit owners to sell or transfer without operator consent to affiliates or due to mergers or corporate restructuring. Sometimes, owners must pay early termination fees for selling the hotel (which may be calculated on the previous year's management fees).

When a managed hotel is sold (either asset or share deal), is it usual in the 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?

It is common to require operator consent for a sale and to provide that operators cannot unreasonably withhold consent or terminate the agreement if the proposed purchaser is qualified in terms of affiliation, finances and reputation. If the owner sells without operator consent, the operator may be allowed to terminate the HMA. If a hotel is sold with consent, the HMA will usually transfer with the hotel.

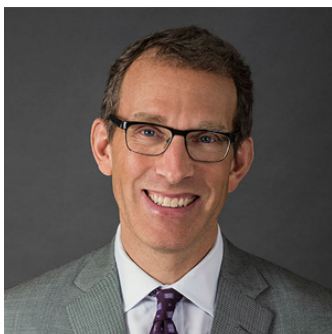
Do HMAs commonly include a right of first refusal for the operator to purchase the hotel?

This is possible but not standard given that operators use HMAs to be asset-light and rights of first refusal are more common in leases.

Is it usual to include provisions which enable the sale of the property with vacant possession ie without the brand?

No, this is unusual. If included, an exit fee would likely be charged.

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