

GERMANY

# 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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# Germany

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## General

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

The German market is still dominated by lease agreements. Compared to other jurisdictions HMAs are therefore less common. Direct HMAs between owners and operators aren't too popular with owners, especially with regulated real estate investment funds, which often cannot conclude HMAs due to not being permitted to conduct any operational business. However, indirect HMAs and Franchise Agreements with a third-party/white label operators in the middle are filling this gap and are more common.

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

Lease agreements are used and preferred by property owners due to the stable and predictable income they guarantee. In addition, banks financing the acquisition of hotel properties also prefer lease agreements. Especially for upscale/luxury hotels, bespoke lease agreements/hybrid agreements with lease and management elements and flexible rent and profit share mechanisms are increasingly used. Direct HMAs are regarded being riskier, and many German players do not see a commercial benefit in HMAs and prefer to take the safe option. German open-end funds are often not able to conclude HMAs due to the aforementioned regulatory restrictions. This being said, indirect HMAs can sometimes be an option as they shift some of those risks to the white label operators.

For budget and midscale hotels operated under international brands, franchise agreements are very common. In this scenario the operator concludes a lease agreement with the owner and, at the same time (as a franchisee with a hotel company) a franchise agreement with the corresponding brand and reservation system.

In the last few years a few hotel operators have also purchased hotel properties. This had been very uncommon for the last decade.

### 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 concerning properties located in Germany are often covered by German law but sometimes based on English or US law. German law is sometimes chosen for HMAs in neighboring jurisdictions, when neither owner nor operator is rooted in this jurisdiction.

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

From a tax perspective there are no particularities with regard to an HMA.

## Term and termination

### Is there a standard contract period of an HMA?

A typical term would be 15-20 years.

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

Yes, usually the term is fixed. Depending on the length of the term, this might sometimes conflict with case law. Terminations for convenience are often excluded, hence the HMA can only be terminated extraordinarily if the other party violates its obligations under the HMA.

HMAs often contain a performance clause according to which the operator is obligated to reach specific financial results with the hotel operation in each financial year. If the operator does not reach the agreed financial results in two or more consecutive years, the owner is usually entitled to terminate the HMA.

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

German HMAs often do not include any specific provisions with regard to liquidated damages or fees for an early termination. Exit fees for early termination other than due to operator default are sometimes seen. In case of a termination for cause, the terminating party will likely have a claim for damages/lost profits etc. pursuant to statutory German Law.

#### **What is the usual position in respect of renewal?**

This is up for negotiation. Sometimes no option rights in favor of a party in order to prolong the term of the HMA exists; however we have also seen various HMAs which contained two options of five years each.

## **Fees**

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

We often see a base management fee and an incentive fee. The base management fee is at a level of 2-4% of the gross revenue and the incentive fee usually amounts to 8-12% of the GOP. Sometimes parties agree on certain incentive management fees, which are applicable when a certain turnover is exceeded.

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

Besides the base management fee and the incentive fee, other agreed fees charged by branded operators often relate to contributions for the provision of technical services, accounting and reservation systems and marketing efforts.

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

The owner often has to set aside funds amounting to 3-5% of the gross revenue per annum. Sometimes parties agree on 1% at the beginning of the contractual period rising to 5% after ten years.

## **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. Generally, the operator must operate the hotel in compliance with standard operating procedures.

#### **What performance measures are commonly used in the jurisdiction?**

Reporting obligations are common in HMAs. A performance test is fairly common (together with a termination right for failure to meet such test) but the type and nature can vary depending on the operator, nature of the hotel, location, etc.

#### **Is an operator or owner guarantee common in the jurisdiction?**

No.

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



The operator typically employs the general manager and sometimes some other executive team members. In a direct HMA other staff are employed by the owner, but usually engaged and discharged by the operator on behalf of and for the accounts of the owner. The operator also selects and trains the staff. However, the owner is often involved in the selection of the general manager of the hotel.

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

Yes.

**Who is responsible for insurance?**

The owner is usually responsible for all kinds of property related insurance. Operational insurance is usually taken out by the operator.

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

No, typically there are no rights given.

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

No.

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

This is rather unusual in Germany in its original sense. However, lease agreements for large upscale/luxury hotels and even some HMAs foresee so-called tenant easements, which are registered in the land register and grant the tenant and/or the HMA holder security in case of an insolvency of the landlord.

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

In case of a project development or a refurbishment, the operator often provides certain planning, equipping, design and opening services to the owner for a technical services fee under a technical services agreement (TSA).

## Transfers and assignments

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

If the owner disposes of the hotel, the HMA is usually transferred to the purchaser. The operator is typically entitled to terminate the HMA if the purchaser is a competitor or operator. It is rather uncommon that the operator has a right of first refusal.

**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?**

In the case of a share deal, the operator's approval is sometimes required for the transfer of a direct HMA to the buyer. In the case of an asset deal, the operator's approval is often mandatory for the transfer of the HMA to the buyer.

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

A right of first refusal is rather uncommon in German HMAs.

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

A standard HMA will not provide for this, and if it is ever given, there is usually an exit fee.

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