HVS

Superior Results
Through Unrivaled
Hospitality Intelligence.
Everywhere.

OCTOBER 2020

EXCERPT

USA | EUROPE | APAC

HVS GUIDE TO HOTEL MANAGEMENT CONTRACTS

2020 EDTION

INCLUDES 2019 SURVEY RESULTS

Daniel J Voellm, *MRICS*
Managing Partner, HVS Asia Pacific

Eunice Wong
Senior Analyst

Level 7, Nan Fung Tower
88 Connaught Road
Central, Hong Kong

HVS

Foreword

Why is this guide more relevant than ever?

Among all the many peculiarities of the hotel industry, the hotel management contract is likely the most unique. A binding contract between owners and operators which has evolved over almost six decades. In fact, the first hotel management contract was signed for the Hong Kong Hilton, which opened in 1963.

The management contract structure allowed hotel companies to expand rapidly and become what is nowadays known as "asset light". Of course, hotel owners stand to benefit in that they can bring in sound management expertise to their property and partake in the financial upside, unlike a traditional lease model which preceded it. Leveraging their management expertise, operators pushed for the hotel management contract to rapidly become the norm in the industry as a 'take it or leave it' proposition to owners.

Over time, the hotel management contract has become an intricate web of terms and clauses that defines the relation between owner and operator. The balance of power in this relationship needs to be carefully established, which was, and unfortunately still is, not always a given. Owners need to be on their toes and bring in expert advice from consultants and lawyers to navigate the complexities of an agreement which can bind them for decades to come.

As the role of the hotel asset manager stands to become more prevalent around the globe and the COVID-19 pandemic ushers in a new era, this is a space that needs to be closely watched. These testing times will cast a shadow on management contracts and call for change on multiple provisions. As we have observed in numerous instances, a strong property that is appealing to operators can secure significantly more favorable terms than a "standard" hotel. After all, gaining market share to impress investors may be more important to some operators than securing strong contracts.

This year's HVS Guide to Hotel Management Contracts by Daniel J Voellm and Eunice Wong gives insights into prevalent terms and how contracts have evolved in the last six years. This guide provides a global reference for owners to understand the language of hotel management contracts while demonstrating our extensive hands-on experience. The authors provide insight into the five principal sections of a management contract: term and renewals, operator management fees, performance test, budget and expenditures, and termination of the contract by owner. Key money and indemnification are also addressed.

We hope this guide can serve the industry as a reference to make better decisions, effecting better and more balanced relations between owners and operators.

Daniel J Voellm, *MRICS*
Managing Partner
HVS Asia-Pacific
24 September 2020
Hong Kong

SUMMARY

The HVS Guide to Hotel Management Contracts is an extensive collation and comparison of key terms and clauses of management contracts across the United States of America, Europe, and the Asia Pacific region. This report presents the critical survey results.

INTRODUCTION

The COVID-19 pandemic has cast a long shadow on the hotel industry. Many hotels and owners are in various levels of distress. Employees and operators are likewise suffering. This is a rare stress-test for the industry and the owner operator relationships that are defined in the management contract. Navigating the terms and clauses that could have an impact on the relationship during adverse times has become critical for owners. The overall structure and format of hotel management contracts never has nor will not change overnight. Thus, it is important maintain focus on the key terms that determine the business relationship of two parties for many years to come.

This survey report is an HVS endeavor to provide a substantial reference document that presents and distinguishes the key terms and clauses of management contracts across three major regions of the world – USA, Europe and APAC. Please note that the aim is not to make hotel owners in any part of the globe feel shortchanged; instead, we urge the readers to bear in mind local factors and influences that could impact regional contract clauses and owner-operator negotiations. Additionally, data confidentiality has been strictly maintained throughout this survey, with results in this report being presented only in aggregate and no individual contract details being revealed.

This survey report is an HVS endeavor to provide a substantial reference document that presents and distinguishes the key terms and clauses of management contracts across three major regions of the world – USA, Europe, and APAC. Please note that the aim is not to make hotel owners in any part of the globe feel shortchanged; instead, we urge the readers to bear in mind local factors and influences that could impact regional contract clauses and owner-operator negotiations. Additionally, data confidentiality has been strictly maintained throughout this survey, with results in this report being presented only in aggregate and no individual contract details being revealed.

SURVEY METHODOLOGY

Data Compilation: Data collection for this survey was implemented using a combination of different ways. We looked at contracts from the HVS global database and held discussions with hotel owners as well as operators. Eventually, the universal survey sample set comprised **61 management contracts (18,300 rooms).** Note that this guide serves as an update from our previous *HVS Hotel Management Contract Survey* (HMCS) published in 2014, therefore, old sample set data of 236 contracts (57,055 rooms) is included in our analysis on age of contract. Regional breakdown for this guide and HMCS '14 is depicted in Figure 1.

FIGURE 1: SURVEY SAMPLE SET (SOURCE: HVS DATABASE)

Number of Contracts

Region	HVS Hotel Management Contract Survey (2014)	HVS Guide to Hotel Management Contracts (2020)	Total Represented
USA	80	29	109
Europe	76	10	86
APAC	80	22	102
Universal	**236**	**61**	**297**

Number of Rooms

Region	HVS Hotel Management Contract Survey (2014)	HVS Guide to Hotel Management Contracts (2020)	Total Represented
USA	22,917	10,740	33,657
Europe	19,232	2,393	21,625
APAC	14,906	5,167	20,073
Universal	**57,055**	**18,300**	**75,355**

Data Analysis and Report Presentation: Primary **independent variables** (defined as inputs or causes) chosen for the data analysis are Market Positioning, Room Inventory and Age of the Contract, as highlighted in Figure 2. Here, it is important to note that the survey captured information on additional independent variables (Figure 3), which have been discussed in this report to explain results "only" where applicable.

FIGURE 2: PRIMARY INDEPENDENT VARIABLES (SOURCE: HVS DATABASE)

Independent Variable	Parameters	
Market Positioning	Midmarket	Upper Upscale
	Upscale	Luxury
Room Inventory	Less than 100 rooms	300-500 rooms
	100-299 rooms	Above 500 rooms
Age of Contract	Before Year 2005 (data from HMCS '14)	
	2005-2013 (data from HMCS '14)	
	2014-2019	

FIGURE 3: ADDITIONAL INDEPENDENT VARIABLES (SOURCE: HVS DATABASE)

Other Variables	Parameters
Type of Property	New
	Existing
Location of the Property	By City
	By Country

Furthermore, all contracts have been analyzed across **six major sections** as highlighted in Figure 4, which are recognized to be critical areas for owner-operator negotiations. Although each and every section can be examined using all independent variables, this report, which follows the same pattern as the table below, focuses only on the primary ones.

FIGURE 4: SURVEY SECTIONS AND REPORT PRESENTATION (SOURCE: HVS DATABASE)

Section	Principal Discussion	Key Area
I	**Management Contract Term**	Length of the Initial Term
		Number of Renewals/ Extensions
		Length of the Renewed/ Extended Term
		Provision for Area of Protection/ Restricted Area/ Non-Compete Area
II	**Operator Fees**	Initation/ Joining/ Commitment Fee
		Technical Services Fee and Pre-Opening Fee
		Base Management Fee
		Owner's Priority
		Incentive Management Fee
		Reservation, Marketing, Loyalty Program and Training Fees
III	**Operator Performance Test**	Commencement Year
		Test Period
		Type of Test (GOP/ RevPAR/ Both)
		Performance Thresholds
		Provision for Operator to Cure
IV	**Budget and Expenditure**	FF&E Reserve Contribution
		Control of Receipt/ Operating/ Revenue Account
		Expenditure Thresholds
V	**Contract Termination by Owner**	Operator Non-Performance (No Cure Made)
		Upon Hotel Sale
		Without Cause
		Termination Fee Payable to the Operator
VI	**Others**	Operator Investment in Property
		Senior Hire
		Indemnification

SURVEY PROFILE

Figure 5 showcases some of the 23 branded hotel management companies represented in the survey of 61 newly added hotel management contracts.

FIGURE 5: SAMPLE OF HOTEL COMPANIES (BRANDED) REPRESENTED IN THE GUIDE (SOURCE: HVS DATABASE)

Accor	Langham Hotels International
Ace Hotel	Mandarin Oriental Hotel Group
Capella Hotels & Resorts	Marriott International
Dream Hotels	Minor Hotels
Dusit Hotels and Resorts	naked Retreats
Four Seasons Hotels and Resorts	Rosewood Hotel Group
Hard Rock Hotels	SH Hotels & Resorts
Hilton Hotels & Resorts	Shangri-La Hotels and Resorts
Hyatt Hotels Corporation	SIXTY Hotels
InterContinental Hotels Group	Yotel
Kempinski Hotels	

ORDER YOUR COPY TODAY!

The full guide comprising around 30 pages can be purchased for US$2,000.

All reports will be available both in PDF (soft copy) as well as in print (hard copy). You may choose the preferred format at the time of placing your order, post which a personalized copy of the report will be sent across.

For ordering instructions or any other assistance, please contact:

Daniel J Voellm, *MRICS*
Managing Director, HVS Asia Pacific
dvoellm@hvs.com

Eunice Wong
Senior Analyst
ewong@hvs.com

Excerpt: SECTION I – Management Contract Terms

Length of Initial Term

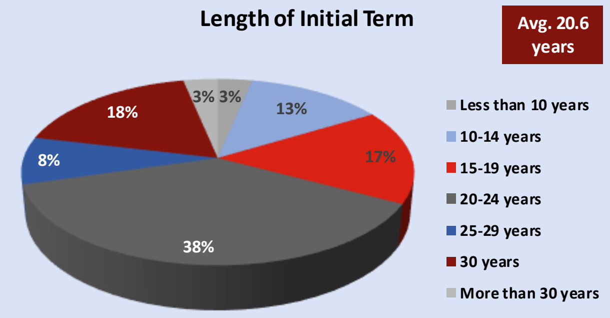
The initial term of a management contract for a new/proposed hotel typically commences from the Effective Date (date of execution of the management agreement) and continues until the expiration of a "specified" number of years **after** the Opening Date. In the case of existing hotels, the initial term is generally calculated from the Effective Date until the expiration of a "specified" number of years. **The average length of the initial term for the universal sample set is 20.6 years.**

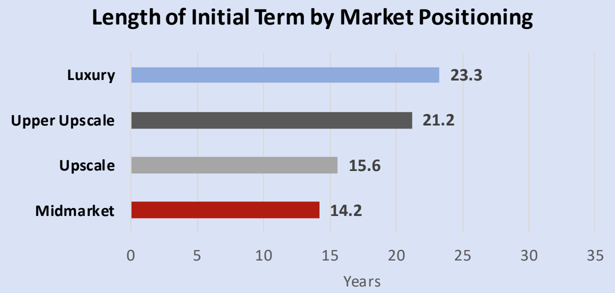
It is common understanding that operators prefer a longer contract term with automatic renewal options citing the need for stability, to protect their brand image and to obtain the desired return on their investment. On the other hand, owners prefer a shorter initial term with multiple renewal options on mutual consent, seeking flexibility. **The length of the initial term is also dependent on the region of operation, hotel's market positioning, room inventory and the year of signing the contract.**

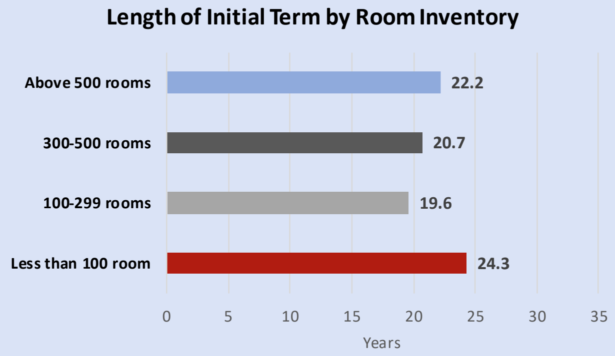
The full report further addresses the following aspects on management contract terms:

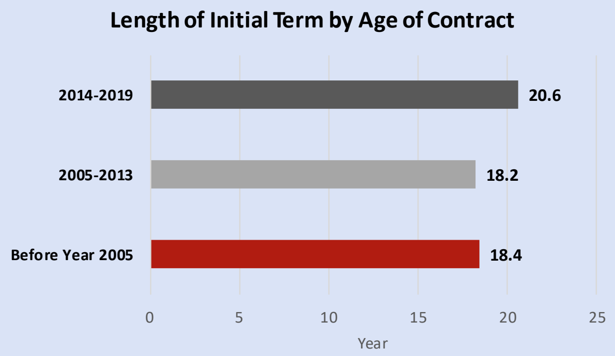
- *Length of Initial Term*
- *Number of Renewals/ Extensions*
- *Length of Renewals/ Extensions*
- *Provisions for Area of Protection/ Restricted Area/ Non-Compete Area*

SAMPLE FIGURES (SOURCE: HVS DATABASE)









Excerpt: Section II – Operator Fees

Base Management Fee

Base Fee and Incentive Fees together make up the Management Fees charged by the operator in exchange for performing the duties specified in the contract.

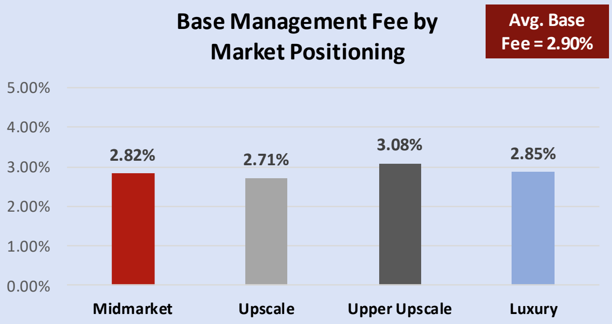
The base fee is usually **calculated as a percentage of the hotel's Gross Operating Revenue**. It could either be a single fee, or a sum of licensing/royalty fee and operating fee. Moreover, the base fee is generally chargeable throughout the life of the contract; however, it could be either computed as a "constant" percentage across all years, or it could rise over the initial years, gradually stabilizing for the remainder term of the contract.

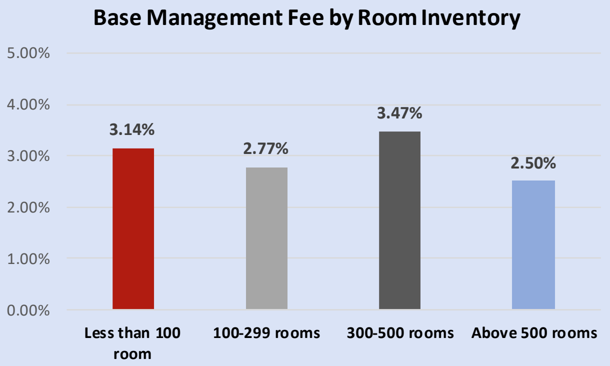
The full report discusses the survey results pertaining to this fee by market positioning, room inventory and age of the contract, respectively.

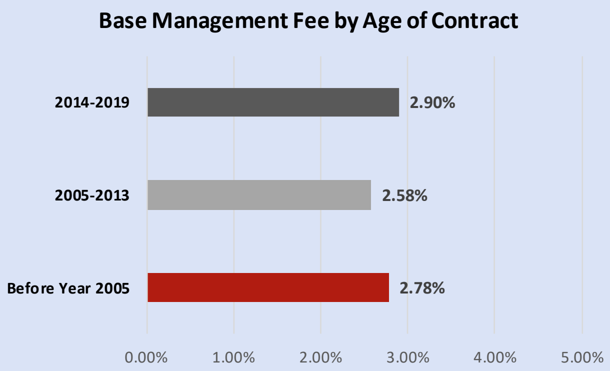
The full survey provides in-depth information in regard to Operator Fees on the following aspects:

- *Initiation/ Joining/ Commitment Fee*
- *Technical Services and Pre-Opening Fee*
- *Base Management Fee*
- *Owner's Priority*
- *Incentive Management Fee*
- *Reservation, Marketing, Loyalty Program and Training Fees*

SAMPLE FIGURES (SOURCE: HVS DATABASE)







Excerpt: Section III – Operator Performance Test

Stipulation of an Operator Performance Test in management contracts – which if failed and left uncured can give rise to an owner's right to terminate the agreement(s) – **is gaining ground worldwide** with the test parameters becoming more and more stringent. Owners have begun to realize that operators need to be held accountable for the hotel's performance and that this clause is perhaps the only way they can exercise termination rights without having to pay any liquidated damages or a termination fee to the operator.

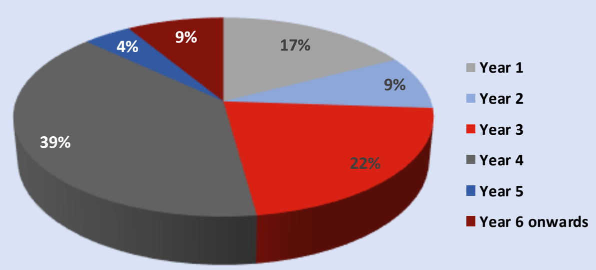
However, the **right of termination of the owner is not exercisable** should the performance test failure occur as a result of a force majeure/extraordinary event; renovation of the subject hotel; material default by owner impacting the operator's ability to perform; closure of a hotel in the competitive set, or any other reason that may have been defined in the contract. After COVID-19, further exclusions can be expected here in the future.

The full report further discusses the following aspects of operator performance tests:

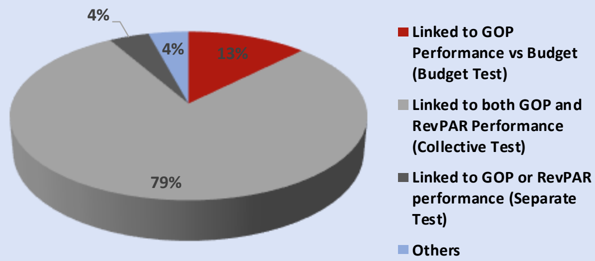
- *Commencement Year*
- *Test Period*
- *Type of Test*
- *Performance Thresholds*
- *Provision for Operator to Cure*

SAMPLE FIGURES (SOURCE: HVS DATABASE)

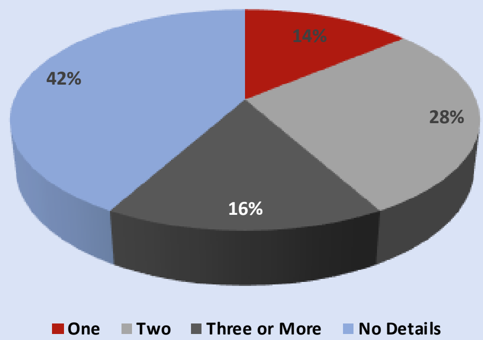
Performance Test Commencement Year



Type of Performance Test



Provision for Operator to Cure



Excerpt: Selection IV – Budget and Expenditure

The annual budgeting process is one of the most **collaborative activities between an owner and an operator** in the life of a management contract, seeking their joint approval on the projected performance and expenditures related to the hotel. This exercise is by and large conducted at the beginning of each year (calendar or fiscal, as may be defined in the management contract) with the **first draft of the annual operating plan and the capital budget** being prepared by the operator, which is then sent to the owner for approval. Subsequently, there can be a lot of back-and-forth before a final consensus is reached.

For both parties, this **activity is important as it helps indicate** the amount the operator could receive as fees; the owner's share of profit; threshold amounts linked with operator performance tests; and extent of capital expenditure to be incurred for the year.

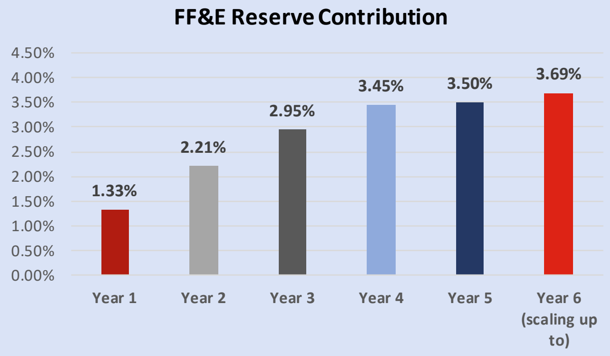
FF&E Reserve Contribution

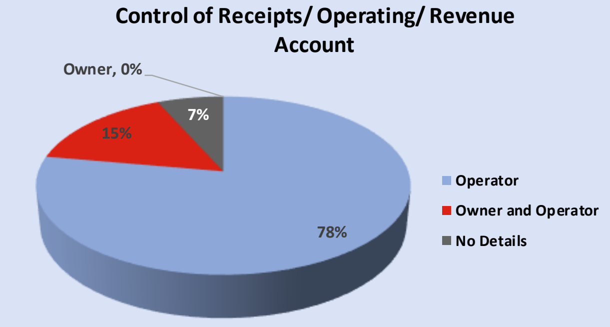
FF&E refers to Furniture, Fixtures and Equipment that can be removed from a property and are not a part of the building structure. FF&E Reserve is an annual/periodic monetary allocation/contribution to fund future expenditures related to the replacement of FF&E.

Generally, the FF&E Reserve allocation is expressed as a percentage of the hotel's **Gross Operating Revenue, ranging between 1.5%-5%.** The extent of withdrawals from this reserve is mostly planned during the annual budgeting exercise. Although this is not a payment to be made to the operator, owners are usually hesitant regarding a higher FF&E Reserve contribution as it has a direct bearing on their share of profits.

On the other hand, operators are insistent that adequate reserves (if not more) be maintained in order to ensure the property's upkeep, which affects its income generating potential and compliance with brand standards.

SAMPLE FIGURES (SOURCE: HVS DATABASE)





In this section, the full report also discusses the following aspects:

- *FF&E Reserve Contribution*
- *Control of Receipts/ Operating/ Revenue Account*
- *Expenditure Threshold*

The final two sections of the report discuss:

- *Contract Termination by Owner:*
  - *Non-Performance*
  - *Upon Sale*
  - *Without Cause*
  - *Termination Fee Payable*
- ***Others***
  - *Operator Investment*
  - *Senior Hires*
  - *Indemnification*

In-depth discussions and analysis on USA, Europe and APAC subsets for all sections will also be disclosed.

Superior Results Through Unrivaled Hospitality Intelligence. **Everywhere.**

About HVS

HVS is the world's leading consulting and services organization focused on the hotel, mixed-use, shared ownership, gaming, and leisure industries. Established in 1980, the company performs 4,500+ assignments each year for hotel and real estate owners, operators, and developers worldwide. HVS principals are regarded as the leading experts in their respective regions of the globe. Through a worldwide network of more than 40 offices and more than 500 professionals, HVS provides an unparalleled range of complementary services for the hospitality industry. For further information regarding our expertise and specifics about our services, please visit www.hvs.com.

HVS ASIA PACIFIC is represented by seven offices in Hong Kong, Bangkok, Beijing, Mumbai, Shanghai, Shenzhen and Singapore. HVS publishes a wide range of leading research reports, articles and surveys, which can be downloaded from our online library.

The team works on a broad array of projects throughout the asset life-cycle that include economic studies, hotel valuations, operator search and management contract negotiation, development strategies for new brands, hotel asset management, research reports and investment advisory for hotels, resorts, serviced residences and branded residential development projects. HVS Asia Pacific's clients include key investors, developers, hotel operators and lenders.

About the Authors

Eunice Wong is a Senior Analyst with HVS Hong Kong. She graduated New York University with a Bachelor of Hotel and Tourism Management. Prior to joining HVS, Eunice gained experiences in hotel valuation and appraisals with LW Hospitality Advisors, as well as, revenue management with Highgate Hotels.

Email: ewong@hvs.com
Tel: (852) 3628 3870

Daniel J. Voellm, *MRICS* is a Managing Partner Asia-Pacific at HVS Hong Kong. With 14 years of consulting and valuation experience, Daniel has provided advice in 24 territories across Asia Pacific. Prior to assuming his regional role, he headed the Hong Kong office after his time as Vice President at HVS' global headquarters in New York (2005-2008) conducting a wide range of appraisals, market studies and underwriting due diligence services in 22 states as well as Canada. Daniel holds a Bachelor of Science Degree from Ecole Hôtelière de Lausanne in Switzerland and is chair of the Urban Land Institute's (ULI) Hospitality Development Council in Asia Pacific.

Email: dvoellm@hvs.com
Tel: (852) 3628 3871