

Asset Management Agreements

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Introduction

Why another fee? When looking at the cost structure of a new hotel investment, many owners wonder why they should engage an asset manager in addition to all the other hospitality specialists that they are bringing on board to run this new asset. The answer is usually found by looking in the mirror.

Many hotel owners today are not hoteliers. If you look in the mirror and Cezar Ritz does not look back, you may be one of the many private-equity firms, high-net worth families, pension funds and other large institutional investors that invest significantly in hotels as part of a larger investment strategy. Where a hotel manager will manage the operations of the hotel, bringing in guests and serving them, a hotel asset manager can assist with the larger picture, whether that is the larger picture of the asset (addressing owner-level costs like real estate tax abatement), the market (focusing on revenue management) or a portfolio (providing financial reporting at the portfolio and entity level). Because an asset manager sits between the owner and the hotel manager, it can often be seen as another, hotel manager but in fact the roles – and the contracts – are quite different.

Scope of Services

The scope of services for a hotel asset manager can be quite broad and varies significantly across owners and asset categories. This is in contrast to the well-defined and fairly standard list of services provided by a hotel manager. The core services provided by a hotel asset manager almost always include oversight of the financial projections and performance of the hotel:

- Review of, and advice to the owner on, the monthly financial reports and forecasts from the hotel manager
- Review of the proposed annual operating and capital budgets and participation for (or with) the owner in commenting on the budgets
- Provide long-term capital expenditure and FF&E expenditure plans
- Review of, and comments to the manager on, the marketing and sales plans
- Review, monitor and advise on rate positioning and market share performance
- Advise the owner with respect to hiring decisions the owner can make under the hotel management agreement

- Oversee the hotel manager's performance under and compliance with the management agreement

Additional services that may be provided by an asset manager vary widely and include:

- Evaluate and advise on the hotel's "green" performance
- Pursue real estate tax abatement
- Review and advise on the hotel's risk management program and insurance program and, in some cases, providing access to the asset manager's insurance program where cost efficient
- Advise as to brand and manager selection
- Negotiate contracts with the hotel manager and hotel brand
- Advise as to concept, brand and manager for spa and food and beverage outlets
- Prepare entity-level or portfolio-level financial statements
- Prepare financial reporting packages for lenders
- Oversee the construction requisition process

Some hotel owners – and many hotel managers - have the experience and in-house personnel to handle many of these jobs themselves. However, for many hotels, there is a gap between what the specific hotel manager and the specific hotel owner bring to the table that an experienced asset manager can fill.

Asset Management Agreement Terms and Conditions

The scope of services is at the heart of an asset management agreement and often the most customized section of the agreement. But it is not the only provision that is handled quite differently than in a hotel management agreement.

Fees: Where the fee structure in hotel management agreements is fairly standard across the industry (base fee equal to a percentage of gross hotel revenues, with in some cases an incentive fee that is a percentage of the net operating income after a return on the owner's investment), there is no set standard for an asset management fee. It can be a fixed dollar amount on a monthly or annual basis, a percentage of total hotel revenues that is either fixed or changes at breakpoints, or structured like a promote in a joint venture, as a share of net operating income after a return on the owner's investment (this is more common where the asset manager is also a minority equity owner). Incentive or success fees can apply, especially where an asset manager is being brought in specifically to improve a hotel's performance in (such as market share).

Reimbursements: Asset managers are expected to visit the hotel so reimbursement for travel costs is expected. The number of visits and type of travel can be identified in advance as part of the scope of services, giving owners more control over this cost than is generally provided under a hotel management agreement.

Term: Length of the contract term can vary widely, depending on whether the asset manager is engaged to address a specific issue or to be part of the overall management and ownership picture for the hotel. A three-to-six month arrangement might work for an owner who wants assistance

taking over an asset but is not yet certain whether asset management will be needed in the longer term. For an owner looking to maximize the hotel's value over time, a three-to-five-year contract that then renews year-to-year provides time to develop a working relationship among the owner, the hotel manager and the asset manager over the course of several budget cycles without being locked in if the relationship does not work out as hoped.

Termination: With the comparatively short terms, termination rights are often less contentious than in hotel management agreements. As the asset manager is acting as the owner's representative at the hotel, it is expected that the agreement will not transfer to a new buyer on sale but will instead terminate. If the asset manager has invested significant resources up front in providing its services or has provided a service that cannot be ended immediately without some cost (such as providing property insurance through its insurance program), there may be breakage costs or termination fees to cover those lost costs. With similar compensation to the asset manager, there may also be a right for the owner to terminate at will. Some asset managers may also want the right to terminate at will, which may be acceptable to an owner, provided the timing is not at the peak period of the annual budget process or some other key point in the hotel's year. Termination rights are also less of a focus in asset management agreements than hotel management agreements as most agreements specify that the asset manager is an independent contractor and therefore not the owner's agent, avoiding the arguments about termination of hotel management agreements under agency law that are working their way through the industry. In addition, timing of termination to allow for compliance with the WARN Act will not apply, as termination of the asset management agreement should have no impact on the employment of the hotel employees.

Insurance and Indemnification: Asset management agreements generally require that the asset manager carries general liability insurance, professional liability insurance and fidelity/crime insurance, at its cost and not as a hotel cost. Correspondingly, the general liability insurance for the hotel (whether carried by the hotel owner or the hotel manager) will cover the asset manager. The indemnification obligations, however, are very similar to those in hotel management agreements, with the hotel owner indemnifying the asset manager for claims arising out of the operation of the hotel and the performance of the services and the asset manager indemnifying the owner for claims arising from the asset manager's gross negligence, fraud or willful misconduct. The asset manager's indemnification obligations may also cover breaches of the asset manager's obligations or actions beyond the scope of its authority. The debates that often arise in hotel management agreements over who is responsible for the hotel employees' actions are not applicable to an asset management agreement.

Governing Law: Hotel management agreements are generally treated as contracts relating to real property. Accordingly, management agreements customarily use the law of the state where the hotel is located as the governing law, although some owners and hotel managers may push for the law of their home jurisdictions. For asset management agreements, which are more generally treated as service contracts, the choice of law tends to follow standard contract law selection such as Delaware or New York. Some might see an argument for the asset management agreement use the same governing law as the hotel management agreement, to facilitate litigation of both

agreements together, but in practice the asset management agreement itself is rarely implicated in the contract disputes between the hotel owner and the hotel manager.

Ownership of Work Product: While a hotel manager may produce intellectual property for the asset it manages (such as developing a film festival at the hotel), any ideas and concepts developed for the hotel are usually site-specific and commonly understood to belong to the hotel and the hotel owner. Accordingly, not much time is spent negotiating provisions relating to intellectual property in hotel management agreements – contrast this to the provisions in branded management agreements and franchise agreements, where the branded manager/franchisor explicitly owns anything developed, for the benefit of the brand. An asset manager's services, however, involve considerable intellectual property, both in analyses and conceptual frameworks that the asset manager has developed for evaluating hotels and improving performance generally and in specific ideas developed to improve the hotel's performance. Asset management agreements need to be clear in distinguishing between these two areas of intellectual property, so that the hotel owner retains the rights to ideas and concepts developed for its specific hotel while the asset manager is not at risk of losing its rights to the unique thinking and approaches at the core of its services.

There are, of course, several areas in which hotel management agreements and asset management agreements address common contract issues in the same (or very similar ways). In addition to the indemnification provisions discussed above, owners and asset managers will address: (i) defaults and other actions and inactions that allow a party to terminate, such as the other party's bankruptcy or failure to perform; (ii) confidentiality of materials provided and developed during the performance of the asset manager's duties and confidentiality of the terms of the agreement; (iii) standards for the asset manager's performance; and (iv) transfers of a party's interest in the agreement and whether a change of control constitutes an assignment that allows the other party to terminate the agreement. This last issue can be more pointed in the asset management agreement, as these services are often provided by a small group or a specific person whom the owner trusts and expects to provide the services individually.

Conclusion

A hotel asset manager is a hospitality specialist, with skills and experience that can allow an owner greater insight into the management and performance of its hotels and greater range of options to improve that performance and maximize the hotel's placement in the market. The asset manager can also serve as a second set of hands for the owner in meeting lender and investor reporting requirements and negotiating key contracts, which is especially valuable for leanly staffed investment groups or owners without substantial experience in the hospitality industry. Asset management agreements reflect and respond to this unique role, raising issues distinct from, although related to, hotel management agreements and should be negotiated accordingly.