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Hospitality matters

Current topics in the hotel industry

Autumn/Winter 2017

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Welcome to

HOSPITALITY MATTERS

Autumn/Winter 2017

Welcome to Hospitality Matters, our regular bulletin for the hotels and leisure industry.

On 1 May 2017, CMS went through a monumental merger with tech and leisure powerhouse Olswang and real estate giant Nabarro. Six months on we are performing stronger than ever.

Thomas Page
Global Head of Hotels & Leisure Group

This issue of Hospitality Matters is being published just in time for our annual Hotel Owner's Conference. This year, we have our largest ever attendance by some margin, which is a small demonstration of how investor interest in the hotels sector remains as strong as ever, despite the political headwinds. Projections from across the industry suggest that both investment activity and operational trading remain strong across Europe.

At our European Hotel Finance Forum in June, the invited group of hotel investors there thought that pricing had come off slightly from the peak, taking a little bit of the heat out of the market, which had perhaps been looking a little frothy at the end of 2016. But otherwise the fundamentals of the sector remain strong; debt remains cheap and available; and the longer term prospects for global tourism and travel look healthy, despite a political trend away from globalisation towards nationalism.

Our own experiences suggest that activity levels have held up across all of Western Europe, including Paris which has bounced back after being hit badly by terrorist events. But in some markets, good deals are harder to find and so we see more of our investor clients looking to Central and Eastern Europe, which have been quieter in previous years, to find value and growth opportunities. Meanwhile, the global operators continue to seek pipeline and Latin America, beyond just Brazil, looks attractive with high growth rates and increased political stability. Will the international investors follow?

Focus on the Paris hospitality market: the city of lights comes out of the shadows

The Paris hotel market emerges from the crisis

The terrorist attacks in Paris in November 2015 significantly impacted the city's hotel market resulting in a substantial decrease in occupancy rates of more than 10%. This decrease in hotel patronage was also exacerbated by the emergence of sharing economy platforms such as HomeAway and Airbnb. Luxury hotels were particularly hard-hit by these events, with 2016 RevPAR decreasing by 21%.

Yet, internationally, Paris remains a particularly prized tourist destination. A JLL study in August 2017 indicated that, absent new terrorist attacks, the Parisian hotel market should regain normality between the 4th quarter of 2017 and mid-2018.

Beyond the inherent attraction to the City of Lights, the recovery in the Paris hotel market is explained by the significant renovation works carried out on emblematic Parisian palaces such as The Ritz Carlton (reopened at the end of 2016), Le Crillon (reopened in July 2017), Fouquet's (reopened in July 2017) and the Lutetia (reopening at the end of 2017).

The Paris hotel market will also certainly benefit from the 2018 openings of new, anticipated hotels, such as the Cheval Blanc hotel to be located in the former La Samaritaine building, the rehabilitation of the Louvre Post Office into an 80-room hotel, the installation of the first Fauchon hotel at Place de la Madeleine and the opening of the five-star hotel, La Clef Champs-Elysées.

Transforming buildings into hotels while facing the specificities of French regulations

A review of the Paris market shows that, given the dearth of land in Paris, recent hotel openings are the result of the conversion of existing buildings.

These renovation projects take place over several years and require investors to take specific constraints into account, particularly if the building is already occupied by tenants renting shops located on a building's ground floor or office space. Indeed, given the specifications of French regulations relating to commercial property (art. L. 145-1 et seq. of the French Commercial Code), the tenant benefits from an automatic right to renew its lease. Failing a renewal, the tenant has the right to be paid compensation to cover the losses suffered from the non-renewal of the lease, with the relevant payment being equal to the value of the tenant's business or the so-called 'lease right' value. While the value of lease rights is limited with respect to office space, these payments for shops greatly impact the amount of the investment of owners of buildings. Moreover, the issue of evictions must be dealt with in advance in terms of project schedules, as it takes several years to obtain a decision definitively setting the amount of the compensation.

> *The Paris hotel market managed to bounce back from the dark times of 2015, during which several terrorist attacks took place. Today, Paris has regained its dynamism, and the impact of the creation and renovation of Parisian luxury hotels has added to this.*

In addition, beyond aspects related to town planning and requiring a building permit to be secured, if the building which is the subject of the renovation includes housing units, specific regulations relating to changes in use will need to be observed, notably in Paris (art. L. 631-7 of the French Construction and Residential Code). Indeed, a change from housing use to commercial use as a hotel may only occur after a prior authorisation has been delivered by the mayor's office, which involves added complication.

Manner of operating hotels in Paris

In the French hotel sector, the principal operating contracts are management agreements, commercial leases and lease-management agreements.

Hotel management agreements remain the preferred mode of operating hotels in Paris. These contracts consist of entrusting the management of a hotel to a third party who assumes responsibility for operational management. The average term of these contracts is 20 years in Paris, and the parties are free to agree upon renewal options. While the base fees vary between 3% and 5% of turnover and have tended to decrease over the past several years, incentive fees generally amount to 6% to 10% of GOP. More often, owners are also entering into franchise agreements allowing the hotel operator to benefit from a hotel brand and its distribution channels, with franchise arrangements recently opening-up to high-end brands.

Commercial leases covering assets in Paris essentially relate to ‘trophy assets’, such as the future hotel in the Louvre Post Office or the Fauchon hotel. In light of the necessary prior renovation of the building in which the hotel will be operated, these leases are generally commercial leases of an off-plan property which require a description of the state of completion of the future hotel.

Given the investments made by the lessor in terms of construction work (the tenant bears only FF&E and OS&E expenses), commercial leases are often entered into for a term of 12 years, sometimes longer. The amount of rent paid for these assets, which generally includes a minimum guaranteed rent and a variable rent, represents approximately 65% of EBITDAR, with variable rents reaching up to 15% – 20% of turnover.

In addition, lease-management agreements are experiencing a certain sort of revival in France, but in Paris these tend to relate to mid-range to budget hotels. Lease-management arrangements nonetheless carry their own constraints for the owner of the business, who must have operated the business for a minimum of two years before placing it under lease-management (art. L. 144-3 of the French Commercial Code), and for the operator, who does not benefit from any eviction indemnity at the end of the agreement.

The choice among these various modes of operation generally depends on the location of the hotel and the wishes of the owner of the building, as investors tend to prefer management contracts and commercial leases.

Despite the short-term impact of terrorism, Paris remains a very strong long-term market for hotels. The lack of supply means investors need to be more creative, driving investment into refurbishment of existing hotels and conversions from other uses, with a variety of operating models available to suit all tastes.

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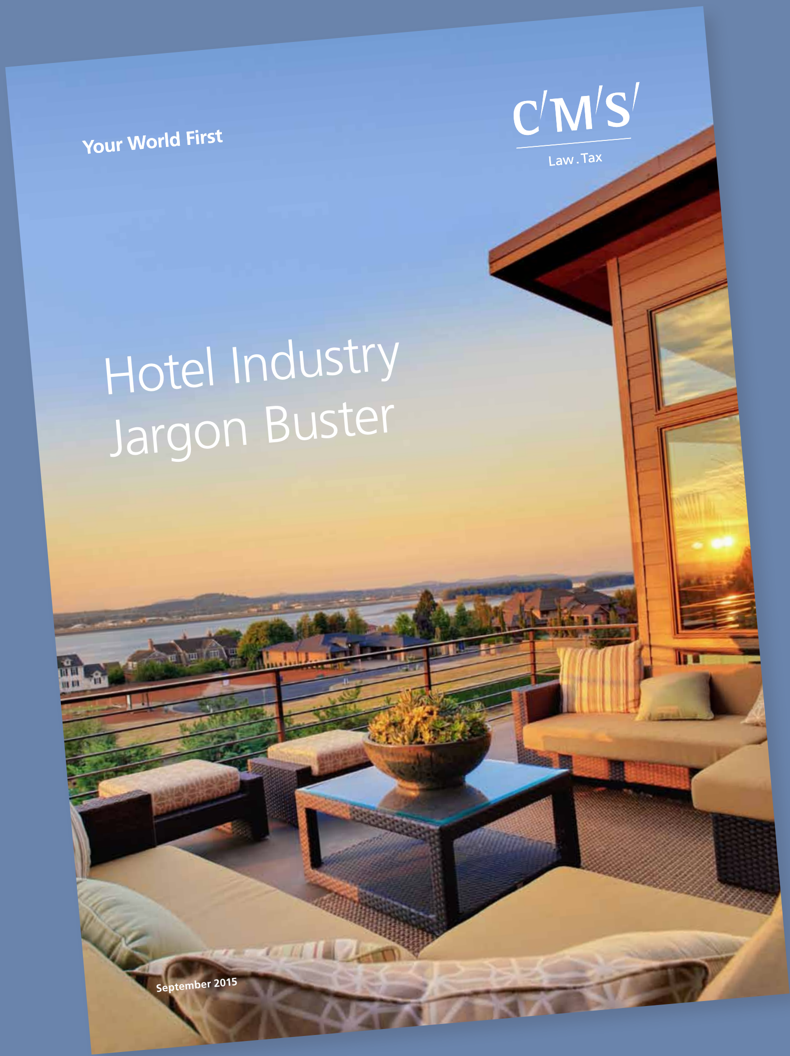
Hotel Industry Jargon Buster



From A&G and half board to opaque bookings and VR – the Hotel Industry Jargon Buster provides you with a comprehensive list of the most current terms in the hotel industry.

This easy-to-use format allows you to look up terms easily and quickly, and can be a useful resource in your day-to-day work.

The list was compiled by CMS experts with the aim of providing you, whether you are an owner, investor, lender or operator in the hotels and leisure sector, with easy access to the latest information.

cmslegal.com/Hotel-Industry-Jargon-Buster

Tee time – the development of golf resorts

Golf resorts are a unique asset class that can be very successful provided that operators 'keep their eye on the ball'. Although not always the largest part of a real estate investment, the sheer size of a golf course (sometimes with associated driving ranges and teaching academies) will typically become the prominent focal point of any golf resort, offering scenic views and a real sense of prestige. Often seen as one of the more luxurious offerings in the leisure market, golf resorts typically attract a higher spending clientele who want the golf amenity other resorts cannot provide.

New resorts?

Why then are we not seeing a huge development pipeline of new golf resorts in Europe and North America? The answer lies in both the fact that there is no shortage of options for golfers to choose from and the challenges in creating new resorts, specifically getting the golf offering right. The 1990s saw a general oversupply of golf courses on those continents, and in turn of golf resorts. That, plus decreasing participation rates as people become increasingly 'time poor', has dampened appetite for new resorts.

The increased cost of acquiring the vast areas of land required to build a golf course and its associated facilities can also make the economic viability challenging, particularly given the period they take to build. For developers with the funds and appetite to purchase new sites, further obstacles can include complying with the title conditions for such large sites, as well as the land being undeveloped and therefore un-serviced. Dealing with issues such as drainage can be expensive.

Obtaining planning consents/zoning approvals to enable development of new golf courses and new hotels can also prove difficult. The very nature of golf resorts means they are typically in areas with picturesque views and endangered wildlife that local residents are keen to protect. Ultimately, speed of navigation through the process is often affected significantly by the strength of desire of national and local/municipal governments for golf resorts in their patch. We have seen examples of projects becoming mired in difficult and protracted approvals processes, whilst others are positively encouraged, particularly for their economic benefits such as providing new jobs and enhancing an area's tourism offering. The golf course aspect can therefore cost more to build than the value of the golf offering to the resort.

Move towards redevelopment of existing resorts

The golf resort is far from dead though. Resorts with golfing facilities can enjoy an average daily rate (ADR) premium, particularly if the course has a sound reputation of quality that will attract golfers from far and wide. This can also lead to a prolonged high season for the resort. A golf course also offers an additional revenue stream through business opportunities such as membership and non-membership daily playing fees.

> *There has been a shift towards existing golf resort assets, particularly distressed assets, being scooped up at modest prices.*

They can then be turned around by reorganising the business model and refurbishing the resort. Strategic enhancements to the resort can easily enhance the customer experience, make it fit for the 21st century guest, and drive up the profitability and value of the resort, while avoiding the high costs and lengthy delays involved in building a new resort.

The purchase of the Fairmont St Andrews in Scotland by Kennedy Wilson is a great example of an existing golf resort asset being snapped up. Bought a year before the Open was staged at St Andrews in 2015, the event allowed the resort to showcase its offering when the home of golf became centre of attention on a world stage.

The benefits of buying an existing resort with a golf course are clear. With the course already in situ, there should be little or no approvals hoops to jump through. The land should have the necessary services and infrastructure. The resort will likely already benefit from hotel bookings and tee time sales. Together with at least some form of customer loyalty, this will all provide the added benefit of cash flow into the resort whilst renovations and improvements are completed.

Growth areas

Whilst golf participation rates are generally in decline in Europe, the US and Canada, press reports suggest a corresponding increase in Asia. It is therefore likely new golf resorts will continue to be built in emerging markets, benefiting from reduced land costs and a general desire from local and national governments to assist in their construction.

In Europe and the US, the shift in the market to snapping up existing golf resorts (particularly those that are distressed or at least struggling) for redevelopment corresponds with precisely what the market requires: that resorts evolve to meet the needs and expectations of 21st century guests.

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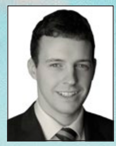

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Latin America: Thriving beyond Brazil

Despite often unfavourable and political uncertainty in some parts of the region, Latin America's tourism and hotel industry in other parts continues to thrive. According to the JLL Hotel Investor Sentiment Survey, although Brazil, Argentina and Mexico continue to dominate the investor markets, Peru, Columbia and Chile were viewed favourably as potential investment destinations over the next two years. Accor too has announced its intention to focus its expansion in the region on these three countries. The WTTC's Economic Impact 2017 report denotes that the total contribution of the tourism industry on continent was USD328.2bn (8.8%) of the GDP, with a potential rise of 2.1% in 2017.

Columbia in particular has a marked upturn of employment statistics for the industry and a project 20% growth for occupancy by international tourism in the next 5-10 years. Chile's investment and marketing of 'sustainable tourism' shows an increased awareness of the country's rich heritage, but could also arguably be an intuitive response to the western tourist trend for all-things 'lifestyle, organic and authentic'. Peru has positioned Lima as the principal destination in the region for international meetings, conferences and events tourism.

In February 2017, we welcomed three established law firms in Columbia, Chile and Peru who joined CMS, bringing with them existing specialism in the hotels and leisure sector to take advantage of this exciting growth in this part of the Latin American region, joining our existing offices in Rio and Mexico City.

Chile

Chile upholds the UN declaration of 2017 as the International Year of Sustainable Tourism for Development

In 2017, the UN-proclaimed International Year of Sustainable Tourism for Development, tourism acquired a special role for Chile. Sustainability in tourism became a priority area in the development of State policies, allowing for diversification in the economy and giving space to an industry with a sustainable approach. It allowed for a new understanding between peoples and a greater awareness and appreciation of tangible and intangible natural and cultural heritage.

Chile has joined the international challenge and has developed a National Agenda for Sustainable Tourism. It seeks to promote a series of public and private initiatives to deepen the work of raising awareness, create tools and develop policies that are being implemented to improve sustainability standards in the tourism industry.

Among them is the *Distinction for Sustainable Tourism*, graphically represented by an 'S' Seal. The Seal guarantees to the visitor that the tourist service meets the global criteria for sustainable tourism, in the socio-cultural, environmental and economic areas. For now, the 'S' Seal applies only to tourist accommodation services operating in Chile.

In addition, in September, Chile will host the **GSTC Global Sustainable Tourism Conference**, which brings together global and national leisure industry stakeholders engaged in the development and promotion of ecological travel; including public sector, hotels, tour operators, academia, development agencies, NGOs, consultants, and more.

It will be interesting to the Hotels & Leisure community to follow up the conclusions around:

— Sustainable tourism certifications in Latin America

— Sustainable hotel management

— Climate change and tourism

— Ecotourism and community-based tourism in South America

— Sustainable food in the tourism industry

— Indigenous tourism

The importance of the public-private alliance for said industry needs to be highlighted.

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> *The importance of international tourism, and particularly of the designation of an international year of sustainable tourism for development, in fostering better understanding among peoples everywhere, in leading to a greater awareness of the rich heritage of various civilizations and in bringing about a better appreciation of the inherent values of different cultures, thereby contributing to the strengthening of peace in the world.*
> *The United Nations General Assembly*

> *Behind the injection of public resources in terms of international promotion, the offer must be strengthening its marketing channels and its private partnerships on an international level so that tourists from the priority markets come to our country.*
> *Javiera Montes, Undersecretary of Tourism of Chile*

Colombia

An important industry for the country´s economy

The Colombian hotel industry has grown significantly over the last few years and is one of the national sectors that has contributed most to the economy of the country. The hotel industry, together with trade and restaurants, generates 28% of the country's employment.

With an income growth of around 12% and around a 3% increase of personnel employed in 2016, in comparison to 2015, Colombia's hotel sector continues on the growth path.

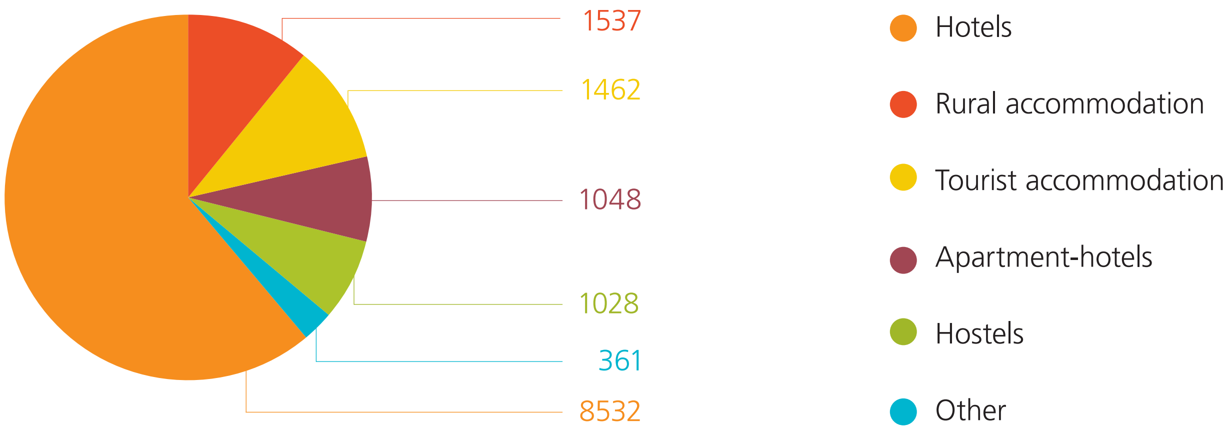
According to 2016 statistics, growth of the industry is the result of more foreign and Colombian travellers who together generated an occupation of 61.46% (nationwide).

Hotel investments have made the sector one of the country´s 'growth engines'. According to statistics from the Colombian Migration Agency, 2.6 million people entered Colombian territory in 2016. Thus, according to Dinero Magazine, hotel occupancy by international tourists has grown during the last decade and today represents almost 40% of the industry´s occupancy.

Some relevant statistics about the industry

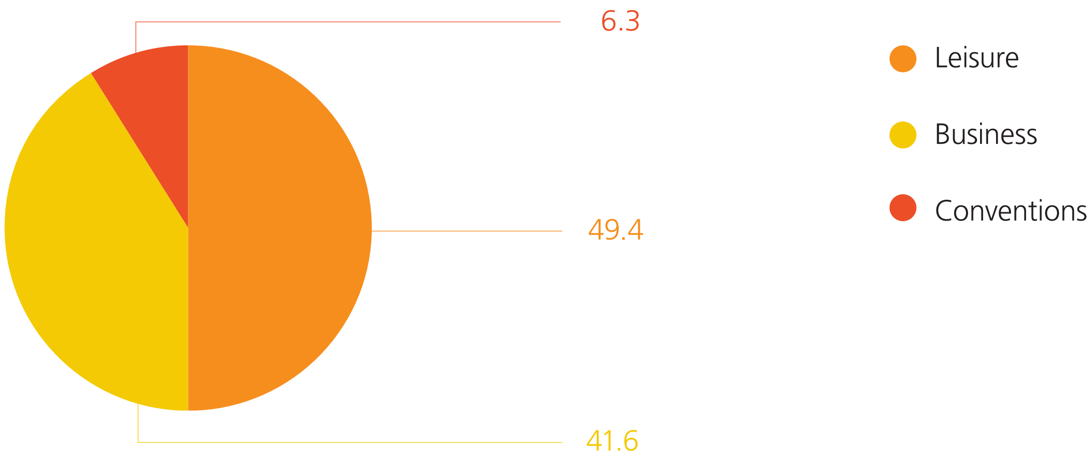
According to COTELCO, as of November 2016, nearly 13,968 hotels were registered in the country (with 254,956 rooms), out of which approximately 8,532 fall under the category of hotels, 1,537 under the rural accommodation category, and 1,462 under the tourist accommodation category; 1,048 are apartment-hotels and 1,028 are hostels (refer to the graph overleaf).

Also, as of the date of issuance of this report, there are 63 new hotel projects in Colombia.



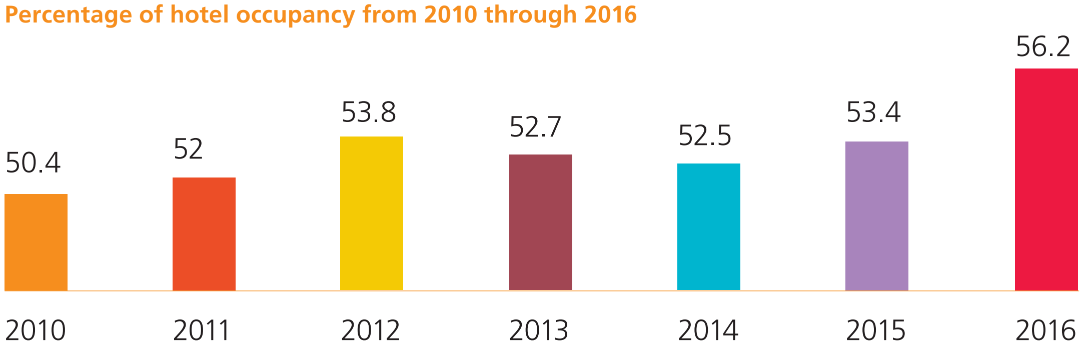
Source: '*El Espectador*' journal.
http://www.elespectador.com/publicaciones/buen-viaje/asi-se-comporto-el-sector-hotelero-colombia-durante-201-articulo-671336

Main reasons why Colombians travel (%)



Source: '*Ministerio de Industria y Comercio*' (Ministry of Industry and Commerce)
http://www.mincit.gov.co/publicaciones/36391/en_febrero_crecimiento_del_sector_hotelero_de_colombia_se_mantuvo_en_alza

Percentage of hotel occupancy from 2010 through 2016



Source: '*El Heraldo*' journalism.
https://www.elheraldo.co/mas-negocios/el-sector-hotelero-impulsado-por-la-inversion-y-el-turismo-363095

Foreign investment and income tax benefit

According to the 2002 Law 788, hotels built in Colombia between January 1st, 2003 and December 31st, 2017 will not pay income tax for 30 years. This fact has been very attractive for investors.

According to Procolombia - an entity in charge of promoting Colombia´s tourism, foreign investment, exportations (excluding mining-energy activities) - between 2010 and 2016, this tax benefit helped investors in the incorporation process of 53 different hotel projects. This included international chains such as Accor, Hilton, Marriott; Atton and Cityexpress representing investments of no less than USD $1.470 million. In addition, tourism represented more than USD $5.600 million for the country in 2016.

2017 perspective

According to COTELCO´s statistics, hotel occupancy in Colombia decreased over the first two quarters of 2017. As of June 2017, the occupancy rate was 53.52%, which represents a decrease of 1.51% compared to the same period in 2016.

However, the industry is confident that these numbers will increase during the third and fourth quarter of the year, especially during December 2017, which is one of the busiest months of the year for the hotel industry. According to industry experts, such as Gustavo Toro Velásquez, COTELCO´s Chief Executive, the increment of occupancy in the industry has grown iat a rhythm of 8% to 10% in the past few years. If this rhythm continues, in a few years the occupancy rates in the hotel industry will be between 65% and 70%. Gustavo also mentions that it is necessary to improve the country´s international connectivity by providing broader access to the country from foreign markets.

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Peru

Lima: the main city for meeting and events (MICE) tourism in South America

Much of the international attention on meeting and events tourism in recent years has been focused on Peru, due to its exquisite gastronomy, amazing landscapes and important airport and hotel infrastructure. Lima has become the trendy city for this kind of tourism.

The Peruvian government is focused on the development of tourism, establishing the goal of receiving 7 million foreign tourists by the year 2027, and for year 2017, more than 4.36 million foreign tourists will arrive in Peru.

In the last few years, Peru has built a strong tourism sector, growing on average by 10% annually.[1]

This was expected due to the country’s remarkable economic growth, Lima’s strategic location in South America, privileged air connectivity to the principal destinations in America and Europe, and important airport and hotel infrastructure. Lima has become the best destination for the meeting and events segment according to the International Congress and Convention Association (ICCA), positioning itself between the major cities for this kind of tourism within the South American region and ranked 39th in the world.

Travel industries and related services represent almost 10% of Peru’s GNP, overtaking manufacturing, banking and education sectors. Thus meeting tourism generates more than US$180 million in revenues for Lima and the principal beneficiaries are the hotel companies because 70% of the sales of 4 and 5-stars hotels in Lima come from the business sector.

In the coming years, it is expected that Peru will improve its position in the MICE market since investments of US$1,141 million for the construction of 62 hotels of international and national hotel chains are projected for the period 2017 – 2021.

[1] In accordance with the study made by ‘Analisis Hotels & Tourism Advisor’ elaborated for the Hotel Society of Peru.

Also, in the next few years, Lima will receive thousands of additional tourists due to major events like the Dakar Rally in 2018 and the Pan American Games in 2019.

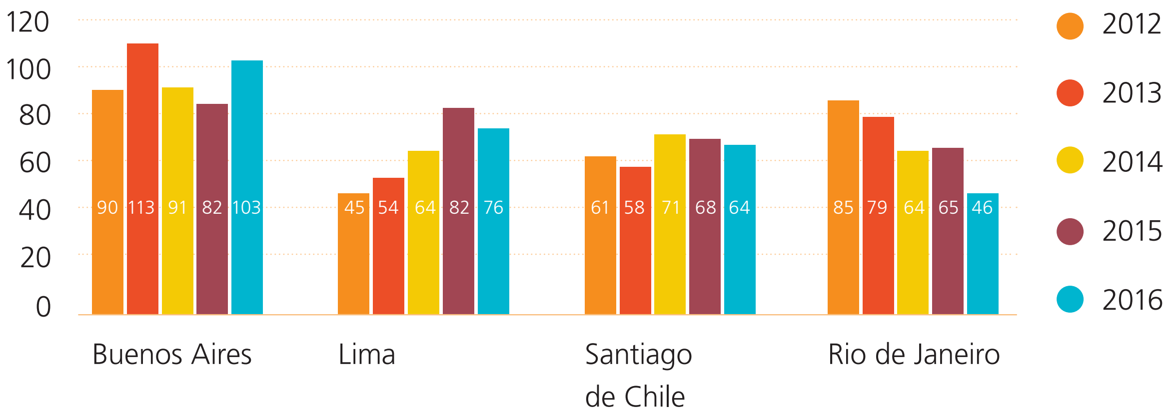
The growth of this sector is reflected by the presence of some of the most important global hotel companies such as Marriot International, Hilton Hotels, Accor Hotels and IHG, among others.

Pan American Games

The Pan American Games will take place in Lima between July 26 and August 22, 2019. Around 6,700 athletes will participate in 55 disciplines and more than 12,000 people among coaches, assistants and executives and 250,000 tourists will arrive during the 15 days of the competition.

The Parapan American Games will also take place in Lima and more than 1800 athletes will participate in different disciplines.

For the development of both games, Lima will have nine sports venues. The Panamerican Venue Project, recently awarded to Besco-Besalco consortium, will have seven 20 storey-high buildings in order to host around 9,000 athletes.



Source: International Congress and Convention Association (ICCA) statistics reports.

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Recent restaurant credentials

Our leading hospitality and leisure team provide domestic and international support to some of the world's fastest growing restaurant businesses and concepts. Our full service offering provides a seamless service to up-and-coming as well as global and sophisticated hospitality businesses. Whether it's acquiring some of the highest profile restaurant groups around or advising the premium or fast casual dining market, our practice is familiar with our client's requirements.

Hakkasan

Advised Hakkasan in relation to its acquisition of Cha Cha No Hana Limited, operator of the high-end Japanese restaurant Sake No Hana. Also negotiated restaurant management/franchise agreements in India, Indonesia and Bali.

D&D London

Advised the shareholders and management of D&D London on the management buy-out backed by private equity firm LDC. Also on their UK leases including assisting with the new leases at the television centre in White City, Battersea Power Station and sites in Manchester and Leeds.

Balthazar

Advised Caprice Holdings Limited, the restaurant group that owns The Ivy, Le Caprice and J Sheekey, on a joint venture with US restaurateur Keith McNally to bring the New York restaurant concept 'Balthazar' to Covent Garden.

Hawksmoor

Advised the shareholders of Hawksmoor on its sale to Graphite and on the development and roll out of Foxlow, as well as new leases for their restaurants in Knightsbridge, Borough Market and a site in Manchester.

Pizza Hut

Advised the management team of Pizza Hut (UK) Limited in connection with the sale of their dine-in restaurant business to specialist restructuring investor Rutland Partners.

Aquavit

Acting on the licence agreement from owners of 2-Michelin-star NYC restaurant Aquavit and its entry into the UK market with its first lease in London in St. James's Market.

Gr8 Investments

Advised in relation to the sale of 18 AC Restaurants in the Netherlands to the supermarket chain Jumbo.

Deliciously Ella

Acting for the Deliciously Ella and the Mae Deli on various commercial, real estate and funding-related matters.

Tom Aikens

Acting for Tom Aikens in relation to bar and restaurant concept design agreements for projects in the UK, Hong Kong, Qatar and Dubai.

Ignite

Acting for Ignite regarding bar development and management agreement for the Wylde bar in Starwood London and the Eclipse bar in Starwood Barcelona.

Grainstore

Acting for Australian Airport Retail in relation to its licence of the vegetarian concept created by Bruno Loubet, Grainstore for London Gatwick airport.

Groucho Club

Advised the sellers, including private equity firm Graphite Capital, on the management buy-out of the Groucho Club, the exclusive private members' club in Soho, London.

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Roof top rents and the impact of the Digital Economy Act 2017

The Digital Economy Act 2017 (the 'Act') made headlines this year owing to several controversial provisions around data sharing and collection. However, also packaged within this new legislation is a topic which has garnered comparatively sparse commentary: the reformed Electronic Communications Code (the 'Code'). The Code regulates the legal relationship between landowners/occupiers of land and telecommunications operators who seek rights to locate electronic communications apparatus on land. The Code is expected to come into force by the end of 2017.

Many hotel owners/operators generate additional income from allowing telecommunication operators to place installations on hotel rooftops in space that is otherwise not income generating. It is not uncommon to see multiple masts on hotel rooftops, each one leased to a different operator and each one generating income. For as long as the roof top is not needed, this can be a good source of income.

The Act is about to change things, and not necessarily in the hotel owners/operators interests. Rents under new agreements are going to go down, and notice periods to terminate rights of occupation increase. There will be no increase in premiums for sharing with other operators or for upgrading equipment. It is too early to tell whether the changes to the Code will create a detrimental imbalance in the relationship between landowner/occupier and operator. One thing is clear, the economic benefits of having telecommunications on your rooftop are about to change.

We summarise below some of the biggest changes to be aware of.

Reforms: Valuation

One of the most fundamental changes to the Code is the altered methodology for valuation. It is here that the Government identifies scope for incentivising investment in the UK's telecommunications infrastructure. Currently, most operators pay a market rent negotiated between the parties. Going forward, the Government wishes to clarify its view that landowners should not be entitled to a share of the economic value created by the services an operator offers. Instead, the consideration is to be valued on a 'no scheme' basis. No value will be attached to sharing rights and other benefits. This means that where you had previously enjoyed enhanced payments from multiple operators, now one operator will be able to share with multiple operators and only pay once.

The new approach to calculation looks to reflect the underlying value of land on the basis of compulsory purchase principles. In this sense, it brings valuation in line with the system used for domestic utilities and providers of other essential services. The land value is to be assessed according to its value to the site provider (i.e. the landowner or occupier) as opposed to the operator.

Reforms: Site Sharing

In a big change from the current Code, the Government has decided to confer automatic rights to upgrade and share apparatus. It will now be possible for operators to upgrade their equipment and share their sites without the permission of a landowner. This applies to all new agreements entered into once the new Code comes into force. The intention is to allow operators to make the best use of sites across their portfolio, without additional cost considerations.

However, this is a drastic change for landowners who have previously been able to restrict sharing arrangements and upgrades, whilst negotiating at arm's length with the operators for such rights. Whilst landowners will be given new powers to require details of who is on the land and what equipment, it will be a new concept for many landowners who will find they cannot restrict occupation. As the Code will enshrine assignment rights, there will no longer be the opportunity for landlords to negotiate new terms and rent increases in the event of equipment and lease assignment.

> *The new valuation scheme, combined with an inability to contract out of the Code and lengthy termination rights, places landowners in a weaker position.*

Terminating Code rights

In another major change, removing operators from rooftops will become more protracted. Currently the termination mechanism under the existing Code is such that the operator, on receipt of a notice, has 28 days in which to serve a counter-notice. Under the new Code, however, the time periods for termination are to be significantly extended. The reformed provisions require site providers to serve a notice specifying the date at which the agreement is to cease, being no less than 18 months from the date of notice. In tandem, the period allowed for the serving of a counternotice is to be extended to three months.

These altered termination provisions are clearly far more burdensome. Therefore, if hotel operators/owners have development plans that involve the roof, longer lead-in times will be required to ensure operators can be moved.

CMS Comment

There can be little doubt that the previous Code was in need of reform: the nature and role of digital communications has changed radically since its introduction. The Act seeks to make it easier for operators to roll out electronic communications apparatus and infrastructure, allowing for improved coverage, improved capability and improved capacity.

On the face of it, this weighting in favour of operators ought to be welcome news to commercial providers. However, it could also be considered unfortunate that the Government has not taken the opportunity to strike a different balance between operators and landowners. Since 1984 operators and landowners have found ways of working together. Operators are now sophisticated, well-advised corporates. Deals are reached. The new valuation scheme, combined with an inability to contract out of the Code and the lengthy termination rights, places landowners in a weaker position than that in which they had found themselves under the previous Code.

The new provisions will apply to all new agreements reached after the coming into force of the Code. Some of the new provisions will apply to existing agreements e.g. the termination provisions. If you need advice on the current position on any mast agreements you have and the impact of the new Code on your hotel operations then please do not hesitate to contact the writers.

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Hotel hot topics

UK: Lease or licence? Still an important distinction

The UK courts have re-confirmed that a licence to occupy does not grant the occupier a proprietary right. This decision is relevant to retail and F&B occupiers, in hotels and leisure centres that only have a short-term licence, rather than a lease of their premises.

For more information, please visit: http://bit.ly/2wZtAe9

UK: Business rates – finally some good news for a rate payer

A recent case issued is likely to have a significant positive effect on rates liabilities for owners and developers of property which is the subject of refurbishment or redevelopment.

For more information, please visit: http://bit.ly/2yuFNuM

Netherlands: Notification requirement holiday rental

The Amsterdam Housing Regulation has been amended in an attempt to curb the growth of Airbnb and similar platforms and to accommodate rising concerns around illegal hotels and the nuisance that they create for the city's residents. The amendment becomes effective on 1 October 2017.

For more information, please visit: http://bit.ly/2ym8ji5

Netherlands: Heineken Hoek Hotel on hold

On 3 October 2017, the court of Amsterdam annulled the permits to construct a hotel on the premises of the Amsterdam landmark 'Heineken Hoek'. The court ruled that because the building permit was granted in conflict with the policy rules for hotel developments of the municipality, the environmental permit should not have been granted until the building permit was final.

For more information, please visit: http://bit.ly/2iiim22

Poland: Hotel investments – new challenges for advisors

Poland has considerable potential for further growth. Between 2006 and 2015 the number of hotel night stays increased by 86 percent and boutique hotels are thriving. However, as most administrative permits in Poland are not transferrable, it is crucial to structure a hotel transaction with great precision, especially regarding the time schedule and sequence of actions.

For more information, please visit: http://bit.ly/2tTVaLh

Italy: New merger filing thresholds in Italy

From 29 August 2017, the new law on market and competition has enforced new filing requirements on mergers – most predominantly affecting the creation of a fully-functioning joint venture.

For more information, please visit: http://bit.ly/2i9JMHq1

Viceroy Palm Jumeirah: a spark to ignite a future of HMA terminations?

Could the heated dispute between operator Viceroy Hotel Group and owner Five Holdings over the Viceroy Palm Jumeirah Dubai spark a trend away from the historic 'hand-shake' terminations of HMA?

Termination Rights

It is well established that branded HMAs will always be subject to stringent termination provisions. Generally, owners will only be given the right to terminate on failure of an explicit performance test or on a material breach being committed by the operator. Some operators will agree to termination upon payment of liquidated damages, but generally this is only exercisable on certain milestones and the liquidated damages payable tend to be substantial. Breach by the operator, despite detailed provisions in the HMA, is tricky to prove in practice, even in respect of a breach of the performance test. This is largely down to the unique nature of the HMA, with shared responsibilities, particularly where employees are employed by the owner but act under the directions of the operator, blurring the lines on which party should be held responsible.

It has long been established that owners must accept such stringent termination rights. In the event the owner wishes to terminate an HMA, the preferred approach tends to be negotiations with the operator behind closed doors, if possible. With the reputation of both parties at stake, particularly in respect of well-known assets, it makes sense for both parties to keep a low profile in the event of any disputes.

Five Holdings vs Viceroy Hotels Group

This was not the approach followed by the owner of the Viceroy Palm Jumeirah. Whilst the exact nature of the breach has not been reported, reports state the owner has sought to forcibly extract Viceroy as manager of the hotel due to breach of the HMA. It has been reported that the initial measures taken by Five Holdings (as owner) included the physical removal of Viceroy's management from the hotel and the removal of the Viceroy signage and branding of the hotel. Viceroy immediately sought (and was granted) an injunction prohibiting the owner to take any action that would prevent Viceroy exercising its 'exclusive authority to manage and operate' the hotel. Five Holdings responded by filing a case with the Dubai Joint Judicial Committee to have the HMA declared null and void. The situation remains unresolved, with the hotel continuing to run under the Five hotel brand. Whilst historically the operators have generally had the 'upper hand' in negotiations, recent years have seen some pushback from owners. Depending on the nature of the operator and the asset, owners will have more or less freedom to negotiate strict termination provisions. We have seen an increase in the breadth of termination provisions available, both through the traditional performance test provisions, and with specific rights to terminate upon the occurrence of certain events or at set times during the term of the HMA. We have also seen particularly novel provisions, such as the right to convert to franchise with the same operator during the term of an HMA.

> *With the hotel only having been open for a matter months, the case highlights the importance of careful drafting of the termination provisions in HMAs.*

Comments made by Five Holdings in the press also refer to the desire for owners to retain management rights, allowing them closer control and lower costs. This fits in with a general trend in the industry away from the management model to a franchise model.

Franchise models also enable owners to use third-party 'white label' operators to provide management services, often on a more cost-effective basis with shorter terms and easier termination options.

Termination Options

In the event that owners wish to terminate an existing arrangement with an operator, they should consider their options carefully.

Firstly, the owner will need to consider whether termination is in fact the best option. Given the owner's obligation to pay for any rebranding and redevelopment of the hotel to cater for a new operator, it often makes financial sense to continue with the existing operator when possible. Mechanisms can be put in place and agreed between owner and operator to improve performance and remedy breaches to ensure the better performance of the hotel going forward.

Secondly, the termination provisions in the HMA will need to be carefully considered to establish whether there is a potential cause of termination. This will seek to ascertain whether the grounds for termination are sufficient, and what the best termination provision to enforce under may be.

Subsequently, the owner will need to establish their position from a reputational and risk perspective. Other than reputation, the main risk involved in the owner forcibly removing an operator is a substantial claim for damages by the operator, should it be shown the termination was wrongful. Depending on the jurisdiction, the operator may also request their reinstatement at the hotel (which could lead to damages being payable elsewhere if an agreement has been signed with an alternative operator).

The potential level of damages the operator could claim, as well as associated legal costs, needs to be carefully assessed against any liquidated damages provisions in the HMA (if present) when determining the best approach to take. The owner will also need to consider the timing and cost implications of bringing litigious proceedings, or indeed entering into any formal dispute resolution process.

Lastly, the owner will need to take into account their relationship with the operator in the future (particularly if it holds other assets).

CMS Comment

Whilst the dispute over the Viceroy Palm Jumeirah serves as a useful reminder that there remains the potential to forcibly remove hotel operators, we do not believe there to be a high risk of increased litigation among owners and operators. The risks associated with this approach are considerable, and it is generally much more favourable for both parties to resolve any dispute outside of formal proceedings. Given the importance of reputation in the hotel industry, both for the parties involved and the asset itself, it makes sense to maintain face and deal with issues outside of the public eye.

There does appear to be an increasing trend for franchise models, and we believe that the trend for white label managers in the US and UK will spread in Continental Europe and the Middle East. We are already beginning to see an increased interest in such operators with the Middle East.

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Recent hotel credentials

Indigo Bath

Advised Clydesdale Bank on the refinancing of the development by the Somerston Group of an Indigo Hotel in central Bath which are subject to a sale and leaseback arrangement with Nationwide Pension Fund.

Roomzz Aparthotel Edinburgh

Advised TH Real Estate on an agreement for construction and lease of a 73 room Roomzzz Aparthotel as part of the Edinburgh St James mixed use development. The overall development is valued at £1billion.

Lyndene hotel, Blackpool

Advised private individuals on the sale of the Lyndene Hotel in Blackpool to Singapore buyer Fragrance Group. The hotel was the largest independently owned hotel in Blackpool.

Generator Hostels

Advised Patron Capital on the sale of Generator Hostels to Queensgate investments for an enterprise value of c.€450 million, comprising 14 hostels (12 operational and two under development).

London Hilton Hotels

Advised Maple Hotels on the separate £115 million sale of Hilton London Kensington Olympia to HPL and the sale of Hilton London Gatwick Hotels to the Arora Group.

Lone Star and Amaris Hospitality

Advised Hudson Advisors, Lone Star and Amaris Hospitality on the separate disposals of the Mercure Bristol Holland House Hotel, the Brandon Hall, Hotel and the White Hart Hotel, Salisbury.

LFPI Hotel Portfolio

Advised on the sale-and-leaseback of ten hotels in Germany and France within the context of a structured bidding procedure.

Belambra Club

Acquisition of the Hôtel du Golf, a renowned hotel located in Arc 1800, a famous ski station in the French Alps.

Hyatt Place, Schiphol

Advised Hilgate Properties and Volker Wessels on the €53.8 million sale of the Hyatt Place Schipol to Avignon Capital.

Hotel Lebenberg, Kitzbühel

Advised on the purchase of the famous Hotel Lebenberg Kitzbühel, Austria, and the re-negotiation of the hotel lease agreement.

Holiday inn/HIE Aberdeen

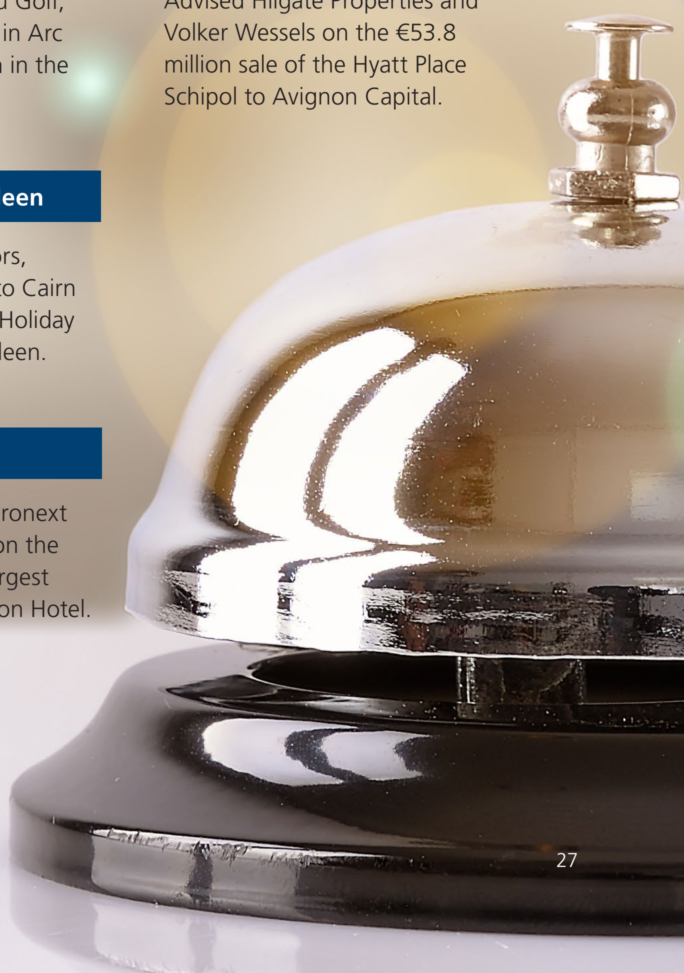
Acted for the administrators, FRP Advisory, on the sale to Cairn Group of Holiday Inn and Holiday Inn Express, both in Aberdeen.

Melià Hotels International

Advised Melià Hotels on two hotel management agreements with private Italian hotel group for a new Gran Melià hotel in Venice and a new Innside by Melià hotel in Rome.

Sheraton Brussels

Advised Prime City, the Euronext quoted investment fund, on the acquisition of Belgium's largest 500+ room former Sheraton Hotel.



UK tenants find rights of renewal harder to secure

This summer the UK High Court ruled that a landlord's development scheme, devised with the sole purpose of defeating a tenant's security of tenure, effectively defeated a tenant's right of renewal.

The decision in *S Frances Limited v The Cavendish Hotel (London) Limited* is a further illustration of the low threshold for landlords to oppose tenants' purported protections under the Landlord and Tenant Act 1954 (the 'Act') The decision highlights this statutory protection is not as secure it may appear and hoteliers who are tenants are better protected by other means, such as options to extend and renew.

The Facts

S Frances is the tenant of a retail art gallery within the Cavendish Hotel. The tenancy has the protection of the Act which permits tenants to remain in their premises following lease expiry and request that the landlord grants a new lease on the same, or similar, commercial terms (subject to reasonable modernisation). Landlords may oppose such applications on various grounds specified in the Act and Cavendish did so under section 30(1)(f) of the Act citing its redevelopment proposals to convert the art gallery into two retail units. Such redevelopment, Cavendish argued, would not be possible without the removal of S Frances. Evidence of a written undertaking was provided to the Court to show Cavendish's intention to undertake and complete the works which were calculated to cost Cavendish over £700,000.

However, the package of works was devised, as admitted in Court by Cavendish, with the intention only of satisfying ground (f) to achieve the eviction of S Frances. There was little to no regard by Cavendish as to the practicality or commerciality of the works, which, for example, included demolishing internal walls only for these to be immediately replaced with similar walls. Cavendish admitted that the works would not be undertaken had S Frances not been in occupation and it was even found that the proposed scheme could not lawfully, on planning grounds, be used.

S Frances argued that, in view of this and other factors, to allow such circumvention of the Act would be to go against the Parliament's intention. If a landlord can devise a package of works to secure the eviction of a tenant, and then subsequently reverse the works undertaken, the inherent protection of the Act is called into question.

Intention v Motive

The High Court took the view that the Courts should be concerned only with intention, and not motive. If a landlord has a genuine intention to undertake substantial works (and can provide suitable evidence of its intent) this is sufficient for the purposes of the Act. On the facts, the undertaking offered by Cavendish was persuasive. The Court considered that its role is to consider what a landlord intends to do and whether he intends to do it, not why he intends to do it. There need not be a genuine motive to undertake the works.

What does this mean?

The current law remains clear – so long as a landlord can evidence its intention to undertake its proposals (whatever these may be), its motive remains irrelevant. To many, this is worrying in creating the possibility for landlords to contrive unrealistic and artificial schemes to defeat a tenant's rights to renew. Protection and 'security' appears illusory and is not always guaranteed.

Given the importance of property assets to hotel and restaurant operators in particular, the case calls into question whether the Act provides sufficient protection and/or whether operators should require options to extend and renew, rather than rely on the Act. Nearing expiry of a lease, the allure of an objective and agreed approach to extending the lease term by way of a guaranteed option or procedure for renewal is no doubt appealing to most.

Whilst the current law remains as is for now, S Frances has been granted leave for a leapfrog appeal to the Supreme Court. Despite there being no guarantee that the Supreme Court will take the case, any Supreme Court decision would be an interesting one for both hotel and restaurant owners and operators alike.

This outcome is similar to the relatively recent decision of *Humber Oil Terminals Trustee Limited v Associated British Ports* in which the landlord successfully opposed the tenant's statutory right to renew using ground (g) of the Act (an intention to occupy the premises, or part of the premises for the purposes of a business) notwithstanding that there seemed to be significant practical issues and limited economic sense in the landlord taking back occupation for that business. Pertinent to hotels, that case also decided that a landlord itself can satisfy ground (g) where the landlord intends to outsource the management of the business to a third-party operator.

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Upcoming events

HICAP - Hotel Investment Conference Asia Pacific
18 – 20 October 2017, Hong Kong

Hotel Owners Conference
Thursday 19 October 2017, London
(invitation only)

World Travel Market, International Travel Trade Show
6 – 8 November 2017, London

Deloitte European Hotel Investment Conference
Wednesday 8 November 2017, London
(invitation only)

Henry Stewart: Hotel Finance, Investment and Development Conference
30 November 2017, London

ALIS - The Americas Lodging Investment Summit
22 – 24 January 2018, Los Angeles

International Hotel Investment Forum
Monday 5 – Wednesday 7 March 2018, Berlin

MIPIM
Tuesday 13 – Friday 16 March 2018, Cannes

Hotel Investment Conference, South Asia
4 – 5 April 2018, Mumbai

Arabian Hotel Investment Conference (AHIC)
17 – 19 April 2018, Ras Al Khaimah

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