HOTEL INVESTMENTS BOOT CAMP

Key Business Terms / Concepts in Major Hotel Agreements

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Management Agreements:

- **Term**: Management agreement terms vary from 1 year to 50 years; often have automatic extensions; Independent management companies usually have much shorter term than brand managed companies

- **Base Fee**: Base fees are typically structured as a percentage of total revenue; usually 3%-4% of revenue for full service and 4% of revenue for limited service

- **Incentive Fee**: Incentive fees are usually structured as a percentage of income in excess of a certain GOP (Gross Operating Profit), or as a percentage of income in excess of a preferred return on owners invested capital

- **Termination Fees**: Brand managed assets usually have substantially greater termination fees than independent management contracts; termination fees can range from the remaining term of the contract down to no fees; independent management contracts usually have a sliding scale starting at 3x prior year fees and reducing to 1x

- **Change of Control**: Most management agreements are not assumable; so new owners have to work through similar economics with an existing or new manager; often the ability to acquire a hotel unencumbered by management, increases the pool of investors and reduces the cap rate by 50 to 100 bps

KEY BUSINESS TERMS / CONCEPTS IN AGREEMENTS – FRANCHISE AGREEMENTS

Franchise Agreements:

- **Term**: Typically 20 years, but often 10 years
- **Royalty Fee**: Range from 4% to 6.5% of gross rooms revenue, and for some franchisors from 0% to 3% of Food and Beverage Revenue
- **Marketing / System Fee**: Usually about 4% of gross rooms revenue
- **Fee Ramp Up**: For new investors / buyers making significant capital improvements, common to see some reduction in earlier year royalty fees
- **PIP**: Property improvement plan; required by a franchisor on change of ownership of an asset; designed to bring the hotel up to current brand standards; PIP is written based on a certain scope and not with specific dollar amounts.
- **Termination Fees**: Payment required to exit a franchise agreement, either voluntarily or based on a sale of the asset

KEY BUSINESS TERMS / CONCEPTS IN AGREEMENTS – FRANCHISE AGREEMENTS CONTINUED

Franchise Agreements:

- **Liquidated Damages**: If franchise is terminated prior to term, there is a liquidated damages calculation
- **Radius Restrictions**: Limitations on where the franchisor can grant another franchise
- **Key Money**: Usually structured as a forgivable loan that self-amortizes over the life of the underlying franchise agreement; can be very valuable to owners as it replaces equity that otherwise would have been invested in a deal
- **Debt Restrictions**: Some stronger franchisors impose certain covenants or limitations on debt financing for their franchisees
- **Change of Control**: Franchise agreements are usually not assumable so the new asset buyer must negotiate a new franchise agreement with the franchisor

KEY BUSINESS TERMS / CONCEPTS IN AGREEMENTS – JV EQUITY AGREEMENTS

JV Equity Agreements:

- **Equity Contribution**: Majority equity partners will want sponsors to have enough “skin in the game” to align interests
- **Asset Management Fees**: Sometimes structured as % of revenue; sometimes structured as % of asset value; used to offset costs of overseeing the assets and the venture
- **Preferred Returns**: Most JV agreements with private equity sources have preferred returns to capital invested, before the sponsors receive a promoted interest
- **Promotes**: Promote structures take many forms, but are utilized to prevent outsized incentive compensation to deal sponsors for strong returns and performance
- **Splits**: Some deals are structured with splits in lieu of promotes; the splits simply govern how net cash flows are allocated to the partners
- **Financing / Refinancing**: Decisions on financings are critical and heavily drive the potential returns to JV partners and the promotes to the sponsor

KEY BUSINESS TERMS / CONCEPTS IN AGREEMENTS – LOAN AGREEMENTS

Loan Agreements:

- **Rate**: Can be fixed or floating
- **Amortization**: Typical to see 25 year amortization for hotel loans, some have 30 year, and for lower leverage loans, some may have no amortization and are interest only
- **Term**: If a CMBS 10 year is most common for fixed rate loans, followed by 5 year loans are most common for floating rate CMBS, and they are typically structured as 2 year loans with 3 year extensions
- **Points / Fees**: Fixed rate loans typically have no origination fees; floating rate loans will usually have 1 point origination fees
- **Prepayment**: Floating rate loans will typically have some lockout period during which the loan may not be prepaid, followed by yield maintenance

Loan Agreements:

- **Defeasance**: Substitution of U.S. government securities as collateral for a property removed from a loan; fixed rate loans will typically require defeasance to exit the loan

- **Yield Maintenance**: Designed to keep a lender indifferent between keeping a loan outstanding and paying it off; calculated as the present value (usually using the Treasury rate as the discount rate) of all of the future debt service payments, less the outstanding principal balance