Client Alert

January 2024

Branded Residences

In brief

It was 2016 when we last published a newsletter on this topic in a prior newsletter "Branded Residence Developments in Asia – exploring the complex and potentially lucrative relationship between developers, residential owners and operators."

In the intervening period, we have worked on many more branded residence developments ("**BRDs**") all over the world including Australia. BRDs can be distinguished from hotel management agreement ("**HMA**") arrangements in at least three ways:

- It is an entirely different business to hotel management and comes with the potential of significant rewards for both owners and operators but also significant legal exposure for both parties.
- BRDs are inherently more complicated than hotel management arrangements involving a range of parties including the operator, the hotel developer/owner, the branded residence developer (who may be the same entity as the hotel developer or one of its associated entities) and the purchasers/owners of the branded residences ("**BRs**").
- Negotiations are generally less adversarial than HMA negotiations with the majority of the negotiating time devoted to the legal and other advisers working collaboratively to ensure that the standard brand residence structure used by the operator throughout the world works within the strictures of property and other laws of the host jurisdiction.

We strongly advise that you read the prior newsletter (and the HICAP Master Class presentation to which it refers) as this newsletter updates and develops the information discussed in that newsletter.

Lastly, we also provide a link to the Branded Residence Report – 5th Edition published last year by Graham Associates. This publication is arguably the most comprehensive dissertation on the topic we have reviewed. We strongly recommend that you have a look at it as well.

As with all our newsletters, the views expressed herein are solely those of the author.

In this issue

Let's dive into the detail

As mentioned above, a good starting point is to compare BR negotiations with HMA negotiations. The three key differences are:-

1. **Two completely different businesses with two completely different risk profiles**

   The single legal relationship regarding hotel management involves the operator providing services to the owner (e.g., operational supervision of hotel employees, the provision of a hotel brand, centralised services such as reservations, training hotel employees, customer surveys and the like and bespoke technical advice and assistance). In consideration the operator receives various fees calculated in various ways. The operator's business risk is relatively low and mainly concerns the prospect that fees are not paid when due or not at all.

   By comparison, the multiple legal relationships applicable to BRDs are far more complex and nuanced and may involve all or some of the following legal documents:-

- **Marketing Licence Agreement ("MLA")** - the operator contracts with the BR developer to provide its brand in return generally for a percentage of the sale price of each BR (or the rent received on a BR if the developer decides not to sell all the BRs as part of a single sales campaign).

  Pursuant to the Radisson Suites case [https://www.queenslandjudgments.com.au/caselaw/qca/2005/199], an operator may in certain circumstance be liable for the misdeeds of the BR developer if a reasonable person in the shoes of a potential or actual BR purchaser could assume that the operator is closely linked to the developer's BR sales programme. This is perhaps the most significant element of business risk that distinguishes the operator's role as part of a BR sales programme as opposed to the operator's business risk attributable to the provision of services pursuant to a HMA.

  The principles enunciated in the Radisson Suites case create the strong inference that the case will be influential in any court proceedings not only in Australia but internationally as well. It is a powerful decision and we strongly recommend that any operator seeking to embark on a BR transaction should study the judgement closely. We have written extensively on the case and invite you to reach out should you wish us to provide you with a copy of this material.

- **Trademark Licence Agreement** - the operator contracts with an entity representing the BR owners (which may be a statutory entity variously known as an owners' corporation or a body corporate (hereinafter generically referred to as the "**OC**") or some other representative entity) to licence the relevant brand in return for a fee. If the BRs consist of a vertical development such as a multi-story building then this would allow the brand to be displayed on the side and/or the roof of such building. If the BRs consist of a horizontal development such as multiple villas or bures then the physical aspect of the branding could be used in other ways (such as at the entry point to the BRD as a whole).

  The approach we usually advocate when we are acting for the operator is to ensure that the TLA contains very stringent provisions which allow the agreement to be terminated by the operator if the OC breaches the agreement and fails to remedy the breach(s) within a specified time period. This then gives the operator the comfort that if the OC fails to comply with its obligations under the TLA (e.g., fails to pay relevant fees or comply with applicable brand standards) then the TLA can be ended, the signage and the relevant rights relating thereto can be removed and the operator can walk away from the BRD with minimal, if any, brand damage. We prefer this course to the alternative which is to incorporate into the TLA a cure regime in circumstances where any court action contemplated by the operator or actually undertaken will be against a defendant OC which generally has little or no financial worth (with litigation often needing to be funded by special levies) and which is controlled by a group of BR owners who are potentially ill-equipped to deal with the types of decisions that such litigation typically calls for. In short our advice to such operators in such circumstances is "cut and run" rather than "stand and fight".

  The operator rarely if ever provides a licence to any of the BR owners to use the brand. If the BR owner wishes to sell or rent or otherwise needs to describe its BR then it usually does so by refence to a description along the following lines – "For sale (or lease) a residence in the "X" (reference to brand) building." The reference to the brand generally cannot be stylised or in any manner incorporate the trademarked form of the brand or any aspect thereof.

- **Hotel Services Agreement ("HSA")** - the hotel owner contracts with the OC to provide various services including:-

  - caretaking and maintenance services (for which a fee is paid to the hotel owner by the OC);
  - a la carte services to the BR owners and occupants (for which a specific service related fee or charge is paid to the hotel owner by the specific person receiving the service (e.g., housekeeping, maintenance of the specific apartment, room service etc.)).

- **Rental Program Agreement ("RPA")** – there are usually multiple individual agreements between a specific BR owner and the hotel owner effectively making the BR available for use as hotel inventory at specific times and on specific terms. There may also be provisions in the HSA to facilitate the orderly operation of the rental programme.

  A BRD may be structured with a mandatory or discretionary rental programme. A discretionary programme is more common than a mandatory programme because it gives the BR owner the choice to participate in the rental programme, to rent out its BR independently on either a short term or long term basis or to not rent it out at all. The availability of this choice as to how the residence can be used is generally considered the best way to maximise the price at which the BR can be sold by the developer as well as subsequent sales.

  It is usual for the hotel owner to require that a BR which is earmarked for participation in the rental programme contains furnishings consistent with a furniture pack authorised by the hotel owner (in conjunction with the operator).

In certain jurisdictions the availability of a rental programme may trigger the applicability of securities laws which may carry significant criminal and civil penalties if breached.

- **Hotel Management Agreement ("HMA")** - as mentioned above, the hotel owner contracts with the operator to provide services with respect to the hotel in return for a fee. The HMA may contain various provisions in relation to the BRD. With respect to the HSA services, the operator may be remunerated by virtue of its relationship with the hotel owner pursuant to the HMA with the fees and charges paid by the OC and the BR owners and occupants forming part of gross revenue for the purposes of the HMA. Alternatively the operator may seek a separate and distinct fee from the hotel owner to supervise the provision of the hotel owner's services under the HSA in which event the fees and charges paid by the OC and the BR owners and occupants would be specifically excluded from gross revenue for the purposes of the operator's fee calculation under the HMA.
- **Technical Services Agreement ("TSA")** - The hotel developer/owner and BR developer contract with the operator to provide technical assistance in relation to the construction and fit out of the hotel as well as the BRD in return for a fee.

We attach at the end of this newsletter a diagrammatic representation of a typical consolidated document trail for a BRD.

2. **BR negotiations are inherently more complicated than HMA negotiations**

As may be self-evident from the discussion under the previous heading, structuring a BRD is not for the faint hearted and it is immeasurably beneficial that the relevant players have advisors that understand the intricacies of the documents needed to put these developments together.

Operators usually know the ropes and not only have in house lawyers that are highly experienced and know the template BR documents intimately but also engage competent external lawyers to advise upon the intricacies of local laws – particularly property structuring, securities, consumer protections and foreign investment.

Owners (in their capacity as the hotel owner and the BR developer and vendor) equally will be rewarded by engaging competent advisors (both commercial and legal) to negotiate the multitude of complex issues that the documents used to establish these developments need to deal with.

3. **BRs are much more jurisdictionally specific**.

HMAs are usually prepared and used as global precedents and adopt a "one size fits all" approach as deals are done from jurisdiction to jurisdiction with relatively few, if any, modifications to accommodate the legal requirements of any specific jurisdiction.

BR template documents, by contrast, need to be tweaked significantly to comply with specific jurisdictional issues.

The starting point is to determine whether local laws provide the opportunity to create an OC. This entity usually has control of the BRD common property and is owned and controlled by the BR owners. Common property would usually include entryways, front of house and back of house (to use hotel terminology) lifts, hallways which permit entry into each of the residences, all external surfaces including the roof, car parking and service areas. It usually has statutory powers to regulate activities conducted in the common property. Such an entity is very convenient to contract with – the TLA and the HSA being prime examples. If a rental pool is contemplated then the HSA will include provisions to deal with the orderly operation of the programme to the extent that it relates to the common property, noting that such documents will often be overlaid with other jurisdiction-specific documents such as building management statements or OC by-laws.

In jurisdictions where local law does not recognise such an OC like entity then an alternate means of dealing collectively with all the BR owners needs to be devised. It may be some form of owners' representative acting as agent for all the BR owners. Such an approach is usually more cumbersome and complicated than where an OC can be contracted with but ultimately appropriate documents can be put in place to achieve the same outcome as dealing with an OC.

Key issues

Whilst each BRD needs to be approached on a bespoke basis, there are a few issues which tend to crop up time and time again. These include:-

- **Will the BRD be stand alone or located adjacent to a "related" hotel?**

A BRD located adjacent to a "related" hotel has the benefit of accessing the hotel's services to augment the guest experience of the BR owners and occupiers. This would principally be access to hotel facilities such as a gym, swimming pool, saunas

etc. Also there is usually access to a la carte room service and other food and beverage amenities. Importantly the BR owners may have the ability to participate in a rental programme as discussed above.

Self-evidently a stand-alone BRD would not have access to the abovementioned hotel services, facilities and amenities. To a certain extent substitute service offerings and arrangements can be put in place. For example, arrangements can be made to access a nearby gym or swimming pool (if not included as part of the BRD which would generally be the case). Food can be delivered to any of the BRs by using one of the many delivery services currently on offer. A rental pool arrangement can also be made available as between those of the BR owners who wish to participate. This can be operated by the BR developer or a duly appointed licensed leasing agent.

The choice as to whether a BRD is stand alone or attached to a "related" hotel is generally a commercial decision based on factors such as land availability, zoning, as well as highest and best use considerations.

- **Will the BRs compete with the hotel as a short term letting facility?**

  This is usually a major commercial consideration. Generally speaking where there is a BRD adjacent to a "related" hotel, the hotel owner and operator are keen to ensure that the BR owners do not operate a short term letting operation in competition with the hotel. To some extent this can be alleviated by offering BR owners participation in a hotel rental pool. To the extent that a BR owner elects not to participate in a hotel rental pool, the hotel owner and operator usually are not entitled to prescribe that such BR owner cannot separately engage in short term letting.

  Of course, it is generally the case that the hotel owner and operator make participating in the hotel rental pool attractive, thus minimising the prospect that the BR owner will act independently. Also, other practical steps can be taken in respect of the common property to make it unattractive for any BR owner to go down the independent letting route.

- **Should the rental programme income be pooled or not?**

  This is a commercial decision and is generally BRD specific.

  For example if there is a high rise BRD with some BRs enjoying spectacular views and other BRs having relatively ordinary views then pooling is generally not pursued. The owners of the "spectacular" BRs may consider that they are being short-changed especially if such owners were required to pay a purchase premium on account of the view.

  In a building where all of the residences are by and large of equal value (e.g., sold for roughly the same price, substantially similar physical size and amenity) then pooling may make more sense.

  As mentioned above in some jurisdictions the availability of a rental programme, whether pooled or not, may constitute a regulated security. Failure to comply with the relevant security laws can attract substantial civil and criminal penalties.

- **Strata title restrictions**

  Strata title laws are generally jurisdictionally specific and need to be understood in detail before setting up a BRD in the relevant jurisdiction.

  We have mentioned above that generally it is very difficult if not impossible to regulate the interior of a BR and this extends to placing any restrictions on the ability to undertake short term accommodation letting (subject to local planning restrictions).

  Certain jurisdictions also place controls on any contracts which are entered into by the OC while the developer is in control (during the initial ownership period before ownership transfers to each individual owner) including agreements such as the TLA and the HSA. Once the BR owners gain control of the OC there may be scope to terminate or vary all or any of the developer driven agreements.

Summary and conclusions

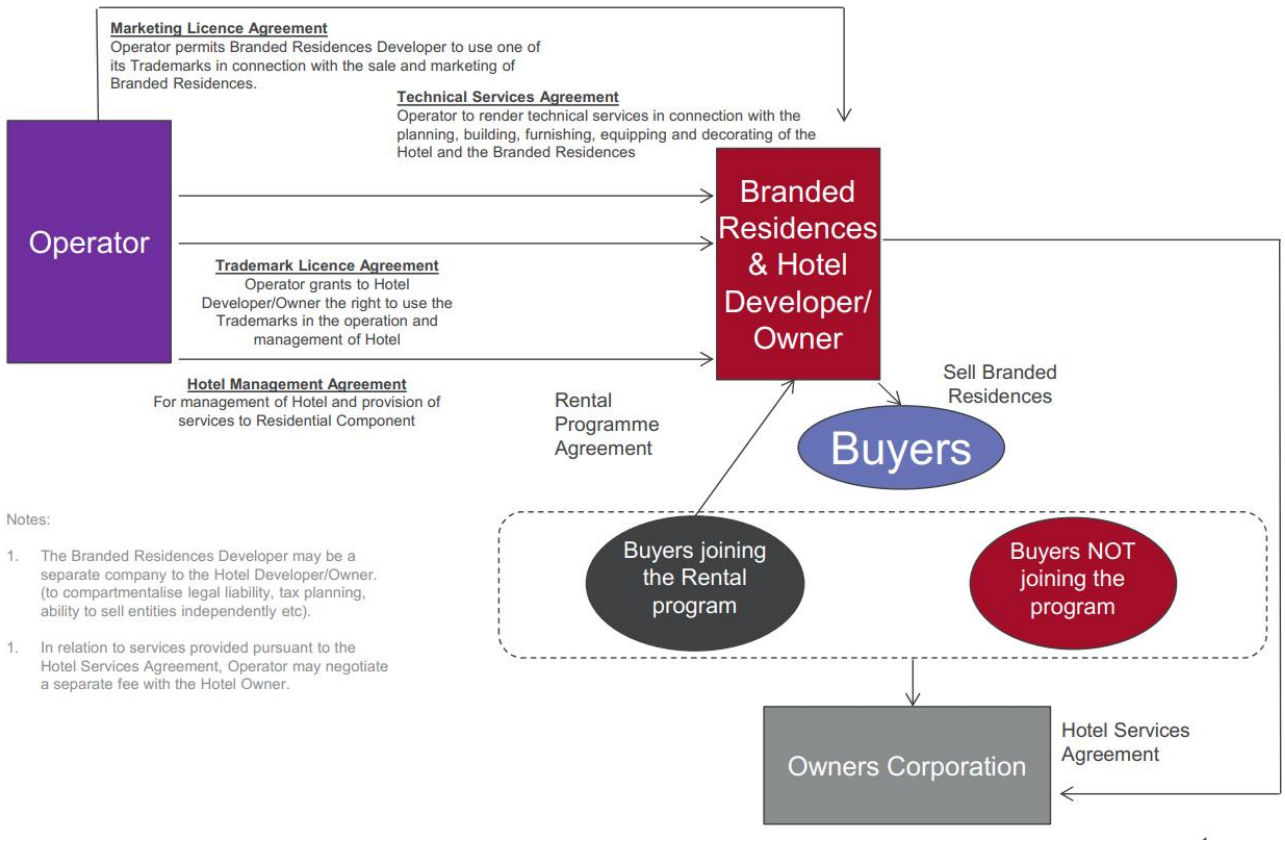
BRD transactions are fundamentally different to HMA transactions and need to be viewed through a completely different lens. An operator can potentially earn substantial fees but must also recognise that brands can be put at risk and significant damage inflicted.

Like HMAs, BRDs and the issues that need to be confronted continue to evolve at an ever quickening pace as the sheer number and geographic reach of these developments continues to increase at exponential pace.

BRDs bring together the combination of globally driven business models combined with the need for nimble adjustments on a jurisdiction by jurisdiction basis.

We are excited to be immersed in the world of BRDs and will continue to issue newsletters on this topic as we reflect on developing issues and themes. We trust that you enjoy reading them as much as we do producing them.

Structure of a typical Branded Residences project which is located adjacent to a "related" Hotel in a jurisdiction where the law recognises an Owners' Corporation



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