



INTERNATIONAL ASSOCIATION OF YOUNG LAWYERS

Hotel Projects for the next generation: What are the key factors for foreign investors in order to ensure a successful running hotel business?

Commission in charge of the Workshop:

REAL ESTATE COMMISSION

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GENERAL REPORTERS

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Introduction:

In general, new hotel projects nowadays really change the daily life and the face of a city. Suddenly, the city as a whole is upgraded to a new stage of growth and status of prosperity, often combined with spectacular next generation urban architecture style. As a result, and as AIJA people perfectly know, 21st century networking, recreation, business and socializing places are born that inspire us and often allows us to celebrate unforgettable events as a genuine leap into the future of our profession.

For the Annual Congress 2015 in London, the Real Estate Commission is planning to prepare a Workshop with the hot topic *“Hotel Projects for the next generation: What are the key factors for foreign investors in order to ensure a successful running hotel business?”*. Our aim and wish is to compare and share views from different jurisdictions with regard to transactions types, market situation, legal and common hotel business structures and, last but not least, we would like to discuss the effects of the financial crisis in that context.

Below you will find a list of questions related to these aspects. Please try to answer as many questions as possible. If you have any questions, please do not hesitate to contact the responsible General Reporters!

I.- MARKET SITUATION / TYPE OF TRANSACTIONS / MIXED USED TYPE

1.- Give a brief overview of the hotel sector market situation in your country (or region): Specifically, what are the current trends and/or what are the main targets for investors? What are the general expectations for the near future?

On a macro level, the number of arrivals has been improving after being negatively impacted by the latest global economic downturn. The number of total arrivals decreased in 2008 and 2009, when such trends hit the bottom and then the trend reversed. 2011 as well as 2012 registered an increase in arrivals of more than 5% each year. Out of all arrivals in 2013, more than 50% were represented by foreigners¹.

¹ Source: Czech Statistical Office



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This trend is expected to continue and the addition of further room nights in the market is affirmed by the recent acquisition of Czech Airlines by Korean Air who have selected Prague for its European hub².

Prague is by far the most important hotel market of the country. The international hotel groups represent a considerable portion of the hotel supply in Prague; more than 400 hotels within the 3 to 5-star hotel categories are being recorded in Prague, accounting for c. 32,963 rooms. Only 99 of the hotels have more than 100 bedrooms, the largest hotel is the Top Hotel Praha, which is a 4-star congress hotel with 810 rooms, closely followed by the 5-star 791-room Hilton Prague³.

New construction projects systematically decreased from 2008 whereas in 2011 no new hotel was opened in Prague. The available sources mention the following openings of new hotels in Prague: in 2008 8 hotels, accounting for 1,370 rooms; in 2009 7 hotels, accounting for 970 rooms; in 2010 4 hotels, representing 343 rooms; 2011 no new hotel opening; in 2012 1 hotel of 88 rooms opened; and in 2013 4 new hotels accounting for 645 rooms. There are no hotel projects planned to open in 2015 and 2016. In 2017 4 new hotels should open⁴.

The hotel transaction market in the CEE region has followed the same trend as recorded in Western Europe. Since limited amount of capital and mainly debt is available, few hotels changed hands in 2010, 2011 and 2012. This trend is gradually reversing and in 2013 the total amount of transactions in the hotel sector reached € 185 M⁵.

PRK Partners has been involved in two by far the most important hotel transactions closed in 2013/2014 in the Czech Republic. More precisely, PRK Partners acted as the advisor to Best Hotel Properties a.s., a large publicly traded hotel property owner, in connection with the purchase of one of the most prestigious hotels in Prague – InterContinental Hotel Praha; the reported purchase price amounted to € 115 M. In addition, PRK Partners advised Northwood Acquisitions LLC, an American investment fund, in connection with

² Source: Cushman & Wakefield analysis

³ Source: Cushman & Wakefield analysis

⁴ Source: Cushman & Wakefield analysis

⁵ Source: Jones Lang LaSalle



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the purchase of another 5-stars hotel in Prague – Four Seasons Prague; the reported purchase price amounted to € 70 M.

2.- What type of transactions are the most usual in your jurisdiction (development, purchase, sale, lease, management agreement, sale & lease-back, franchise, etc.) ?

All types of transactions are being usual in our jurisdiction.

3.- Are there mixed use types (Hotel & Residential or Resort/Relaxing facilities, condo-hotels/condominium, etc.)? If so, please describe some typical schemes you know about or which you find interesting to share. Please describe pros & cons, if so, of one structure compared with others.

Most of the hotels are business/residential. No Resorts can be found in Prague. The worldwide spreading wellness hospitality is getting more and more popular in the CR and such type of hotels is increasing.

A new concept also arrived to Prague called "fusion hotel". It is a hybrid lodging concept, offering rooms of different sizes and standards (typical hotel rooms for two, typical hostel dorm rooms for 4-8, apartments and a specialty room with big bed for 8 people)⁶.

4.- Is the off-plan project always a common scheme to follow or is it an out of date concept?

It is not an out of date concept but is goes down.

5.- Are new projects involving renewable energy popular in your country? Are those more attractive than standard projects even though they are more expensive? Do they involve lots of clauses which can be considered "*condicio sine qua non*" for the signing of the contracts?

⁶ Source: Cushman & Wakefield analysis



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Yes, they are popular. But not of such an importance in case of sale/purchase. It is not, however, the popularity which increases their spread, but mainly the legal requirements which are getting more demanding (regulation and technical norms).

6.- Lawyers and Project Managers: Do they work well together or is there friction between them?

I am afraid, they cannot work well together by nature... ;-) but anyway, it is always about concrete people.

7.- Are there favorable tax or other promotion plans for resorts for elderly people in your country?

I have no information in this respect, but it is not excluded. Mainly thanks to EU funds, plenty of similar projects might be (co)financed.

II.- BUYING AND SELLING THE HOTEL BUSINESS: PLEASE DESCRIBE THE MAIN SCENARIOS WHEN IT COMES TO A HOTEL ASSET OR SHARE DEAL SITUATION.

1.- Please describe the pros & cons or simply the differences to keep in mind when the “Hotel Business” changes ownership – the answers may contain legal as well as practical aspects.

Asset deals are almost not used in any M&A transaction due to increased acquisition costs and longer time required for the effectiveness of the acquisition.

The main pros & cons as compared to a share deal are as follows:

(i) pros

- as from 1 January 2015 the so-called principle of "material publicity of entries in the Cadastral Register" introduced under the new Civil Code will start to produce its effects, i.e. excerpts from the Cadastral Register will become real proof of ownership of real estate. As a result, each acquirer of real estate (or any right in rem to such property) who purchased it against a payment and in good faith in the correctness of the relevant entry in the Cadastral Register will be protected against



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any third party claiming its ownership even if the entry into Cadastral Register was incorrect

- the buyer does not inherit undisclosed liabilities
- the purchase price, including goodwill, can be depreciated for tax purposes
- it is easier to buy a part of a business

(ii) cons

- lengthy process of registration into the Cadastral Register
- tax consequences (4% transfer tax, seller is subject to tax on any gain)
- no contracts will be transferred automatically (which makes the acquisition more complicated and burdensome)

2.- In cross-border situations: Tell us about your experience or lessons learned when it comes to local differences and how to deal with these situations (e.g. are there some peculiar legal or cultural aspects, which investors should keep in mind when they want to invest in hotel business in your country?)

I am not aware of any of them.

3.- Have you had lots of M&A transactions involving Hotel Projects in your country in the last two years?

The hotel transaction market in the CEE region has followed the same trend as recorded in Western Europe. Since limited amount of capital and mainly debt is available, few hotels changed hands in 2010, 2011 and 2012. This trend is gradually reversing and in 2013 the total amount of transactions in the hotel sector reached € 185 M⁷.

III.- HOTEL BUSINESS STRUCTURE - MANAGEMENT AGREEMENT/LEASE AGREEMENT/FRANCHISED OR ALL MANAGED BY THE OWNER?

1.- How would you describe the usual hotel business structures in your country. Who are the key parties/players involved and who is responsible for which part of the running business? (For example, in case the owner is responsible for

⁷ Source: Jones Lang LaSalle



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everything, that means he owns the building and also owns & operates the hotel business – please give a short overview.)

Large hotels in Prague are typically operated under a management agreement with an international hotel brand. There are very few hotels that are operated under a lease agreement and there are only few hotels operated under a franchise agreement in Prague as this is generally due to the lack of experienced local third party operators in the Czech Republic and the preference of international hotel companies to offer management agreements more than franchise. There are still a lot of hotels that are operated by the owning company but these are typically small hotels or hotels that are located in a secondary location and therefore would be difficult to brand⁸.

2.- In the event of a management agreement, i.e. the owner owns the building and the hotel business, what are the most important clauses or aspects to be structured or dealt with (duration, fees, liability of the management, operating risks, etc.)?

Term of the contract should be considered provided that unless the contract is concluded for a fixed term, it can be terminated at any moment and without stating any reason with a three month notice period (unless such notice period is extended by the parties). Maintenance and repair clauses seem to be of relevance as well as the operating risks.

3.- In the event of a lease agreement, i.e. the owner owns the building but not the hotel business, what are the most important clauses or aspects to be structured or dealt with (duration, rent, early termination rights, change of control clauses, pre-emption rights, etc.)?

Term of the contract should be considered provided that unless the contract is concluded for a fixed term, it can be terminated at any moment and without stating any reason with a three month notice period (unless such notice period is extended by the parties). Maintenance and repair clauses seem to be of relevance as well as the operating risks.

4.- In the event of a franchise system, what are the most important clauses or aspects to be structured or dealt with (contractual relationships and parties involved, etc.)?

⁸ Source: Cushman & Wakefield analysis



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I have no personal experience with franchise system.

5.- Please describe which one are the most common financial leverage or instruments to be arranged by the builders or investors?

Banking financing.

6.- Is a private equity scheme more common than traditional bank loans in your jurisdiction?

No.

IV.- EFFECTS OF THE FINANCIAL CRISIS

1.- Please describe the effects of the financial crisis in your jurisdiction, if any. Are there a lot of forced sales scenarios? Give examples.

See the introduction above.

2.- Financing of hotel transactions – how does that work nowadays? (Which are the most obvious differences in contrast to earlier times? Which expectations and requirements do Banks have at the moment?)

The banks have new (broader) possibilities as regards securing of the debts. They are asking for all security arrangements available.

3.- Litigations matters: Are many of the failed transaction resolved by arbitration or is traditional litigation used in your jurisdiction?

Arbitration. Usually ICC or sometimes the Arbitration Court attached to the Czech Chamber of Commerce and the Agricultural Chamber of the Czech Republic.

4.- In case a criminal proceeding is involved: Is there also a way to protect third parties involved without awaiting the decision of the Criminal Court?



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Yes, the prosecutor has nowadays quite large competencies in this respect.

5.- In your opinion: Is the crisis also a financial opportunity for speculators who can invest in "unfinished projects" with few resources?

Yes, but not in the hotel business in Prague.