



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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### National Report of Argentina

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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?

During 2014, the hotel sector market suffered a reverse at a moderate pace. The primary reasons for this decrease were: (i) inflation; (ii) foreign exchange restrictions limiting the ability to acquire foreign currency which is involved in most real estate transactions; and (iii) lack of long-term financing.



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As a consequence, franchises and management agreements are considered the current trend and main targets for investors considering they require less risk and investment than development for example.

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

See question 1.

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.

Yes. In Argentina there are mixed use types such as Hotel & Residential. This type of real estate developments are increasingly proliferating against other more traditional types of lodging such as the traditional hotel. Generally, the usual scheme involves the physical division of the building by floors, being part of the building used for residential occupancy, while the other part is used for hotel purposes, or different buildings but within the same lot and with certain common areas. The Hotel Sector of one building may be completely owned by one party (for example the developer) or the different rooms or units included in the Hotel Sector may be sold to retail investors which would receive an apportioned rent from the earnings of the Hotel. Amenities may be exclusive of the hotel or shared.

In addition condo hotels (a modality where the building rises as a hotel but it may be sold per room) or fractional (where investors own a non-physical portion of a room) are proliferating modalities but not yet fully developed.

On the contrary, resorts have not yet been fully developed to the date.

The legal framework, particularly, the regulations on condominiums do not specifically address this type of mixed use developments. Hence, they require extensive contractual regulation. Some of the regulation on real estate are public policy, hence, restricting the freedom of contract.



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

Yes, in Argentina it is a common modality due to the fact that real estate properties are highly expensive and traditional mortgage financing is rather expensive and does not cover the demand. Off-plan projects, often administered by a trust (or in other cases a Special Purpose Vehicle), provide an alternative for cheaper financing and housing.

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?

Gradually, the hotel industry in Argentina is becoming aware of the need to implement renewable energy. Due to the increase in service fees, the willingness to implement renewable energy is more linked to economic reasons. However, awareness is still far from massive and only in luxury projects may be considered as more attractive than standard projects.

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

In general Lawyers and Project Managers work well; it is important that they work as a coordinated team through the development of each project. In my experience, usually there is friction between project managers and lawyers whenever the projects being developed are not standard hotels but other more complex enterprises (such as a mixed hotel and residency building). In such cases, hotel administrators, and/or investors may want the hotel to have powers and exclusivity over certain areas/decisions regarding the whole structure which may not be possible due to hard law provisions which defend each of the owners (including residential owners) as equals with respect to the condominium rights and obligations.

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



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There are no favorable tax or promotion plans for resorts for elderly people in Argentina.

## **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.

The following key considerations apply when a “Hotel Business” changes ownership:

### Tax Considerations

A future sale of a target asset by an Argentine company or trust that is an Argentine resident is subject to Argentine income tax at a rate of 35% on the difference between the sale price and the residual tax value of the target asset. It also requires the preparation of a costly notarial deed, if the transfer of real estate is involved, and the payment of stamp tax (usually between 1 and 3% of the value of the asset, depending on the location of the target asset), and may trigger issues in connection with Argentine value added tax and turnover tax. An alternative would be to transfer a specific asset through a reorganization process (merger, spin-off, division). Several requirements must be met to frame such process as tax free (among others, continuity of interest for two years, which might preclude for transfers within two years from the reorganization takes place, maintenance of activity, notification to local Tax Authority, etc.).

If, instead of selling the target asset itself, the transaction is structured through the sale of equity of the Argentine company owning the target asset –or sale of securities of an Argentine trust, as may be the case– the sale of those shares or securities would be exempted from Argentine income tax if the sellers are not Argentine residents. Otherwise, the sale of equity (other than equity quoted in a stock exchange market) is subject to income tax at a general rate of 15%.

### Foreign Exchange Considerations

The seller and the buyer of real estate located in Argentina are free to decide to have the price paid in foreign currency outside Argentina or in Pesos in Argentina. If the price is paid in foreign currency outside Argentina, even if the seller is an Argentine resident, the seller is not required to transfer those funds to Argentina and sell them for Pesos.

### Antitrust Matters



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According to Law No. 25,156 (the Antitrust Law), certain transactions are deemed economic concentrations when control of one or more companies is assumed by means of any of the following acts: (i) merger; (ii) transfer of businesses; (iii) acquisition of shares; and (iv) any other agreement or act through which assets of a company are transferred to a person or economic group.

Economic concentrations require approval by the Antitrust Authorities if the aggregate volume of business generated in Argentina of the companies involved in the transaction exceeds Argentine Pesos 200,000,000 (approximately US\$ 23,500,000).

#### Labour Laws

Labour laws, including the joint and several liability of contractors and subcontractors and of affiliates and related companies, are public policy and may not be contractually limited by the parties.

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?)

See question II. 1. In addition, investors should keep in mind that Argentina's economy has begun a slowing trend in 2012 following two years of high growth, and a that there is a perceived elevated risk associated with recent political and economic policy decisions, which have negatively affected inflation, exchange rates, consumption and overall business investment.

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

No, there have been very few M&A transactions involving Hotel Projects in Argentina, due to the sharp decline in real estate investment since 2011.

### **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



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business? (For example, in case the owner is responsible for everything, that means he owns the building and also owns & operates the hotel business – please give a short overview.)

There are two standard structures used in Argentina's hotel business structure. In some cases, a company owns the building and provides for the management of the hotel, while in other cases (including most commonly international Hotel brands), the land and building is owned by one or more parties (one, or several as in the case of trusts) which are the owner and responsible for the hotel (for example a local partner), and a management and/or operation agreement is celebrated with another company (for example an international hotel brand). Usually, in the latter case the operating company is entitled to compensation with a fixed and a variable component (which depends on gross operating profit and net sales) for services rendered.

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.)?

There are several aspects that should be considered when structuring a management agreement:

#### Rights and obligations

The management agreement should focus on delimiting the respective rights and obligations of the owner and the operator in order to avoid disputes.

#### Maintenance

Management agreement should address issues regarding periodic maintenance and renovation of furniture, equipment and building, in accordance to the relevant brand standards.

#### Operator's fee

The operator's remuneration or management fee for the provision of services must encourage the operator to correctly fulfil with the hotel management agreement. Furthermore operator's remuneration must be agreed in foreign currency or adjusted to inflation, given the current high inflation rate in Argentina.

#### Operating risks

Management agreement should clearly distinguish the responsibilities to be assumed by the owner and operator. This will clarify which party is responsible for the operating risks that may arise.



### Non-compete

Usually owners limit the operator's right to perform management agreements with other hotels which are direct competitors or in a determined geographical area.

### Management liability

The owner should take the appropriate measures to provide for the case that management incurs liability.

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.)?

The following clauses and aspects should be considered when structuring a lease agreement:

### Rights and obligations

The lease agreement should focus on delimiting the respective rights and obligations of the owner and the operator in order to avoid disputes. In this sense, lease agreements must specify which party is responsible for example for major expenses; generally of the owner.

### Rent

Rent could be fixed or variable; fixed rent must be agreed in foreign currency or adjusted to inflation on a monthly/year basis, whereas variable rents are generally based on the total or net hotel revenues.

### Early termination rights

The lease agreement should be clear about the rights corresponding to each party in the event of an early termination. Although no document can insulate the parties from later lawsuits or claims, a clear termination and release can strengthen their defence if such claims arise. The owner and operator can mutually agree to end a lease agreement at any time. Generally the owner may require the operator to make a payment (or a fee) for early termination.

### Change of control clauses

When the owner is thinking of restructuring the business (i.e. merging or amalgamating with another company or otherwise changing the effective voting control) it should provide a change of control clause.

Most leases will limit the operator's right to assign or sublet a lease, either wholly or partially, in some form or another, including a "change in control" provision, which





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invariably favours the owner. These provisions will usually require that the tenant obtain the owner's prior written consent, which consent usually cannot be unreasonably withheld.

#### Pre-emption rights

Lease Agreements frequently contains the following term; "In the event of the Lessor receiving, at any time during the period of this lease, a written offer of purchase of this property, the Lessee shall have the 'option' to purchase from the Lessor, at the same price and on the same conditions as the written offer received by the Lessor".

At the heart of the distinction between an "option" and a "right of pre-emption" lies the obligation imposed on the owner in terms of an option to sell, whereas the grantor of a right of pre-emption cannot be compelled to sell the subject of the right. Should he, however, decide to do so, he is obliged, before executing his decision to sell, to offer the property to the holder of the right of pre-emption upon the terms as contained in the contract creating that right.

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.)?

In our experience, the most important clauses governing the contractual relationship in the event of a franchise system are the following:

#### Rights Granted

E.g. The Franchisee is granted the rights in accordance with the provisions of the Agreement, during the Term.

E.g. The Franchisee shall not sell the Products, use the Franchise Business Model and/or the Trade Marks anywhere other than in the Store at the Premises except with the prior written consent of the Franchisor.

E.g. The Franchisee acknowledges that no territorial or any other kind of exclusivity is granted to the Franchisee under the Agreement.

#### Premises and lease

E.g. The Franchisee shall follow the Franchisor's criteria for the location of the Premises... The Franchisee shall obtain written confirmation from the Franchisor that the retail location for the Premises complies with such criteria before the negotiation of the head of terms and/or lease contract for the location.

E.g. The parties acknowledge that the choice of the Premises and the decision to operate the Franchise Hotels at those Premises were made exclusively by the Franchisee and the Franchisor shall not be responsible for the success or failure of the Franchise Hotels.

E.g. The Franchisee shall be prohibited from changing the Premises location, except with written consent from the Franchisor....



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E.g. The Franchisee shall remain as owner and/or tenant of the Premises throughout the Term.

E.g. The Franchisee shall take sole responsibility for the payment of all fees related to the Premises.

E.g. The Franchisor will under no circumstances have any responsibilities or be held in any way responsible with respect to or in connection with the stipulations of the lease of the Premises.

#### Term and Renewal

The franchise is granted for a Term, and may provide for a renewal option, or the option of the Franchisor to take over the operation of the Franchise Hotels, upon expiry of the Term, the terms and conditions of which shall be discussed in good faith negotiations of the parties.

#### Breach and termination

E.g. The Franchisor may terminate this Agreement with immediate effect at any time by means of written notice, if the Franchisee commits any breach of any the provisions of this Agreement and, if such breach is remediable, the Franchisee fails to remedy that breach within a period of 30 days following receipt of a written notice of default giving full particulars of the breach and requiring it to be remedied.

E.g. The following cases are expressly exempted from the above provision (regarding remediable breach within a 30 day period), thus granting the Franchisor the right to terminate this Agreement with immediate effect at any time by a written notice to the Franchisee.

E.g. The termination or expiry of this agreement for any reason whatsoever shall automatically terminate the non-exclusive trademark licensing agreement.

#### Advertising and marketing

Typically, the Franchisor shall develop promotional and advertising materials. The amount, allocation and expenditure of the seasonal Marketing Budget is mutually agreed upon by the parties.

#### Building and Equipment

E.g. The Franchise Hotels shall comply with the aesthetic, architectural and decorative standards.

E.g. The Franchisee shall solely bear the costs and risks for (re)building the Franchise Hotels.

E.g. All construction must adhere to applicable laws.

#### Use of trade marks



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The Franchisee shall only use the Trade Marks at the Franchise Hotels at the approved Premises.

#### Obligations of the Parties

E.g. The Franchisee shall maintain the high standards and uniform specifications of the Franchise Business Model. Typically, the quality and performance standards are included in the Agreement, or in a Manual as an exhibit to the Agreement.

E.g. The Franchisor shall assist the Franchisee in the selection, preparation opening and operation of the Franchise Hotels in accordance with the terms of the Agreement and the Franchise Business Model.

#### Assignment

None of the rights or obligations arising under the Agreement may be assigned, transferred, sub-licensed, sub-contracted or otherwise dealt with by the Franchisee without the prior written consent of the Franchisor.

The Franchisor may, at any time, assign or otherwise deal with the Agreement and its rights and/or obligations under the Agreement, in whole or in part to any member of the [Company Group] without requiring the prior consent of the Franchisee.

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

One fairly common financial instrument is the use of trusts in which the settlors and beneficiaries are investors who make contributions of money and/or land to the trustee (who could be a professional separate entity) to own the project and manage the assets to develop it by contracting with third parties the construction and development of the project or the sale of the project to third parties. See 4 above.

Also, public financial trusts which issue debt or equity public securities placed in a public offering to undetermined investors seeking a financial rent have been used as instruments for financing certain real estate projects or a part of such projects but are still not widespread.

Other commercial projects may be structured as “build to suit” lease, in which the developer or landlord builds to long term tenant's specifications. The landowner pays for the construction to the specifications of the tenant, and the tenant then leases the land and building from the landowner, who retains ownership. In this setting, it is usually to see the tenant financing the construction through a direct loan or advancing future rents.



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Finally, traditional guaranteed bank loans are another financial tool used in Argentina for project development, although banking financing has been historically expensive.

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

Yes, a private equity scheme is more common than traditional bank loans in Argentina. Generally, foreign banks are reluctant to lend money for projects located in Argentina.

Traditional bank loans usually require real estate guaranties (such as mortgage guaranties) or third party guaranties or insurance that may be burdensome.

#### **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.

As mentioned in question 1, financial crisis in Argentina led to a decrease in the development and purchase of hotels. High inflation rate and lack of long-term financing have made Argentina more costly to invest in the development and purchase of hotels. Furthermore, foreign exchange regulations have increasingly restricted the ability of investors to purchase foreign currency producing a decrease in the development and purchase of hotel considering that most of these investments are disbursed in foreign currency. Consequently, management agreements, off-plan projects and franchises had been the main targets for the investors. There have not been significant forced sales due to the financial crisis. Nevertheless, crisis led to several hotels closing. 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?)

In recent years, private equity (“PE”) funds have been taking equity interests in closely held portfolio companies, rather than debt interests. The equity interest is usually acquired through corporate acquisitions of ordinary shares of corporations or quotas in a limited liability company. In a lesser degree, PE transactions involve the acquisition of a minority interest.



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In our recent experience, joint ventures or acquisitions through preferred stock are less common.

Leveraged buyouts (“LBOs”) were frequent during the 1990s. However, these types of transactions are now rarely seen due to several reasons, including current FX regulations, limited access to credit and capital markets, and certain legal uncertainties identified as a result of the LBOs that took place during the 1990s, among others.

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

Both arbitration and traditional litigation are used in Argentina in order to resolve failed transactions. Nevertheless, arbitration as a dispute resolution method has become more common in the last decade and has increasingly been used in recent years in international and domestic disputes. Arbitration agreements in contracts in areas such as hotel sales have become more common in recent years.

It is fairly common to provide for international law and jurisdiction (for example New York law and courts) or arbitration (for example International Chamber of Commerce or UNCITRAL) in agreements involving both local and foreign parties.

**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?**

According to Criminal Law and Federal Constitution any person is innocent until criminal liability is proved by a competent court. The initiation of a criminal proceeding does not prevent the parties from initiating civil or other type proceedings or arbitrations and obtaining the relevant monetary judgment or awards, even pending a criminal case’s judgement.

From another side, criminal procedures could have an adverse reputational impact on any party involved on the developing or marketing of real estate projects.



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

Some consultants project that 2016 will present far better market conditions, subject to a change in Administration (presidential elections will be held in October 2015). From this perspective, and considering Argentine assets may be considered undervalued in a medium or long term scenario, the current economic situation could be a financial opportunity for speculators looking to invest in “unfinished projects” or marginal lots of land, expecting a future economic turnaround. However, in our experience, foreign investors are still reluctant to invest in these projects due to the unstable economic and political climate.