



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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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?

In 2013 the trade volume for hotels in Austria amounted to EUR 330 mio. The Austrian hotel market - especially the luxury segment - is strongly focused on its capital city Vienna. Since 2003, 10 new projects have been realized within the luxury segment in Vienna.



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From an investor's perspective, Vienna as the city with the highest transaction volume is the most solvent hotel market in Austria. There is considerable interest in hotels located in other Austrian cities such as Salzburg or Graz.

Another trend in the Austrian hotel market is that international hotel chains such as the Ritz Carlton show considerable interest in premium objects in Austria. In the first half year of 2014 alone 68% of the trade volume was generated through cross-border-investments. Especially investors from the United States of America and China invest in Austria.

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

All types of transactions, including various mixed forms are present in the Austrian jurisdiction. After years in which lease agreements were the predominating form of agreements in the hotel market, the popularity of management agreements is now on the rise. For example, Marriot currently insists on concluding only management contracts. Other major hotel chains try to reduce the number of their lease agreements while increasing the number of management contracts or utilizing other mixed forms. Furthermore, the international real estate market shows a significant increase of sale & lease-back transactions.

Interesting transactions of 2014 in Vienna were the sale of the hotel Adlon, acquired by an investor of Eastern European origin, or the sale of the Mercure Hotel Vienna, which went from E&P Real Estate GmbH & Co KG to a Russian investor.

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.

There are "mixed use types" in Austria. A typical scheme would be to sell the penthouse as apartments to high net worth individuals. The lower floors are used as a hotel. The owners of the rooftop apartments have the option to use parts of the infrastructure offered by the hotel (e.g. parking, spa). Due to the high rate of return for top floor apartments in contrast to the yield for hotels, this model is currently very popular. Until now this model in the Viennese luxury segment has mainly been utilized by Russian investors (not so much from



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the Middle East). The current financial crisis in Russia has led to a decline of the demand in this sector.

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

The off-plan is a highly popular concept. Our firm presently advises in a major off-plan project in the in the second largest city of Austria. Off plan projects usually create the chicken-or-egg dilemma, in the sense that the investor is willing to buy only after an operator is secured, whereas the operator only wants to commit himself after the investor is secured.

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?

Green & Blue Building certifications are relevant only in the business hotel sector and not as much in the leisure/tourist sector.

Generally, so-called green building regulations are seen more as a marketing tool and less as a real benefit to the environment, because many of the rules are universally applicable and do not fit to the Austrian market. Eg, Austria is one of the few countries with an abundance of water. Thus, regulations aimed at saving water are not perceived as a real need.

Hotels that comply with green/blue building standards are mainly built in the highly competitive markets (Vienna) where hotels need to stand out. For example in Vienna, the Hotel Schani Wien, the Star Inn Hotel Schönbrunn, the Motel One and the Hotel Wende in Neusiedl am See.

The demand for green or blue hotel buildings is driven by the policies of large corporations, which require that their staff books hotel rooms only in such hotels. However, note that this is only one of many factors to bear in mind. Eg, some hotel chains insist on installing sprinkler systems (which are not mandatory under Austrian building



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regulations), because certain American corporations will book rooms for their employees only in hotels which are equipped with sprinkler systems.

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

This entirely depends on the project and the persons involved. We have made good experiences and not so good experiences.

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

In Austria, each province autonomously operates its own subsidy system. Due to this decentralized structure, the selection criteria for subsidies can diverge depending on the province.

To bring an example for promotion plans to enhance the living conditions for elderly people: Vienna promotes age-appropriate, accessible remodeling to a maximum of EUR 4,200 per residential object. The conditions are among others:

- (i) 65 years old
- (ii) Principal residence in the apartment to be renovated
- (iii) Income limits 70 % of the annual household income according to section 11 para 2 Vienna Housing Promotion Act (Wiener Wohnbauförderungsgesetz – WWFSG)
- (iv) Counselling interview. If all these conditions are met and the remodeling measures such as the installation of a lift or a ramp have been made, the promotion will be granted.

In the foreseeable future the average age in our population will rise considerably. Due to this fact, we see a lot of opportunities in the range of age-appropriate hotel businesses. To that effect, the Austrian legislator is already planning to introduce regulations in the Austrian Rent Act, which will facilitate accessible renovation to the lessor of an apartment.

Interestingly, the City of Vienna promotes mixed projects such as a home for the elderly situated next to a student home in order to prevent ghetto-building.



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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.

Most importantly it must be ensured that the sale does not entitle the operator of the hotel to terminate its (usually long term) contract.

Legal peculiarities in the hotel sector are especially competition clauses in the contracts. Such a competition clause prevents the owner of the hotel from selling it to a competitor of the operator.

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?)

In my opinion, the main problem is adapting the Room Books/Design Guidelines of hotels to different and sometimes diverging legal and technical standards in the individual countries. Thus, it may be possible that the international hotel chains’ technical standards cannot be implemented in Austria. Likewise, the hotel chain may be faced with additional requirements which they had not expected, leading to discussion on who bears the additional cost.

Also, the expectation regarding the respective maintenance, repair and renewal obligations is different from one jurisdiction to another. Therefore it is worth while discussing this topic in more detail when negotiating the agreement.

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



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Yes (see above)

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

The typical life story of a hotel in Austria would be that it is planned and built by the development department of a large construction company to fit the needs of an international hotel chain. Once the hotel is set up and a long term lease agreement is concluded, it is sold to an institutional investor.

Many hotels are indeed owned by institutional investors such as banks, insurance companies or property owners such as the Vienna airport. These owners prefer lease contracts with a fixed rent or a small turnover based factor. Certain insurance companies have started selling off hotels (among other real estate) in 2014 due to solvency regulations.

Certain prestigious hotels have been family owned for decades or even centuries, such as the Hotel Sacher. These do not play a big role in the market, as they are owned and operated within the family and will neither be sold nor rented out.

Hotel chains are pressing to conclude management agreements (rather than lease agreements), thereby generating a fixed management fee for themselves (subject to certain concessions) and passing the risk to the owner. This is typical in second tier locations where hotel chains have a better bargaining position.

In Salzburg 40% of hotels are brand hotels and 60% of hotels are independently managed. In Graz 68% are privately managed. In Linz 54% of hotels are brand hotels and only 46% are private institutions.



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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.)?

The advantages and risks of a management agreement differ depending on the design of the contract. Business opportunities and risk for an investor are significantly higher upon conclusion of a classic management contract than it would be in the case of a lease contract. The major advantage of a classic management agreement is the possibility of a manager influencing the management. To reduce the investor's financial risk it is possible to sign management contracts that include guarantees or reserve funds.

Tricky aspects include the calculation of the management fee. The agreements frequently refer to the Uniform System of Accounts for the Lodging Industry (USALI), which contains definitions that differ from common Austrian notions.

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.)?

One aspect (of many) is the issue of FF&E and SOE reserve funds. For the tenant, whether or not to invest in the hotel is mainly mathematics: Will the investment generate additional income in excess of the cost of the investment.

In case of a (partly) turnover based rent, the landlord will benefit from any additional income, irrespective of the cost incurred by the tenant.

Thus, typically the landlord will insist on including an obligation of the tenant to invest a certain percentage of the turnover in the hotel, whereas the tenant will push hard to retain the freedom of choice whether or not to invest.



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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.)?

The most important aspect of a franchise agreement is having the brand of a reputable hotel group in the background. A disadvantage that arises within a franchise system is that cooperation between the many parties involved can prove very difficult at times. Also, the financial standing of the franchisee is usually not very high. The franchisee's resources are further diminished by high franchise fees.

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

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

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.

Due to the tight economic situation, the overall performance of the hotels was muted, with ADRs and occupancy rates plunging compared to previous years. However, there were no forced sales in Austria, because the major banks have been standing together through the financial crisis, and no hotels were auctioned.

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?)

Since the financial crisis and (mainly) as a result of the Basel III regulations, it is much more difficult to obtain loans for hotel projects as for any other project. To meet the



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requirements potential beneficiaries are now obliged to deliver at least 30 to 40% of their own capital.

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

In Austria arbitration and also the traditional litigation are common.

(i) The main reason for the popularity of the **traditional litigation** in Austrian is its efficiency and rapidity, especially in comparison to other neighbouring states such as Italy. A further reason for the popularity of traditional litigation is the cost-effectiveness and the possibility to get legal aid.

(ii) **Arbitration** is especially popular because of its professional competence and also because of the lower costs. The possibility to conduct arbitration is regulated in sections 577 to 618 of the Code of Civil Procedure (ZPO). The arbitral tribunal is competent only on the basis of an arbitration agreement between the parties to a particular dispute. If both parties choose the arbitral tribunal, the arbitral tribunal will decide on the dispute. If there is no arbitration agreement, the civil court is competent.

In this context, a special and popular institution is the **“Vienna International Arbitral Centre” (VIAC)**. The VIAC is one of Europe’s leading arbitral institutions and a focal point for the settlement of commercial disputes in the regional and international community. Since its inception the VIAC has administered over 1,500 proceedings and is thereby one of the most experienced arbitration centres in the region. VIAC administers international cases involving at least one party with its place of business or normal residence outside of Austria or cases concerning disputes with an international character. The arbitral proceedings are individually designed according to the parties’ requirements and have to be conducted in accordance with the VIAC Rules of Arbitration (“Vienna Rules”).

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?

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



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The number of unfinished hotels available on the market in Austria is very low. The best-known example of a failed hotel project is the Shangri-La in Vienna. The agreement was terminated by the hotel brand Shangri-La two months before the planned opening leaving the owner (a subsidiary of a large Austrian bank) in sheer panic. After the failure of the agreement with Shangri-La, the hotel brand Ritz Carlton has now been awarded the contract. The building was finally sold for approximately EUR 120 million to the Kazakh investor Verny Capital and Ritz Carlton will operate the hotel. In addition to purchase price for the Hotel, the remodelling of the finished hotel cost about three to four million Euros.
