



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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National Report of Poland

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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?

As the number of people visiting Poland and accommodated in hotels has been steadily growing since 2010 the hospitality market each year grows as well. Poland has seen a recent increase in new hotel openings due to the UEFA European championship in 2012, however the country still offers plenty of hotel development opportunities especially in secondary cities.

The Polish hotel market is very dynamic and many developments are under construction at the moment. A large number of hotel projects are expected to be completed in the coming



two years, including internationally branded hotels such as Hilton, Marriott, Motel One and Raffles.

At the date of preparation of this report the Central Statistical Office did not publish the exact data for the year 2014. However according to the data for previous year: there were 2,008 hotels in Poland at the end of 2013 offering 103,087 hotel rooms. This represents an increase of 5.2% in number of hotels and 5.9% in number of hotel rooms compared to the previous 2012 year. The majority of hotel rooms belong to 3-star segment representing 42% of all hotel room stock, followed by 4-star, 2-star, 5-star and 1-star segments.

About 80 % of the market are not part of any chain. These hotels are difficult to be categorized.

As to the chain hotels, the visible trend at present which may be observed is 'asset light' strategy. For example it was clearly announced lately by the Orbis/Accor chain that it will no longer build its own hotels. Instead it will focus on the development of the chain through franchise and management contracts. Moreover, Orbis will manage its facilities through their sale and back-franchising or back-management. These type of structure was chosen lately in the vast amount of transactions. Thanks to this chains do not need large amounts of their own funds and can lower their expenditure, while at the same time retaining an established hotel brand and releasing capital through leaseback agreements. The financial burden is consequently shifted onto the investor, whom the chain provides with a brand, a logo, know-how and access to its reservation system.

The general expectation for the nearest future is of course the constant grow of the hospitality market and increase of number of transactions.

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

The hotel chains currently operating in Poland are not interested in purchasing properties. They are much keener on franchising, management or - less frequently - leasing deals. For example Hilton Warsaw is owned by Atlas Group and managed by Hilton based on a long term management agreement.

The already present chains owning the properties announced their new 'asset light' strategy, which will be based either on franchise or management. They will manage its facilities through their sale and back-franchising or back-management.



As mentioned above it is estimated that around 80 % of Polish hotels are not part of any chain. Therefore it is their owners who choose the form and style of their management and transaction if any is proceeded.

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 all types of the mixed use in Poland: hotel&residential; hotel&spa or condo-hotels. While preparing this report we are finalizing acquisition of a large condo-hotel group in Poland, franchise agreement of the large French hotel brand. Below please find a brief description of the legal structure.

Client signs an off-plan agreement with the developer (in that case being also an owner of the property), and after the condo-hotel is build he acquires the particular premises. Then a tenancy agreement is signed between the client (as an owner of the premises) with the tenant, i.e. company being an operator of the condo-hotel (based on the agreement between the developer and the operator). The subject of the tenancy agreements are the premises (with equipment), the parking spaces, the common spaces and shares in ownership right of the premises designated for common use of the hotel guests (reception, gym etc.). Under the tenancy agreement the landlord allows the tenant (hotel operator) to use the subject of tenancy and collect profits from operation of the hotel in exchange for rent.

The agreements provide for two types of rent – guaranteed and proportional rent.

- The guaranteed rent is paid during the first three years of tenancy. The total rent for the first three years equals to 21% of the value of the premises (5% in first year, 7% in second year, 9% in third year).
- The proportional rent is paid after the first three year period. In general the proportional rent equals to 50% of revenue from the operation of the hotel multiplied by the share of the landlord.

The landlord agrees that the tenant is free to sublet the premises to third parties (hotel guests) without any restrictions. The landlord's right to use the premises is restricted in order to allow the tenant to operate the hotel and therefore the landlord is prohibited from

taking certain actions with regards to the premises. The landlord is entitled to use the premises for 21 days yearly. The term of the tenancy is fixed (usually more than 10 years) and therefore the tenancy agreement is difficult to be terminated by the landlord.

General controversy over the above-described condo-hotel legal structure is that Polish law distinguishes between the tenancy agreement (*dzierżawa*) and lease agreement (*najem*). The tenancy agreement is an agreement under which the tenant may use the subject of lease and collect its fruits. The lease agreement is an agreement under which the lessee may only use the subject of lease. There is a doubt whether the income from operating the hotel using leased premises may be regarded as “fruit” which is an essential element of the tenancy agreement.

Lease and tenancy agreements executed with an entrepreneur can be concluded for 30 years. However a lease agreement with an individual (who is not entrepreneur) may be concluded for 30 years, and a tenancy agreement with such an individual can be concluded for 10 years only.

In case the tenancy agreements for condo-hotels are in fact categorized as lease and not tenancy, after 10 years they will transform into an agreement concluded for unspecified period with a possibility of termination after 3 months as of delivery of termination notice, unless they are concluded with individuals being entrepreneurs which is a rare case. The risk of early termination after 10 years excludes the stability of the condo-hotel business in this case, which is unfavourable for both parties, the owner of the premises and the condo-hotel operator. The longitude of term of tenancy agreement is an important aspect of the condo-hotel business. On the other hand it is very frequent that the owner of the premises in a condo-hotel is an individual not being entrepreneur and therefore it is controversial whether he may conclude the agreement for the fix term longer than 10 years.

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

Off plan agreements are still used in practice. However I think it relates to the smaller investments or condo-hotels.

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?



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Obviously better standard chain hotels use solutions allowing to collect the energy from the renewable sources. It is later used in the marketing campaigns of the new hotel. However generally renewable energy is another evolving market in Poland and it is not related strongly with the hospitality market yet.

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

Although the cooperation between the lawyer and the project manager is a *condicio sine qua non* of a well prepared development project, not every project manager understands it. The good project manager must not only expect from the lawyer “to prepare papers”, but most importantly he should explain the details (including technical details) of the project and his expectations.

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

No

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.

For the investment funds or other owners of the hotel properties there are two types of transactions:

- the sale of a hotel business - the real estate including the hotel plus a package of contracts necessary for operating the business - and
- the sale of the shares in a company that owns a hotel or a number of hotels.

From the point of view of the real estate law, the first above-mentioned acquisition is protected under the principle of reliability of the land and mortgage registers maintained



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for the real properties in Poland (the acquirer may rely on the entries in the land and mortgage register since they are deemed to be correct and consistent with the actual legal status of the real property). In the share deal the investor buys the shares and the principle of reliability does not apply (the buyer is less protected in this respect).

On the other hand the first solution requires the assignment of all contracts related with the real estate, for which, according to Polish law, the consent of the other party of the contract is required (more precisely under Polish law the assignment of the obligations requires the consent of the other party of the contract). This solution requires also the transfer of the permits and licences which is related with the necessity to initiate the appropriate administrative proceedings. If the project is being sold at an early stage of development, the common mistake of the investors (and their advisors) is transferring the building permit without transferring the decisions issued earlier (e.g. zoning decisions or environmental decisions). In case the investor wishes to amend the building permit (according to his new project design) he must present to the authorities that these earlier decisions were issued to him as well. If he cannot prove that because the decisions were not transferred, he must apply for their issuance again which extends the time of completion of any project or its renovation.

In the share deal such problem does not exist. However for the purpose of the share deal the full due diligence of the company is required, while acquisition of assets or enterprise would only require the verification of its particular components.

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 cooperate mainly with the investors from EU or USA and I did not observe any large differences in legal or cultural aspects.

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

At the moment of preparation of this report we are working on transaction of acquisition of one of the largest developer group of companies on the Polish market, conducting



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(apart from couple of offices and over a dozen residential investment projects) two operating condo-hotels and two condo-hotels in the pipeline,

The largest deal which was commenced in the year 2014 was the acquisition of 46 Accor hotels in Poland and 15 other countries of the Middle and East Europe by Orbis for the total price 142.3 million euro.

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.)

There are no typical hotel business structures in Poland.

The vast majority of the Polish hotels are not party to any chain. Usually they are owned and operated by the same entity.

The chain hotels structures are usually owned by one entity and operated by the chain brand entity based on franchise or management agreement. The chain hotels owning the property are aiming to change the structure and the sell the property but maintain operating of the hotel by way of franchise or management agreements.

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.)?

Fees are always important but at the same time are business issue. They are strongly dependable on the negotiating parties. The systems of calculation of the fees are different for different chain. It is always difficult to convince the chain operator to change its view on the fees calculation system existing within the chain, because an undisputable argument “that’s how it is in our chain” occurs.

In my opinion the most problematic area is always the liability of the manager. The provisions of the management contract are not defined in detail by law and may include the provisions which results directly from the arrangements of the parties. The hotel operator intends to exclude the liability in the various aspects which is an obstacle to accept for the owner of the hotel who in fact may not control the actions of the manager on the daily basis but still remains liable for the events which occurred in his property.

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.)?

There most important issues to be dealt with are as follows:

- Duration: Under Polish law, the lease for the defined term (which is almost always the case in large lease agreements) may be terminated only in cases specifically defined in the contract. It is always difficult to negotiate that part of the contract.
- Rent. Under Polish law the landlord may always “terminate” the amount of rent, i.e. change the rent upon delivery of the notice. In case the notice is not accepted by the tenant – the lease expires. Excluding the abovementioned rule requires a specific clause in the contract and is problematic to negotiate.
- Fit-out costs and reinstatement. The parties usually strongly negotiate on who is responsible for payment of the part of the fit-out costs before the lease and who and in what part will take the improvements at the end of the term of lease. The “battle” is also over the time of amortisation of the fit-out costs (e.g. reimbursement of the fit-out costs in case of early termination).

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.)?

I find that the most difficult question to be dealt with are the contractual penalties. The clauses are very detailed and describe a large amount of events, in case of which the penalties for the franchisor are due. The penalties are also stipulated in case of early termination which makes the early termination largely “unprofitable” and in fact impossible. It is extremely difficult to negotiate that clauses from the part of the franchisee being smaller entity. Negotiations on contractual penalties are more equalized in case of large hotels where the position of the owner is better.



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

Regular facility agreement signed either with the bank or the private equity entity.

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

I think private equity is common, though financing by banks are still in frequent use. This issue depends largely on the possibilities to find investor or to seek financing by a regular facility granted by the bank.

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.

There are some examples of the negative effect of the financial crisis, though generally the Polish market has managed to avoid its negative consequences. I know about the one example of the hotel at the Polish seaside which is being conducted by the bailiff under the bankruptcy proceedings until it will be sold. Under Polish law the bailiff may decide to continue the business before the forced sale in order to preserve its value as an ongoing concern.

However generally the hotel business is profitable and the cases of the bankruptcy are rather caused by lack of financing or other financial problems of owners of the hotels.

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?)

Comparing to the old times (before the crisis) the banks conducts their own due diligence in more detailed and very strict way, sometimes requiring remedial actions which are far from the reality and standard practice. Obviously you may observe the larger amount of



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securities the client has to deliver in order to obtain the financing e.g. mortgages, insurances, submission to the enforcement proceedings, bank or insurance guaranties etc.

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

This issue depend on whether an arbitration clause was included in the contract or not. The transactions engaging international parties or large domestic transactions usually contain such clause and any dispute is resolved by an arbitration court.

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?

Generally no. The criminal case is usually initiated *ex officio* and may not be terminated earlier, unless at the prosecution stage (preceding the court stage) you reach an agreement with the prosecutor (upon the consent of the victim), based on which the prosecutor withdraws the accusation.

In case the criminal proceedings are initiated, the third party (e.g. the other party of the contract) may always try to initiate the civil procedure without awaiting for the recognition of the criminal case. However if the civil court suspends the civil proceedings because it will recognize that the criminal case have to confirm whether the crime took place - there is not much you can do actually to accelerate actions and avoid waiting for the criminal case to come to an end.

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

The practice shows that “unfinished projects” usually remain unfinished for some reason which is not just the lack of financing. For example in Poland there is a large amount of projects with incorrect administrative decisions and there is a risk of their annulment in the future. As a consequence, the banks are reluctant to grant financing for the projects with such decisions. In that case the speculators may always try to buy the project for a lesser price and obtain new decisions or take the risk by continuing the construction based on this imperfect decisions.