

Checking In on Hotel Transactions

Article

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As Central Florida tourism continues to thrive, the hospitality industry is reaping the benefits from the influx of visitors. According to Visit Orlando, the region's official tourism association, the Orlando market achieved an average hotel occupancy rate of 72% for the first eight months of the year 2022 alone. These strong occupancy numbers are an important consideration for potential developers and investors looking to participate in the Central Florida hotel market.

Recent noteworthy transactions are yet another indicator of the strong hotel market in Central Florida. For example, Lowndes had the pleasure of representing Orlando-based Xenia Hotels & Resorts, Inc., in its recent \$27.75 million sale of the Bohemian Hotel Celebration, as well as Tishman Hotel Corporation in its \$120.5 million acquisition of the Wyndham Grand Orlando Resort Bonnet Creek and its \$46.5 million acquisition of the Grand Orlando Resort at Celebration. These and other significant hotel transactions and projects indicate a hotel industry continuing to prosper in a post-pandemic real estate market.

The following trends are particularly relevant in today's hotel market:

Entitlements and Permitting Matters

Evolving hotel trends continue to encourage hotel owners and purchasers to renovate and remodel hotels to meet shifting guest preferences. In any sale or purchase of a hotel, entitlements and permitting play a significant role in both the current uses and any future improvements to the property.

A hotel owner or purchaser should engage a land use attorney or consultant with experience in land use regulations and specific design standard requirements of local jurisdictions to ensure such improvements do not run afoul to local regulations.

Business Interruption Insurance

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As the hotel industry continues to improve following pandemic shutdowns, many hotel owners are considering business interruption insurance options to protect against future unforeseen threats to business operations. Business interruption insurance protects against business closure due to physical damage to the property.

Hotel owners should review and analyze their policies to identify the specific exclusions to coverage to determine insurability of losses relating to pandemic, hurricane damage and other natural disasters. It is also worth noting that insurers have begun to specifically exclude viral, bacterial and pandemic-related losses.

Financing Alternatives

In the ever-shifting landscape of the lending industry, many larger institutional lenders may require additional collateralized loan obligations which can be problematic in larger hotel transactions. However, local regional banks appear to remain active in local hotel transactions.

Additionally, the potential of continued increased interest rates may also encourage hotel owners to pursue alternative sources of capital for the renovation, construction, or expansion of existing hotel facilities.

Boutique Management Companies

For many investors, a large franchise model may not be suitable. If a contract requires entry into new franchise agreement with an existing franchisor, investors will be wise to consider the costs and implications of either assuming or terminating existing franchise agreements.

Franchise agreements with national companies have a series of requirements and policies from signage to branding that require specific performance and may include various restrictions that could affect the day-to-day operations of the hotel. These agreements are also generally more expensive to owners than agreements with boutique management companies.

Whether or not you chose to remain with the current franchise, have a boutique management company, or develop your own branded hotel, it is important to carefully review the franchise agreement.

Traditional Issues

In addition to the trends in today's hotel real estate market, several critical issues remain relevant in hotel transactions, including the following:

- **Post-Closing Indemnification**

Buyers need to be aware of the potential risks associated with buying a hotel property from a "special purpose entity" (SPE), whose only assets may be the property that is the subject of the transaction.

Particularly when dealing with a SPE, buyers should negotiate for either (a) a guaranty from the seller's "parent" entity, or a related entity with verifiable assets, or (b) the escrow of a portion of the closing proceeds until the period for indemnification under the applicable purchase and sale agreement has expired.

- **Liquor License Issues**

Liquor license laws vary significantly from state to state. Failure to comply can result in a failed closing condition (the purchase and sale agreement should include obtaining a liquor license as a buyer closing condition), the revocation of an existing beverage license, potentially significant fines, and/or a lapse in beverage service to patrons of the hotel.

Buyers should engage a liquor license consultant or an attorney with experience dealing with the state and local liquor license laws as part of their transaction team.

- Intellectual Property Issues

Many resort properties include a restaurant, spa, or golf club which operates under a well-known name. Buyers need to be careful to specifically negotiate for the acquisition of these significant intellectual property rights, and to properly memorialize and register the conveyance of these rights at closing.

- Employment Matters

The acquisition of an existing hotel often includes the negotiation of a new management agreement. This presents unique employment law issues, since employees are frequently terminated by the seller, and then immediately re-hired by the buyer.

Buyers must be aware of potential employment law issues and tailor the turnover of the hotel accordingly. Compliance with The Worker Adjustment and Retraining Notification (WARN) Act should be addressed as part of the negotiation of the applicable purchase and sale agreement.

The acquisition or development of a hotel property can be a very sophisticated transaction with many complex issues. This article is intended to provide an overview of several key trends in the hospitality industry and should not be viewed as a comprehensive analysis.