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Hotels briefing

Buying a hotel? Look under the beds and know what you are buying

We are seeing increased activity on the hotel acquisition front, both in Asia Pacific and globally. It is therefore timely to re-visit some key fundamentals to consider when purchasing a hotel – acquisition structure and due diligence.

Acquisition structure

A key decision which must be made early on in the acquisition process is whether to purchase:

- the corporate vehicle which owns the hotel business and property, by way of share purchase; or
- the hotel business and the property, by way of asset purchase.

This structuring decision will largely depend on individual factors of the purchaser and the seller and the actual asset, and the relevant legal and regulatory requirements. There are advantages and risks associated with either method, a brief comparison of which is set out below.

Share purchase	
Advantages	**Risks**
• tax advantages • ease of acquisition • generally no issues with assignment of contracts (other than potential change of control issues)	• prior obligations/ liabilities (known and unknown) • future and contingent liabilities
Asset purchase	
Advantages	**Risks**
• limiting/mitigating risk of known and unknown existing liabilities • ability to choose which assets to purchase	• transaction costs (e.g. stamp duty) • approvals and licences • assignment of contracts and approval rights • transfer of employees

Due diligence

Due diligence is an essential part of any purchase, whether it be a company, stand-alone business of any size, commercial office building or a hotel.

Every type of acquisition (regardless of the structure) will involve different due diligence considerations. In addition, the chosen structure of the purchase will generally determine the type of due diligence undertaken prior to the proposed acquisition. For example, where the chosen structure of the acquisition is by way of *share purchase*, the focus of the due diligence will be on:

- the corporate vehicle;
- tax issues;
- organisational issues, including ensuring a proper corporate existence, compliance with the applicable company reporting rules of the jurisdiction and identifying shareholders and related rights;
- financial information, including financial statements and audited accounts;
- employees and employee benefits, including pension plans and accrued leave entitlements;
- tax positions of the company, including ensuring that all tax filings are up to date, and a determination of the future tax liability of the company;
- existing and pending lawsuits against the company and initiated by the company; and
- material contracts, including shareholder agreements and joint venture arrangements.

A purchase by way of *asset purchase* does not usually include a transfer of liabilities of the company (although may include certain environmental and tort liabilities relating to the land). The due diligence required for an asset purchase is usually simpler and focuses on the ownership of the land, encumbrances, property tax liabilities, condition of the property and land-specific material contracts which will be required to be assigned to the purchaser (e.g. leases and licences).

Due diligence on a hotel purchase (whether by share or asset purchase) is unique, as a hotel sale and purchase involves additional complexities given the complex nature of the interrelated business and real estate components of a hotel.

Apart from the usual property/title enquiries that need to be performed for the purchase of any large asset, consideration will need to be given to the following legal, financial and operational details:

- hotel operating agreement and related agreements entered into between the seller of the hotel and the existing operator and its affiliates;
- large number of employees (particularly relevant to large hotels and upscale and luxury hotels and resorts where staff-to-guest ratios are high);
- large number of operations contracts spanning every aspect of the business, from accommodation contracts through to lift servicing;
- identification of business assets owned or leased by the hotel, including stock/inventory (e.g. wine store), hotel vehicles, furniture, fixtures and equipment, and operating supplies – depending on the operator of the hotel, many of these assets should be listed on a central fixed asset register;
- current financial information for the hotel including revenue, budgets and bank accounts;
- historical financial information for the hotel including historical occupancy and rate;
- capital expenditures and any current expenditure projections;
- all licences and permits required to operate the hotel in the jurisdiction (e.g. liquor licence);
- all commercial and retail tenants and related details (e.g. term of lease, rental deposits and rent) – in larger hotels or mixed-use developments, there can be a high number of "non-hotel" tenants to consider;
- current insurance coverage, including cost and expiration;
- intellectual property (e.g. trademarks) relating to the hotel whether owned by the seller of the hotel or the operator;
- details of any administrative action or litigation threatened or pending against the hotel (where the named party is either the seller of the hotel and/or the operator);
- future reservations and bookings; and
- ownership of guest data which has been collected for the hotel – particularly in jurisdictions with significant privacy protections.

The above list is not exhaustive and each specific acquisition will bring with it different considerations during the due diligence process. It is important to remember, however, that thorough due diligence will help a purchaser to understand what he/she is buying both from a valuation and legal/business risk perspective – allowing a purchaser to achieve the right purchase price or to make the correct decision as to whether or not to proceed with the purchase.

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Further information

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