

Hotel Deals Part II

How changes to Thailand's FBA will affect hospitality investment

By Desmond Hughes and Kris Limcharoen

Last month, we summarised the preparations that should be made when considering ownership and investment in hotels in Thailand and the use of the assets of a hotel company, which includes land and the building itself. Such preparations seem all the more pertinent and appropriate in view of the recent changes to the regulatory environment of Thailand in relation to the Foreign Business Act, notification procedures in relation to foreign voting control of companies and those industries which may be exempt from the provisions. At present, those industries which are potentially involved in 'Trading Land' which is in List 1 of the Foreign Business Act will have to consider a) notification of control and b) re-organisation of shareholdings if control is weighted towards foreigners.

Those businesses which comprise a 'service' under the Foreign Business Act will have to a) notify and b) consider if 'hotel management business,' which is carved out from 'hotel business' in the services excluded from the re-organisation provisions, is applicable to its business. Overall, at present, those who consider that they may fall within the re-organisation provisions should consult in the near future through advisers and communication with the authorities to properly establish what steps they ought to be taking. At the time of writing, this is the recommended approach. Certainly, achieving Board of Investment Status would assist in resolving a number of issues which rear their head in relation to control, concessions, tax, treatment of foreign labour in relation to work permits and other administrative issues.

Post Investment Structure

After the investment structure has been settled, the matter of implementation of the concept of the ho-

tel must be attended to. The investors will normally, at this stage, have already injected monies in relation to land acquisition and preliminary due diligence perhaps with the assistance of bank finance. The next stage is to design, construct and put in place a fully operational hotel which will match the financial projections indicating a 'break-even' and subsequent 'profit' point in the future. The way in which contractors are managed in hotels has obvious overlap with the construction of large luxury resorts, and the 'local' construction issues are also very similar. Investors will want assurances that the hotel will be built in a structurally sound fashion with proper and correct structural and non structural defects guarantees in the construction agreement, that the timing of the phases of construction are realistically planned and certainly contain in such a large project penalties for non-performance, and to minimise breakdowns in communication resulting in litigation in the court system of Thailand – a good internal complaints, arbitration and resolution procedure.

Flexibility in the building is key, because a hotel in generally large enough to mean that even with a very experienced team of architects, changes to the implementation of the design at the construction phase are very likely. Again, investors should ensure that there is expertise in the management team to ascertain what a 'design flaw' is and what is simply a matter of unforeseeable issue resulting from implementation of design.

Overall, the architect contract, construction contract and project management contracts all need to work together and flow so that there is enough flexibility to avoid unnecessary disputes, but enough rigidity to encourage

proper performance and effecting of quality driven obligations.

Creating Revenue Streams through Contract

In a resort bases hotel comprising individual rooms and villa type accommodation, sale and leaseback scheme can be created to a) generate a capital return for the investors and b) encourage participation by numerous individual 'investors' in the hotel as a brand and income stream generator. To achieve this, the investors would create a sales scheme in which each 'unit' in the hotel would be 'sold' normally under a long lease to an investor with a fixed rental return. The sold unit would be leased back to the hotel's management with a usage allowance provided

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to the original owner and some benefits or privileges of the hotel also provided as an incentive. For a potential purchaser of one unit in the hotel the incentives are a) capital growth on resale if the hotel is properly renovated at appropriate intervals and the units and hotel retains and increases value b) hotel operational based income stream from the placement of the unit in the hotel scheme (placement would ordinarily be mandatory) and c) potentially higher rates of return than standard investments.

The legal framework for producing such a scheme should take the product beyond the 'timeshare' concept, which is unfortunately shrouded in negative connotations arising from abuse of the concept in certain jurisdictions. Instead, the legal

documents for selling a unit in a hotel should make absolutely clear the right to resell a unit; the scope of fees that a purchaser will be liable for – the largest issue being whether the hotel can call upon the purchasers for a capital contribution relating to renovation which could impact on the hotel income derived to individual purchasers, and the basis on which an investment can be 'terminated' such as non-payment of fees for operation of the unit.

Acting for hoteliers, lawyers will look at ways of ensuring that the hotel does not become wrapped up in the activities of a miscreant or non-performing unit owner; and acting for a purchaser, lawyers will look at ensuring that an investment is safe, the scheme's legal framework is sound and allows at least for a level of legal protection and recourse commensurate with the value of investment made by the client.

Hotel Management Contracts

Hotel Management Contract forms a topic in itself, but overall, investors in the hotel will be extremely keen to vet a management contract to ensure that any mismanagement of the hotel as an 'asset' and impact upon its goodwill can be tempered by action and ultimately, if absolutely necessary, effective recourse to a legal forum. For a hotel manager, a contract ought to contain a fixed term with limited opportunities for termination because the first years of management might not necessarily generate the return the hotel manager is looking for on a hotel. Some hotel management companies are expert in taking on a hotel with dilapidations, draining a few years of marginal profit out of the hotel and then selling the hotel management on based on location and a rising market. In such in-

stances, individual investors in a unit in a hotel to generate 'hotel income stream return' should be aware of the status of hotel management companies, their past performance and intentions in respect of a hotel (i.e. planned renovation or improvements and whether the cost will be passed to 'owners of units' through a call for cash injection right under contract. Again, the way in which the contracts for individual investment are drafted are critical in relation to the use of a scheme, the intention of the investors and the projected or advertised returns.

Summary

After investors have overcome the planning stages in relation to the structure of ownership, control, investment in a hotel, the implementation of the hotel in relation to its construction, modification and generation of capital and revenue streams should be carefully analysed with regard to the contents of the legal agreements reflecting the same. Flexibility will be necessary in relation to certain types of contracts, and more rigidity is required in respect of others. Dispute resolution procedures are critical when timing of deliverables under contracts is likely to produce a tension between employer and contractor and these resolution procedures may not necessarily be the same in each contract relating to the hotel. A hotel development plan should include a section of planning relating to 'legal' matters, and advisers given the opportunity from an early stage to discuss potential issues and solutions with investors.

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