



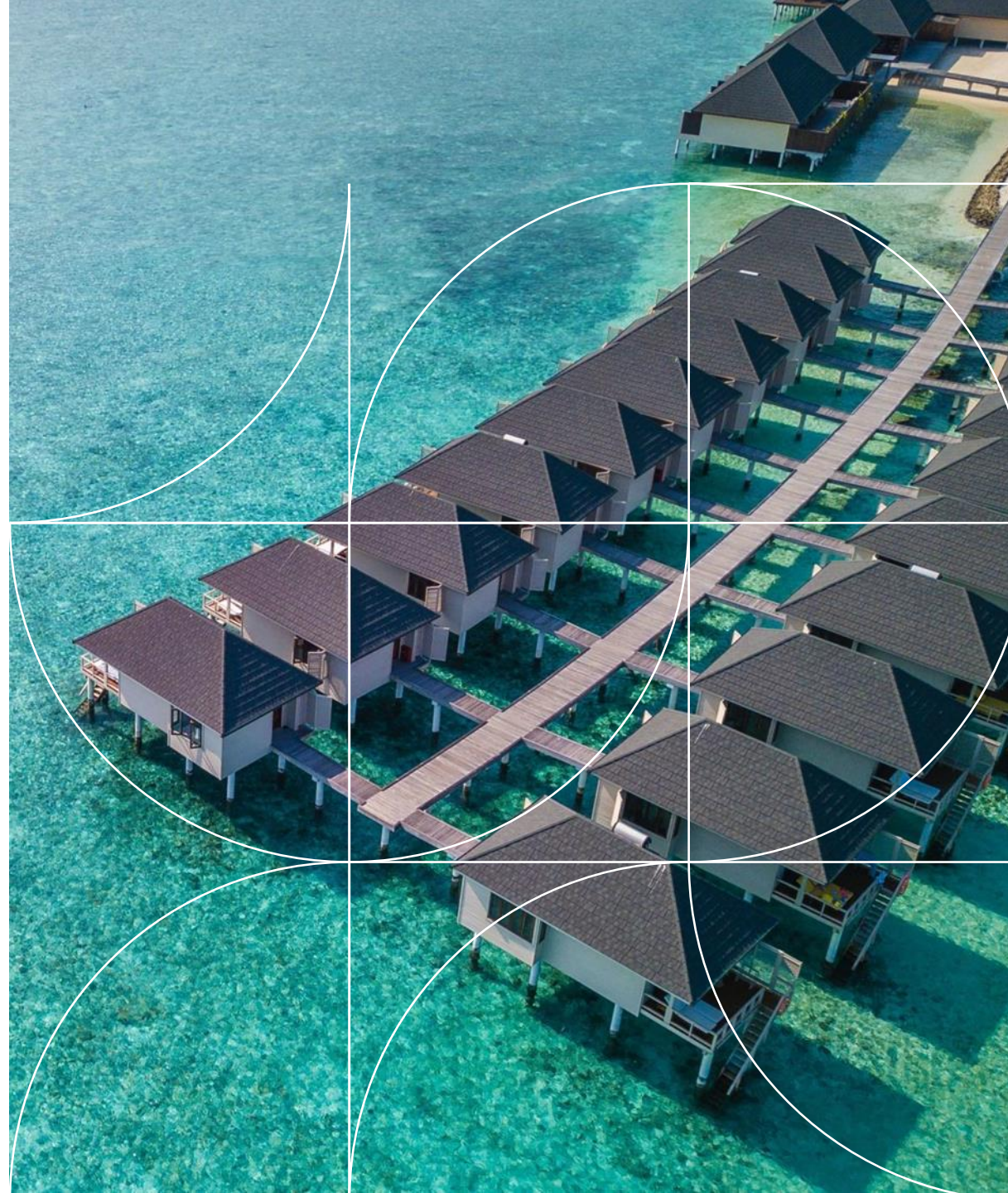
The Legal Landscape of Hospitality: Key Perspectives and Considerations

Part 4: Unique Real Estate Issues and Challenges in Hotel Sales and Acquisitions

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Seyfarth Shaw LLP

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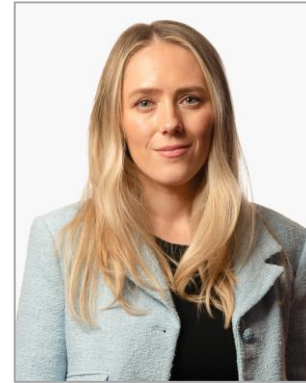
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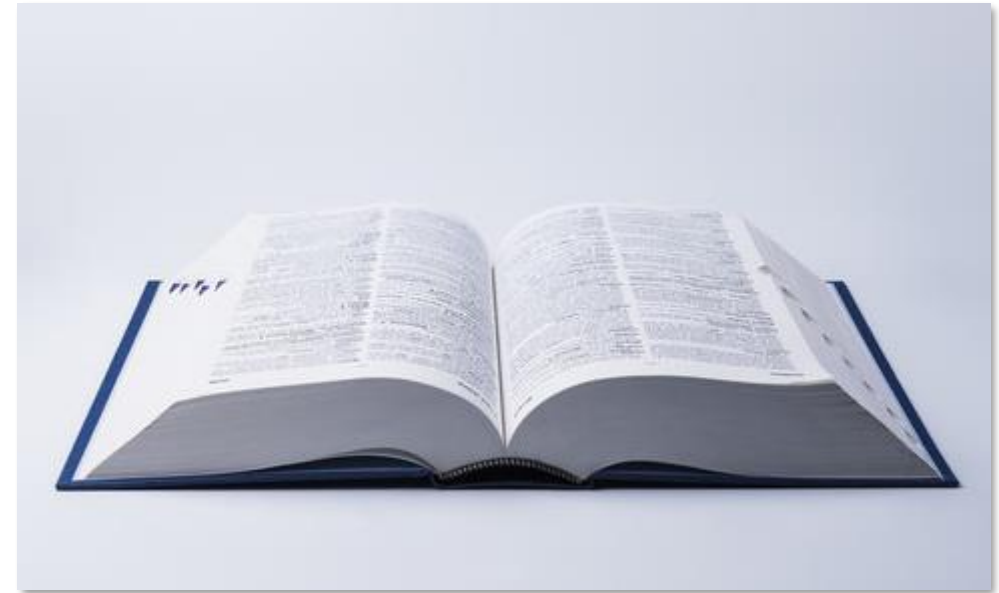


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Defined Terms and Assumptions

- “PSA” refers to the Purchase and Sale Agreement for the sale of the hotel.
- “Closing” refers to the consummation or completion of the sale of the hotel.
- We will assume that the sale of the hotel is an asset sale (instead of an entity sale).
- We will assume that existing management company is terminated at Closing (and that the Buyer engages its own management company at Closing).

NOTE: Some of the issues discussed in this webinar become non-issues if the Seller’s management company is retained by the Buyer, and such retention greatly simplifies the transaction.

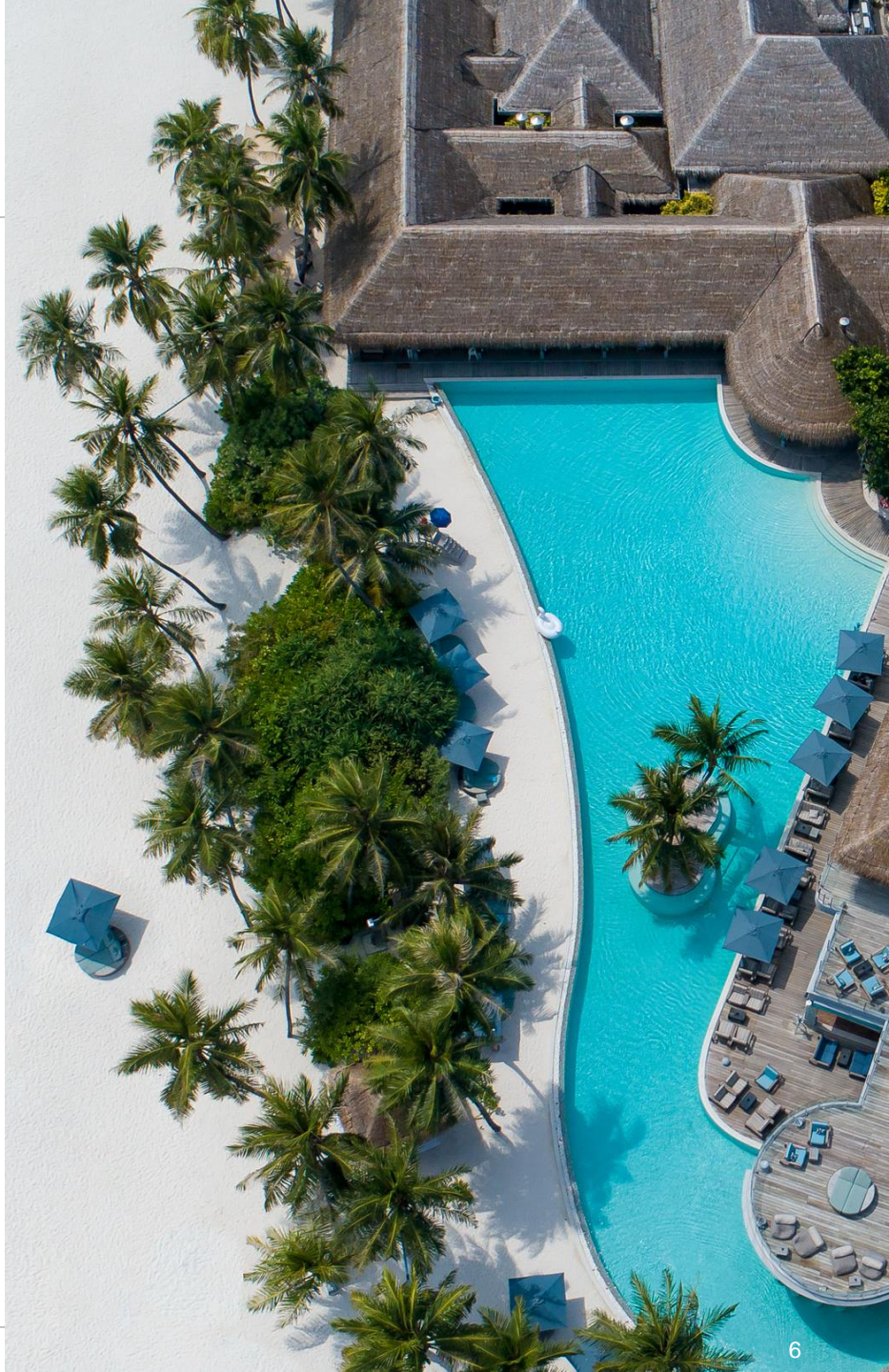


Introduction to Hotel Sales & Overview of Topics

- Unlike other real estate assets, hotels are operating businesses.
- This results in hotel sales having several unique issues not present in non-hotel sales.
- The issues unique to hotel sales include:
 - Franchisor and Franchise Agreement issues
 - Hotel Management Company and Hotel Management Agreement issues
 - Tax issues, including successor liability for pre-Closing sales and occupancy taxes and sales tax on the transfer of the tangible personal property and/or inventories
 - Liquor license issues
 - Special Closing prorations and Closing adjustments
 - Post-Closing obligations and liabilities, including mutual indemnities
 - Labor and employment issues, including the WARN Act, unions, and pension fund withdrawal liability
- The PSA should address these unique issues to avoid future surprises and to minimize the Seller's and Buyer's respective post-Closing obligations and liabilities.

General Issues Regarding Hotel PSAs

- Because of the myriad of issues in hotel sales, hotel PSAs are much longer and more complex than PSAs for other asset classes.
- Hotel sales take longer and are more complex than sales of other asset classes.
- Generally speaking, for hotels it is more difficult to secure financing at favorable rates and terms.
- The due diligence period for hotels is often 45 to 60 days, which is longer than for most other asset classes, and the Buyer often has extension rights and special contingencies or conditions precedent.
- The closing period for hotel sales is usually 30 to 60 days after the due diligence period expires, and the Buyer often has extension rights to give it enough time to secure financing and the Franchisor's consent to the sale and/or a new Franchise Agreement.



Franchisor and Franchise Agreement Issues

- When a hotel is sold, the existing franchise agreement typically terminates or is “assigned”. Buyer must negotiate a new franchise agreement if they wish to retain the brand and should be sure to incorporate the franchise approval process within the timeline of the PSA.
- Sellers may be obligated to pay termination fees upon the sale of the hotel. However, these fees are often waived if the buyer enters into a new franchise agreement with the franchisor.
- Both Buyers and Sellers may want Buyer’s successful acquisition of a new franchise agreement to be a condition to closing (for Buyer’s operation purposes and for Seller’s avoidance of liquidated damages purposes).
- Buyer should be aware that a new franchise agreement may trigger a new property improvement plan, which could increase Buyer’s costs.

Hotel Management Company and Hotel Management Agreement Issues

- Hotel management agreements may either be branded or with a third-party management company.
- When there is a third-party management company, the seller needs to be cognizant of termination rights and notice periods under its management agreement, and the buyer needs to require a termination of the management agreement at closing.
- The representations and warranties in the purchase agreement should capture the knowledge of the hotel manager.
- The seller will need to coordinate with the hotel manager with respect to ongoing operating covenants during the term of the purchase agreement and ensure that the hotel manager transfers any licenses that may be held in the hotel manager's name.

Occupancy and Sales Taxes

- Many states, counties and cities have occupancy and sales taxes, and most jurisdictions provide for successor liability to the Buyer, even if the hotel was sold in an asset sale.
- This means that the Buyer is liable for any pre-Closing occupancy and sales taxes that were not paid by the Seller.
- The occupancy tax rate can range from 5% to 20% and the sales tax rate can range from 5% to 10%.
- Successor liability may not be imposed on the Buyer for pre-Closing occupancy and sales taxes for years after the Closing.
- The Buyer should seek protections in the PSA to minimize the liability, including securing tax clearance certificates from the taxing authorities and/or a Seller indemnity for such taxes that survives the Closing.

Sales Tax Upon Transfer of the Tangible Personal Property and Inventory

- In many states sales tax may be owed upon the sale of the tangible personal property and/or inventory.
- The sales tax rate can range from 5% to 10%.
- Sales tax may not be imposed by the taxing authority until a year or two after the Closing.
- In most states an exemption should apply, but in some states the exemptions are narrow.
- To avoid any surprises after the Closing, the PSA should specify which party is responsible for paying any sales taxes imposed on the sale of the tangible personal property and/or inventory.

Liquor License Issues

- Liquor licenses are not freely transferable in most, if not all, states, so the Buyer either needs to obtain a brand-new liquor license or the liquor licensing authority's consent to the transfer, and in most states that may take several months and may not occur until after the Closing.
- Most Sellers are not willing to wait that long, and thus, make it clear that the Buyer securing such new license or consent is not a condition to the Closing.
- In most states one of two options is available to allow the Buyer to continue liquor operations from and after Closing:
 1. Temporary liquor permit
 2. So-called “interim agreement,” where the Seller allows the Buyer to operate under the Seller’s liquor license



Liquor License Issues (*Cont.*)

- The availability of such options varies widely from jurisdiction to jurisdiction.
- In some states, both options are available.
- In many states, interim agreements are illegal.
- The Buyer should engage local liquor counsel to advise as to such options and to assist with securing the new liquor license or the licensing authority's consent to the transfer.

Special Prorations and Adjustments

- Hotels have many more revenues, expenses and obligations that should be prorated or adjusted at Closing, and many of these are subject to negotiation.
- Examples:
 - The Seller will often want the Buyer to “buy” certain inventories by giving the Seller a credit at Closing for the value of such inventories, but the Buyer will often push back altogether or only agree to buy certain inventories.
 - The Seller will often want the Buyer to “buy” the accounts receivables by giving the Seller a credit at Closing for the face value of such accounts receivable, but the Buyer will often push back or only agree to buy certain receivables and the Buyer may insist on a formula based on the age of the receivables.
 - The Buyer will often want a credit at Closing for the value of any outstanding gift cards and vouchers, and the Seller will often provide a formula with discounts based on the age and type of the gift cards and vouchers.
- The PSA should have a detailed mechanism for reconciling and correcting estimates, errors and omitted items post-Closing given the number and scope of the prorations and adjustments made at Closing.

Post-Closing Obligations and Liabilities & Mutual Indemnities

- Hotel sales have many more potential pre-Closing obligations and liabilities that may arise post-Closing than sales of other asset classes.
- Such obligations and liabilities include (among others):
 - Employment liabilities (such as discrimination and wage and hour claims)
 - Union liabilities (such as a breach of the Collective Bargaining Agreement)
 - Sales and occupancy taxes
 - Personal injury and property damage claims
- Hotel PSAs often contain robust mutual indemnification provisions, whereby the Seller indemnifies the Buyer for certain pre-closing obligations and liabilities, and the Buyer indemnifies the Seller for certain post-closing obligations and liabilities.
- The terms and conditions of such mutual indemnities, and the limitations on the Seller's post-Closing liabilities with respect to such indemnities (such as the basket or deductible, cap and survival period) are often heavily negotiated.
- Where the Seller is a single asset entity, the Buyer will often want some sort of security to backstop the Seller's liability, but the Seller will often push back.

Employee Issues

- Assumption: Because almost always the employer of the employees is the Seller's management company, I will assume that the employer is the management company.
- The PSA needs to address various employment issues, including (among others):
 - The termination of the employees upon Closing and the re-hiring of the employees immediately after Closing
 - The payment and/or proration of wages, salaries, benefits, and accrued paid time off
 - The WARN Act
- The WARN Act is very complex and requires a thorough factual analysis.



The WARN Act

- The WARN Act is a federal law that requires certain employers provide at least 60 days advance notice of mass terminations and mass layoffs, and it imposes stiff penalties on the employer for failing to provide such notice.
- Many states have their own version of the WARN Act, and they are known as “mini-WARN Acts.”
- If the Buyer is engaging a new management company at Closing, the employees will have to be terminated by the Seller’s management company upon the Closing.
- Such termination may trigger the federal WARN Act and/or, if applicable, the mini-WARN Act if the applicable employment loss thresholds are satisfied.
- The federal WARN Act is triggered if at least 50 full-time employees suffer the loss of employment, and “full-time employees” are those who average at least 20 hours per week.
- State mini-WARN Acts, where applicable, may have different and/or lower triggering thresholds or requirements.
- It is critical that an attorney with extensive withdrawal liability experience be engaged work on the employment provisions of the PSA, especially those dealing with the WARN Act.

Unions

- If there is a Union representing any of the hotel's employees, that greatly complicates things, and the PSA needs to account for the Union issues.
- The Union issues that need to be provided for in the PSA include:
 - Sufficient advance notice of the sale to the Union
 - The potential assumption by the Buyer or its Hotel Management Company of the Collective Bargaining Agreement
 - The Buyer signing a new Owner's Letter, where required
 - If applicable, union pension fund withdrawal liability



Pension Fund Withdrawal Liability

- Unionized hotels, particularly in the major metropolitan areas, have Collective Bargaining Agreements that often require the employers to participate in multiemployer defined benefit pension plans for the unionized employees.
- These pension plans are subject to the Employee Retirement Income Security Act (or “ERISA”).
- Withdrawal liability is very complex and technical.
- Under ERISA, whenever there is a “withdrawal,” the Employer will be responsible for paying its share of the amount by which the pension fund is underfunded, and such share is known as “withdrawal liability.”



Pension Fund Withdrawal Liability (*Cont.*)

- Under ERISA, unless an exemption applies, the termination of the Union employees at Closing often will trigger a withdrawal assessment for the employer if the sale results in the employer ceasing to employ most or all of its unionized employees who participate in that fund.
- The withdrawal liability is often very high and can be several million dollars; and sometimes there is no withdrawal liability.
- If the Buyer is engaging a new management company at Closing, because the Union employees will be terminated by the Seller's management company at Closing, if that constitutes most or all of the management company's employees, such termination will trigger a withdrawal and, therefore, may trigger complete or partial withdrawal liability, even if all the Union employees are re-hired.
- However, the PSA may contain provisions that minimize the withdrawal liability to the Seller and existing Management Company, and such provisions are usually heavily negotiated.
- There are many nuances and issues with respect to such PSA provisions, and they are beyond the scope of this overview and webinar.

NOTE: Even though the Seller is not the employer and thus not directly liable for the withdrawal liability, the Seller is usually indirectly liable under the Hotel Management Agreement.



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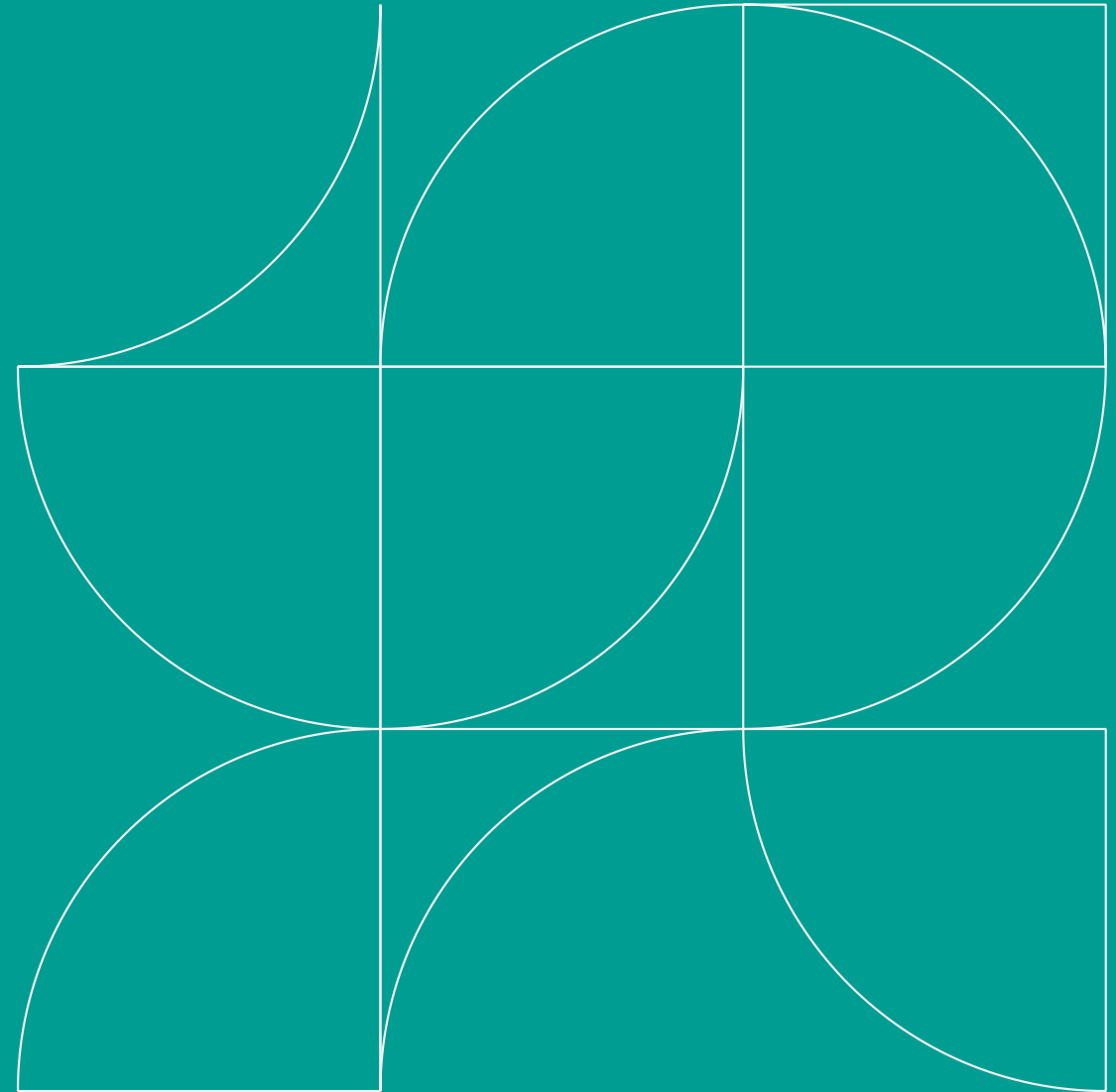
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