Hotel Joint Ventures: Four Keys to Success

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Hotel Joint ventures are springing up like weeds in the hotel industry.

Nearly two years after the collapse of the old economic order of easy money, the biggest players in the hotel industry are using the joint venture structure to seize opportunities for acquisitions and expansion.

But everyone knows joint ventures can be risky. Why is the JV model being used and is there a way to minimize the very real risks that exist in every joint venture?

In her article below, which was recently published by Hotel Business, hotel lawyer Catherine Holmes, a senior member of the JMBM Global Hospitality Group®, explains why the joint venture model is being used for hotel acquisitions and expansion, what inherent risks exist in the the JV structure, and offers “Four Keys to Success in Hotel Joint Ventures.”

Cathy’s straightforward and timely advice is based on her experience representing numerous hotel owners in the acquisition process, whether it is a debt or equity transaction, a joint venture, a public-private partnership, or a deal that requires a complex capital stack. She recently represented Formosa International Hotel Corporation in the acquisition of the Regent brand hotels with operations in Asia, Europe, the Middle East and the Caribbean.

Hotel Joint Ventures: Four Keys to Success
Catherine Holmes | JMBM Global Hospitality Group®

Joint ventures are popping up everywhere in the hotel industry. Nearly two years after the collapse of the old economic order of easy money, the biggest players in the hotel industry are using the joint venture structure to seize opportunities for acquisitions and expansion. In recent months, Starwood Capital and Hersha Hospitality Management announced their joint venture to expand Hersha’s hotel management platform, and Thayer Lodging Group and Jin Jiang Hotels formed a joint venture to acquire Interstate Hotels & Resorts. Though the number of hotel acquisitions is still small, several of those transactions that have successfully closed have used the joint venture model, including the just completed acquisition of the 279-room/suite Renaissance Syracuse Hotel in a joint venture between Richfield Hospitality and Shelbourne Falcon Investors.

Joint Ventures Offer an Alternative to Traditional Financing – and Have Different Risks and Rewards. Using a joint venture model for hotel acquisitions offers the benefits of increased access to capital, sharing of risks and rewards with a partner, access to greater resources, such as specialized staff, technology and expanded relationships. Particularly in the current economic environment where traditional lenders are reluctant to invest new capital in the hotel business, a joint venture with partners already active and committed to the hotel business offers an alternative means of financing potential future business expansion. Hotel investors hoping to seize buying opportunities for prime assets may find that the only way they can finance the cost of acquisition is by bringing in joint venture partners. However, a joint venture also creates
its own risks, and these risks are best be addressed by the parties at the time the joint venture is formed, rather than waiting until problems develop later.

**The Essence of a Joint Venture.** A joint venture is, essentially, a partnership between two or more partners who intend to be active in the business. In many joint ventures, the parties intend that the partners will be co-equal in making key decisions for the joint venture, including such key decisions as when to contribute more capital to the joint venture, and when to buy or sell an asset. A joint venture is often created through the formation of a new entity, most often either a general partnership, limited partnership or limited liability company. The rights and obligations of the parties to the joint venture are governed by the partnership or limited liability company (“LLC”) agreement entered into by the parties as investors in the partnership or LLC.

**The Key Internal Risks of a Joint Venture.** As Peter Connolly, Executive Vice President – Operations and Development of Hostmark Hospitality Group and former General Counsel of Hyatt Hotels puts it, “So many times venture meetings, particularly in large ventures will go on waxing poetic about the wonderful opportunity without focusing on the nitty gritty issues of how capital comes in to the deal, how the venturers will decide to spend money, and ultimately, if there is a division of opinion about what the right course of action is in the deal process, who gets to decide.” In other words, the biggest internal risks of a joint venture are disagreements between the partners on important business decisions, such as whether or how much more capital to invest in the business, whether or on what terms to sell assets, what contracts and commitments should the business enter into, and whether both partners are contributing the quantity or quality of services they promised to the business, and when and on what terms new partners should be admitted to the joint venture, or existing partners should be allowed to exit the joint venture.

**Four Keys to Success in Hotel Joint Ventures** Here are four of the most important ways that the internal risks of a joint venture can be assessed and minimized:

1. **Know Your Partners** – Do a thorough assessment of the relative financial strength of the partners, their past history with other business partners, their management style and philosophy, and the personal chemistry between the management of both partners.

2. **Pick the Bus Driver** – Pick the party or the person who is going to run the venture, and vest that entity or individual with the power and ability to get things done. As Peter Connolly advises, “Someone has to drive the bus, and that role has to be made clear at the outset or, when the negotiating process gets to the difficult points, nothing will get done.” That obviously requires that the venture partners have a great deal of trust in the person or entity who holds the primary power in the venture, but without that, the joint venture will not be able to act decisively when it is necessary to make decisions and take actions.

3. **Decide All the Important Issues in Advance and in Writing** – Create a thorough partnership or LLC agreement that provides the full details of each party’s specific obligations, with timelines for performance, as well as specific steps that can be taken by the aggrieved party when the other party fails to fulfill its obligations. The partnership or LLC agreement is what the parties have to protect them when things go wrong, and the more detail there is in the document, the easier, faster and cheaper it will be to resolve any problems if and when they arise or, if need be, unwind the joint venture if it is not possible to continue.
4. **Deal with Conflicts of Interests Up Front**– If there are inherent conflicts between venturers (ie, a manager/owner conflict) get those out on the table at the beginning and resolve them or resolve the method for resolution before engaging in any serious negotiations. For this process to work, the partners have to understand and agree that they cannot have secrets from each other on matters that involve the venture. If there are issues that likely will cause parties to distrust each other’s motivations, set up a process that forces conversation and resolution within a specified time period.

Peter Connolly tells this story to illustrate this point: *I once ran a venture between six hotel companies doing an internet startup deal. The process was much like herding cats. Every day I would have to remind the venture parties why it was good for them to overcome their natural distrust of each other to do the deal, then get them together to advance a couple of issues, and then pull them apart before they remembered how much they really hated each other. Two of the companies were there because they were afraid not to be there. When it came time to close, they bolted, and the structure failed as a result. The process of deal making takes too long and costs too much to let that happen.*

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**Catherine DeBono Holmes** is a hotel lawyer with JMBM’s Global Hospitality Group® and specializes in resort and hotel purchase and sale transactions, resort and urban mixed-use developments, hotel management and franchise agreements, and hospitality asset workouts.

She recently represented Formosa International Hotel Corporation in the acquisition of the Regent brand hotels with operations in Asia, Europe, the Middle East and the Caribbean. Cathy also assists hotel owners, lenders and investors with complex entity structuring, as well as public and private offerings of debt and equity securities. She has worked extensively with hotel owners in the recruitment and selection operators, and negotiation of hotel management and franchise agreements. For more information, please contact Cathy Holmes at 310.201.3553 or cholmes@jmbm.com.

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Jim Butler is a founding partner of JMBM and Chairman of its Global Hospitality Group®. Jim is one of the top hospitality attorneys in the world. GOOGLE “hotel lawyer” and you will see why.

JMBM’s troubled asset team has handled more than 1,000 receiverships and many complex insolvency issues. But Jim and his team are more than “just” great hotel lawyers. They are also hospitality consultants and business advisors. For example, they have developed some unique proprietary approaches to unlock value in underwater hotels that can benefit lenders, borrowers and investors. (GOOGLE “JMBM SAVE® program”.)
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