

Navigating HMAs: Brand Standards



In the competitive global arena of the hotel sector, “brand standards” play a pivotal role in market positioning, performance and the guest experience. In our previous article, “[Navigating HMAs; Key Points for Hotel Owners and Operators](#)” we outlined some of the key commercial points for consideration when negotiating hotel management agreements (“**HMAs**”), including “brand standards”. In this article, we explore in further detail what is meant by “brand standards”, why they are such a critical component in a HMA and the key considerations for both owners and operators.

What are “brand standards”?

“Brand standards” (also sometimes referred to as “operating standards”, “system standards” or simply “standards”) are the standards and requirements that are generally applicable to the design, construction, furnishing, marketing and operation of all hotels operated under the same brand (or group of brands).

These standards will typically include “operational standards” in respect of service and quality levels (this will be particularly pertinent for the operation of luxury hotels), “physical standards” covering design, FF&E (furniture, furnishings, fixtures and equipment) and potentially replacement/renovation schedules, and “technology standards” governing the usage of systems and technology.

It’s all about the money

Whilst the concept of “brand standards” can, at first glance, appear to be relatively operational and administrative in nature, the HMA terms linked to those standards are of real commercial and financial significance. The application of the “brand standards” can have a material impact on the financial returns of both the owner and operator.

In principle, both parties should be aligned in seeking to maximise revenue from the operation of the hotel (and a HMA will typically include an obligation on the operator to seek to maximise profits). However, an operator will also have broader considerations as to any bearing that the operation of a specific hotel may have on its market reputation and brand that may adversely impact the performance of its managed portfolio.

For the owner, an understanding of the scope of the “brand standards” (and the ability for these to be varied/updated by the operator – see “Updating the “brand standards” below) is critical as a number of the

service obligations (and potentially owner funding obligations relating to FF&E and capital expenditure) are generally linked to these. Owners need to ensure that any financial obligations linked to “brand standards” are balanced and manageable.

Balancing operator autonomy versus owner oversight

Operators will generally expect a high degree of autonomy to manage the day-to-day business of the hotel in accordance with their own “brand standards”. This is particularly important in connection with the operation of luxury hotels where brand consistency and image are fundamental to financial performance and guest loyalty. From an operator’s perspective, it is appointed as a specialist manager and should be entrusted with authority by the owner to determine the appropriate manner in which a hotel should be managed in compliance with its “brand standards”.

A HMA will ordinarily include a requirement on the owner to fund capital expenditure necessary to maintain the hotel and FF&E in accordance with the “brand standards”. Such an obligation may have a direct impact on the owner’s financial returns. Therefore, the HMA will need to strike the appropriate balance between giving the operator the necessary operational discretion whilst allowing the owner proportionate consultation on key matters and sufficient commercial comfort as to actions that may adversely impact profitability. In particular in relation to material capital expenditure programmes (see “Keeping up appearances: upgrades and renovations” below), an owner may seek to include express requirements on the operator, in good faith, to consider proposal revisions and/or alter native programmes consistent with the “brand standards” that it may propose.

Updating the “brand standards”

HMAs are generally long-term contracts; larger branded operators will generally seek longer-term contracts (typically around 20 years), potentially with unilateral renewal rights for additional periods, to secure their brand presence/reputation. Over the term of a HMA, there are likely to be changes in market demands/preferences, new innovations and, potentially, a general brand refresh.

An operator will therefore be focused on ensuring that it has the requisite flexibility to update its “brand standards” from time to time to align with its managed portfolio. An international hotel operator will generally be resistant to any constraints on that flexibility. However, material changes to the “brand standards” can result in significant owner cost so there is inherent tension. Therefore, an owner will want to maximise its visibility as to the basis for any updates and, where possible, negotiate certain agreed update parameters. For example, a proviso that an owner is not required to implement any changes to the “brand standards” that would increase the gross square footage of the hotel, materially change the standard guest room size or configuration and/or materially impact the hotel’s structural design (including, for example, changes to ceiling height, scale of window openings and the load bearing structural frame). The rationale being that the operator has been appointed on the premise that it has accepted the core structure of the hotel.

HMAs may include provisions to facilitate owner consultation and agreement, particularly concerning substantial amendments. In particular, an owner may want contractual comfort that any updates are being implemented in good faith by the operator in a consistent manner across its managed portfolio and do not disproportionately impact the owner’s hotel. Particularly where an operator manages hotels under the same brand but within diverse geographies, targeting different clientele

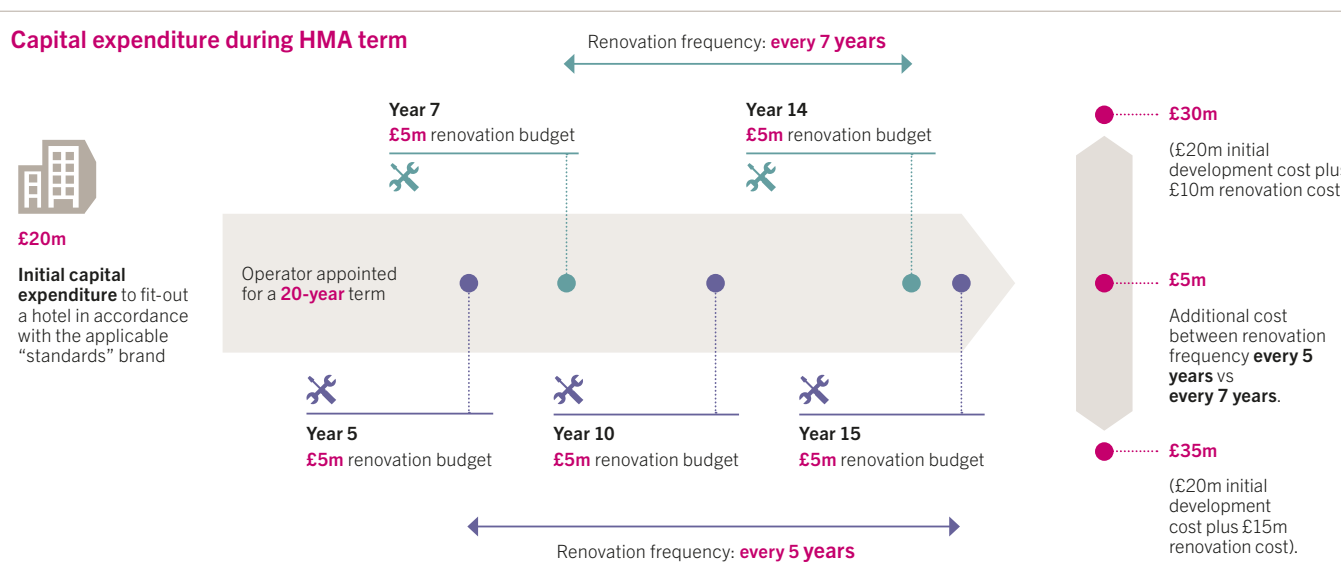
(e.g. business versus leisure travellers) and/or applying distinct operating models (e.g. hotel versus resort), an owner may require parameters in how an operator segments its portfolio for the purposes of determining what updates are necessary.

Further, particularly in relation to the development of a brand-new hotel (or following a material renovation) where an owner has expended considerable financial resources in aligning the hotel with the relevant “brand standards”, an owner may seek an initial period (typically two to five years) during which the operator’s general right to update the standards, where such updates would require capital expenditure and/or FF&E expenditure, is suspended save to the extent necessary in connection with an emergency or to comply with applicable law. Such a suspension right may also apply throughout the HMA term on a rolling basis in respect of any upgrades to hotel facilities or components solely due to changes in the “brand standards” to ensure the owner is not exposed to a sudden whim from the operator.

Keeping up appearances: upgrades and renovations

Hotels will, in the ordinary course, undergo wear and tear. Ideally there should be commercial alignment between owners and operators as to the need to maintain a hotel in good order to ensure its smooth operation with a view to maximising returns. However, there is considerable scope for divergence of opinions between owners and operators in relation to the implementation, both in terms of scope and, in particular, frequency, of material upgrades and renovations in accordance with the “brand standards”. This may be particularly pertinent where the projects in question are more focused on upgrades/new initiatives as opposed to ordinary course maintenance/renovation.

Operators will generally view such upgrades and renovations positively as a means to maintaining consistency across its managed portfolio (which may be important from both a reputational and operational perspective) as well as reinforcing brand positioning, goodwill and appeal in order to maximise room rates and therefore revenue. While operators typically receive remuneration through both a base fee (calculated as a percentage of revenue) and an incentive fee (calculated as a percentage of operating profit), these components are affected differently by renovation costs. The incentive fee is directly impacted by material capital expenditure as it reduces operating profit. In contrast, the base fee provides operators with a degree of certainty in their income regardless of renovation costs, since it is tied to revenue rather than profit. However, it’s worth noting that renovations which temporarily reduce occupancy will adversely affect revenue and, consequently, the base fee during that period.



Conversely, an owner will generally be more cautious as to large capital outlays preferring to defer such projects as long as possible, in particular where the hotel is performing strongly and there is less clarity as to its return on investment.

HMAs and related “brand standards” often do not contractually prescribe the time periods within which renovations should be undertaken. As such, there is the potential for misalignment. In particular where the operator’s appointment under a HMA is long term, there is arguably a benefit for both parties (but, as the operator may have broad operational discretion, particularly for the owner) in there being some up front clarity as to the operator’s anticipated expectations for the renovation programme. Changes in the renovation frequency can have a material financial impact (see the simple illustrative example above). Establishing that certainty can be beneficial over the longer term in minimising the scope for conflict and allowing both parties to forward plan with greater clarity.

Conclusion

HMAs are multifaceted contracts that always require careful negotiation and strategic foresight. “Brand standards” are integral in framing the hotel’s market position and appeal. A well-structured agreement will consider the flexibility of operators to update “brand standards” while ensuring owners have suitable rights to safeguard their commercial and operational interests.

At Linklaters, our real estate team brings a wealth of experience in both corporate real estate and in the hotel and leisure sector as well as a commercial approach to structuring and negotiating HMAs to enable our clients to meet their commercial objectives while navigating the complexities of the hospitality industry.

For expert guidance through these challenges, please reach out to our real estate team at Linklaters.



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