



The Global Hospitality Advisor

### Ask the Hotel Lawyer™

## Condo Hotels: Who Owns What? Who Controls What? Who Pays for What?

“Ask the Hotel Lawyer”™ is a regular feature column of the Global Hospitality Advisor®, providing practical insight into timely legal issues.

June 2006 - In the last column, Jim Butler addressed the complex issue of “condo hotel splits.” In this column, he will share lessons learned at the Condo Hotel Boot Camp session of The Hotel Developers Conference™ sponsored by JMBM’s Global Hospitality Group®.

Our recent Condo Hotel Boot Camp packed a full day’s worth of information into four short hours. In the session titled “Where the Rubber Meets the Road,” four industry professionals distilled into their essential components, answers to the important questions: Who Owns What, Who Controls What, Who Pays for What? I am grateful to JMBM clients and friends Brent Howie, President of Provident Management Corporation and Peter Connolly, President of Palladian Development for sharing their expertise. Together, with my partners Catherine Holmes and Guy Maisnik of JMBM, Brent and Peter provided excellent material for this column. Isabelle Claver of PriceWaterhouseCoopers moderated the panel discussion.

The short answer to each question (Who owns what? Who controls what? Who pays for what?) is: it depends. Not all condo hotel projects are alike, but all must address these critical questions up front and answer them fully in their project’s documents. For example, developers will want to retain ownership of the revenue-producing parts of the condo hotel, but will exchange control of those areas for the flag that will help sell condominiums at a premium. Unit owners are willing to exchange control of common areas for good management and excellent amenities. But everyone must pay their fair share, and the allocation of fair payments is critical to a condo hotel’s success.

## **Shared Facilities and Common Areas**

While condominium units in a condo hotel are owned individually, condo owners share many areas with each other and with hotel guests. Who owns these areas and who has control of areas like the lobby, front desk, kitchen, “back of the house” and parking lot? How are they paid for and how are responsibilities for maintenance enforced?

In many cases, owners and guests also share services such as spa services, bell services and food services. Again, who controls these services, pays for them and has control of them? The owner of the hotel? The operator of the hotel? The homeowners association (HOA)?

When JMBM’s Cathy Holmes asked the Condo Hotel Boot Camp audience if they really wanted 200 unit owners deciding how to decorate the lobby of their condo hotel, the answer to the dilemma became clear: the developer or operator should control the hotel’s non-revenue producing critical areas, but must ask homeowners and others who use them to pay for their fair share of usage.

## **Accounting for All Shared Facilities**

Many developers neglect to take a hard look at all parts of their project, including the “non-public” spaces that do not generate revenue—like the property’s loading dock—who pays for them and controls them?

Peter Connolly, President of Palladian Development, described the discipline of going through each area of his company’s 65-story condo hotel project in Chicago and allocating each function and space to its appropriate column using the Uniform System of Accounts for the Lodging Industry.

All expenses have to be accounted for before fair allocations can be determined. Which are commercial charges and which are room charges? What is a fair allocation for shared facilities and services like security and engineering? Although it is a painstaking process, the allocation formula will be meaningful only when all costs are accounted for.

## **No One “Right Way”**

Provident Management Company has operated condo hotels for 20 years. President Brent Howie remembers when HOAs had control over all common areas. With condo hotels now proliferating, he has seen the pendulum swing to the direction of hotel operators having all the control. He believes we will see the pendulum swing back a bit, with more control for the HOA. He told the audience: “If owners are ultimately responsible, they will want a say.”

He points out that in situations where all units do not participate in the hotel’s rental program, non-participating unit owners may not have full access to facilities and services. In these cases, the unit owner’s maintenance agreement can state that where they have no access, they are charged no fees.

But in a luxury condo hotel scenario, the brand will control many of these decisions by dictating strict standards of uniformity. Owners will willingly give up rights to make decisions, including the right to decorate and maintain their individual units. Standardization is necessary to satisfy the expectations of guests of 5-star properties, and unit owners who pay a premium for luxury property units see standardization as a mechanism for protecting the value of their condominium. In these settings—such as the Mandarin Oriental Hotel and Residences, a condo hotel in Chicago under construction by Palladian Development—the guest room corridors may be the only common area that is controlled by the homeowners association (HOA). But even then, the HOA must comply with the strict standards of maintenance and decor that are set by the condo hotel's operator. Condo owners that do not participate in the hotel's rental program must also comply with these standards, including standards for their individual units. The quickest way for a 5-star hotel to become a 3-star hotel is to have varying room standards.

In the luxury brand condo hotel, developers will also give up a certain amount of control in exchange for the value that the brand brings to the price of condominium units.

But whether a luxury condo hotel or a mid-tier property, developers and operators will want to reasonably limit the rights of unit owners. The developer and the operator will require flexibility so that necessary adjustments can be made regarding the operation of the property. Markets, tastes and circumstances change, and the developer and the hotel operator cannot be locked into agreements with an HOA that seem reasonable when made, but will cause problems later.

### **Allocations Must Be Fair**

When allocating costs for common areas and shared facilities, no one formula can apply to every condo hotel property. But all the experts agree that there must be some substantiated logic to the formula, and the logic must be fair to all involved.

The formula can be based on square footage, by the value of each unit, by the purchase price of the unit or by some other logic that owners will understand. All parties must feel the allocation is fair, but it is up to the developer to make sure that all costs are taken into account when devising the formula. Trust in the hotel management and confidence in the project's developer will suffer if unit owners must be asked to write checks for unexpected expenses.

### **Critical Documents**

Critical documents will govern who owns what, who controls what and who pays for what. Guy Maisnik of JMBM pointed out that it is desirable to have as few documents as possible, but in all cases the documents must be comprehensive and carefully integrated. For example, a condo hotel in a large mixed-use development will include not only a hotel and an HOA, but might include retail, parking garages, a theater and so on. Each separate area has special interests and must be represented in the documents.

Documents must contain clear procedures as to who talks to whom and who pays for what, and it all has to work together.

The documents governing ownership, control, and payment typically include: 1) Covenants, Conditions & Restrictions (CC&Rs), 2) the unit purchase agreement, 3) the unit rental agreement (if offered), 4) the unit maintenance agreement, 5) an association management agreement (if the HOA wants management), 6) a shared facilities agreement (sometimes, not always), 7) the property report, and 8) the hotel operating agreement.

While each condo hotel will be structured somewhat differently, all areas of ownership, control and payment must be clearly detailed in the documents. Many of the documents will overlap and must work together so that the condo hotel operates smoothly, all parties interests are protected and it is clear as to who owns what, who has control of what and who pays for what.

## **Insurance**

Insurance is vital, particularly in resort areas prone to hurricane activity, and developers will want to control this area. In a residential condominium, the HOA typically buys insurance for the structure of the building and the common areas (property damage and liability). In a hotel context, property damage and liability insurance for operations is also needed, as is “loss of revenue” insurance. Developers have to make sure that unit owners have the right insurance and that their insurance remains current.

Lenders will require insurance from individual unit owners, and in many cases these policies will overlap with other insurance for the property. Although there is discussion in the marketplace, the insurance industry has not yet developed a product that will insure all units in a condo hotel.

## **Enforcement**

Enforcing the agreements can be complicated, depending on state law. In California, for example, an association has the right to place a lien on a property if the unit owner doesn't pay for its agreed-upon allocations. However, developers do not have that right. A developer has to file a lawsuit, get a judgment and enforce the judgment. And although most states allow liens, state agencies exist to protect consumers and a state's Department of Real Estate can negate those rights. (This is not the case in many other states.)

The best course of action is to maintain good relationships with unit owners and find out why they aren't paying. If they are unhappy, owners and operators may be able to correct the problem they are experiencing. If they are unable to pay, a “buy-back” program might be the best solution. Provident Management, for example, has an onsite re-sale program that includes a buy-back option. The Trump organization is legendary for its generous buy-back policy, which helps to keep happy, paying residents in their properties.

But Peter Connolly points out that, from an operational perspective, owners and developers cannot avoid the fact that they will have to deal with unit owners on a personal basis, no matter how the documents read. "That is how it works in the real world," he told us. And the real world is where the hospitality industry lives and breathes.



Jim Butler is Chairman of the Global Hospitality Group® of Jeffer, Mangels, Butler & Marmaro LLP, a full-service business law firm with more than 150 lawyers in Los Angeles and San Francisco. The Global Hospitality Group® has more than 1,000 transactions spanning the globe, representing \$35 billion in total acquisitions, sales, developments and financings of hospitality properties and companies. The Group has now been engaged to advise clients on more than 60 condo hotel projects located in every major market in the United States and Latin America. Jim can be reached at 310.201.3526 or [jbutler@jmbm.com](mailto:jbutler@jmbm.com).

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