

The Agreement Outlives the Promise

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The franchise agreement is the most consequential document most hotel owners ever sign, and the least examined.

It runs ten to twenty years. It carries liquidated damages, mandated capital, fee escalators, and territorial terms. It is signed, more often than not, in a hopeful hour: a new flag, a fresh start, a lender comforted by the name on the sign.

The promotional case for the flag is real. Distribution, loyalty, corporate demand, the credibility of a system. We do not dispute it. A well-chosen brand on the right asset in the right market compounds quietly for decades.

But the agreement and the promise are not the same instrument. The promise is what the owner believes he bought. The agreement is what he actually signed. And across the life of a franchise, at its beginning, its middle, and its end, there are three points where the two quietly part ways. Almost no one prices any of them.

We price all three.

During the term: the market you actually bought

The owner believes his radius clause protects his market. Read the clause again: the protection is almost always defined by the specific flag, not the brand family.

The major hotel companies now each carry thirty or more brands. This is not an accident or a failing. It is one of the more skillful pieces of business strategy the industry has produced. Segmentation lets a parent capture demand at every price point, in every market, without cannibalizing its own premium positioning. It works. It is also, by now, permanent.

But segmentation has been executed so finely that the tiers have gone soft at the edges. Two flags under one parent can sit a few dollars apart in rate, nominally in different tiers, serving the same guest, differentiated by a breakfast format or a fitness offering. Inside the corporate deck, those distinctions are real and defensible. On the ground, to a traveler comparing two options on the same street on the same night, they are considerably less meaningful. He is choosing between two hotels. He does not know, and has no reason to care, that one is positioned to protect the other.

It is worth asking who defines a tier in the first place. Chain-scale classification is driven substantially by achieved room rate, which makes tier a consequence of pricing rather than a measure of product. A brand that prices a few dollars higher is classified a step above, and the amenity that supports the premium can be modest: a hot breakfast rather than a continental one, a meat component added to it, a fitness room of a certain size. The tier is not a fixed standard applied from outside. It is dynamic, it moves with rate, and the parent has meaningful influence over where its own flags land.

The result is a portfolio that is less tiered than tier-ish. And it is the tier-ish neighbor, not the identical flag, that shows up in the owner's comp set.

That is the gap the radius clause does not close. It restrains the parent from placing another hotel flying the owner's exact flag nearby. It does not restrain the same parent from placing a sibling into the same trade area. And the clause is narrower still than it reads: protections routinely carve out properties already in the pipeline at signing, conversions of existing buildings, and assets held by an affiliate rather than the parent. Many expire well before the agreement does, five or seven years of protection against a fifteen-year term.

There is also the matter of what happens after signing. An owner who signed in one year negotiated against the parent's portfolio as it existed that year. When the parent later acquires another company, every brand in the acquired family becomes a sibling his clause never contemplated.

We want to be precise about what we are and are not saying. There is nothing improper in any of this. A franchisor is entitled to build its portfolio, to place its brands where the demand supports them, and to write its agreements to preserve that freedom. The documents are not hiding anything; they say exactly what they say. Multiple brands under one umbrella in a single market is a legitimate and durable feature of this industry, and it is not going away.

The failure, when it occurs, is not the franchisor's. It is in the underwriting.

An asset penciled against a protected trade area does not perform as underwritten when a sibling flag opens into the same demand pool. Occupancy splits. Rate softens. The comp set the owner modeled was the wrong comp set. We have underwritten assets whose original thesis was undone by exactly this. Not by mismanagement, and not by anything anyone did wrong, but because the owner priced a market that his agreement never actually promised him.

Everything has a price. Segmentation risk has a price. The question is not whether a parent will place a sibling nearby. It may, and it is entitled to. The question is whether the buyer priced that possibility before he signed, or assumed a protection the document does not contain.

Mid-term: the flag is an asset too

There is a second risk no feasibility study models: the brand itself can be sold.

The agreement binds the owner to the flag. But to the parent, a flag is a portfolio asset like any other. Strategies shift, segments fall from favor, and a brand that no longer fits the family's structure becomes non-core.

We would go further than calling this permissible. It is frequently the right decision, and it takes discipline to make. A brand that has not found its footing, that does not draw the guest, does not command the rate, does not earn its place beside its siblings, is a drag on the system it sits in. Every dollar of development attention, distribution priority, and capital spent propping it up is a dollar not spent on the brands that are working. Holding it inside the family to avoid the admission dilutes the whole portfolio. Divesting it to a system where it may fit better, and redeploying the capital and the shelf space into something with a clearer thesis, is sound portfolio management. It is the same instinct that governs our own work: do not put good money after bad, and do not let a weak asset draw resources away from strong ones.

A parent that prunes a brand it can no longer champion is doing what a good operator does.

The agreement contemplates this. It permits assignment, it survives the transfer, and it says so in language that is available to anyone who reads it. When the flag moves to a lower-tier system, the owner's obligations travel with it: same fee schedule, same remaining term, same liquidated damages, now attached to a loyalty program with less reach, a reservation engine that delivers differently, and a customer who books at a different rate.

We have watched ownership groups absorb exactly this. An owner who bought into a top-tier family's flag, underwrote his asset on that family's distribution and pricing power, and then learned the brand had been sold two tiers down. He had paid for a Ferrari. After the sale, he was holding a Chevy, with Ferrari payments still owed on it for years.

The losses compound quietly. Loyalty migrates. Pricing power softens against a comp set that now outranks the flag. Penetration erodes as a different system delivers a different guest.

None of which the parent did to him. It made a portfolio decision it was entitled to make, under a document that permitted it. What went wrong went wrong earlier, at underwriting: the owner priced the parent's brand equity as though he had purchased a share of it. He had not. He had purchased a contractual right to display a name, and names, like any other asset, change hands.

At exit: the branded life you actually own

The third exposure arrives at the moment the owner expects to be paid for everything he built.

Every buyer of a flagged hotel prices his exit as a branded asset. The trailing cash flows, the trend line, the discounted cash flow, the cap rate at disposition all assume the name on the sign survives the sale. It is the quietest assumption in the entire underwriting, and it is frequently wrong. A franchise agreement does not follow the property. The next buyer does not inherit the flag. He applies for it, and the franchisor decides freshly, at its sole discretion, whether to grant a new term.

That discretion is not unreasonable. A brand's value depends on the consistency of its system, and a fifteen-year-old plant measured against a current prototype may genuinely fall short of it. Declining to re-commit, or conditioning renewal on a substantial property improvement plan, is how a franchisor protects every other owner flying the same flag. It is the correct behavior from where the franchisor sits.

It is simply expensive from where the seller sits. Renewal at end of term is frequently declined, or granted on terms that amount to the same thing: a PIP heavy enough to consume the buyer's returns before the ink dries. And the seller discovers it at the worst possible moment. The asset he priced as a branded hotel is, to its realistic buyer pool, something else. An unflagged building, or a property whose only path forward is a pivot to a lesser system, at lower rate, weaker capture, a lower multiple.

Again, no one did anything to him. The agreement always said the term was the term. What he never priced is that a remaining term is not a number of years. It is the fraction of the asset's branded life he actually owns, and what he sells at the end of it may be the building rather than the flag.

The through-line

Three exposures, one structure. During the term, the protection covers less than it appears to. Mid-term, the brand itself can change hands. At exit, the flag may not survive the transaction. In every case the mechanism is the same: the agreement outlives the promise. The obligations are durable. The value proposition is not.

What is worth noticing is that none of this is concealed. Every one of these outcomes is permitted by the document, disclosed in it, and consistent with how a rational franchisor manages a brand system. The franchise disclosure documents are long, they are available, and they say what they say. There is no trick here and no one to blame.

A risk that is fully disclosed and never priced is more dangerous than one that is hidden, because everyone assumes someone else has accounted for it.

Which is precisely why it keeps happening. The owner reads the promise. The lender reads the trailing statements. The appraiser reads the comp set. Very few read the agreement as what it actually is: a schedule of the ways in which the thing being purchased can change while the payments do not.

These structures are not going away, and there is no reason they should. Multiple brands under one umbrella, portfolio divestitures, renewal at the franchisor's discretion. All of it is durable, defensible, and here to stay. The question is not whether any of it is fair. The question is who is paying attention, and whether it was priced.

What we ask before a dollar moves

When we underwrite a flagged asset, or weigh a flag for one we intend to reposition, the brand's brochure answers none of the questions that matter. These do.

How is the territorial protection actually defined, and against how many of the franchisor's own siblings? Is this flag core to the parent's portfolio, or does it sit at the edge of the family: the wrong tier, the odd segment, the acquisition that never integrated? Has the brand been invested in, or quietly starved? What does the remaining term truly represent, not in years, but as the fraction of the asset's branded life a buyer actually gets to own? Would this franchisor renew this building, in this market, at this age of plant, and if not, what is the asset worth under the most likely replacement flag, at that flag's rate structure and that flag's multiple?

If the value only works as long as the brand stays, and the brand has no reason to stay, then the trend line is a lease on borrowed identity, and we price the building rather than the flag.

Which of these exposures a given asset actually faces, and what can be structured, negotiated, or built into the agreement to survive them, is a function of the specific document, the specific brand, and the specific market. Which is to say: it is the work itself.

Theosis Capital Management acquires and repositions distressed hospitality assets. We don't pursue opportunities. Opportunities pursue us.