

## Looming Hotel Bankruptcies Impact Loan Workouts

Part One of a Two-Part Series Covering Hospitality Industry Bankruptcy Considerations

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COVID-19 has been devastating for hotels and other businesses in the hospitality industry because of significant business closures and the elimination of recreational travel. Oxford Economics predicts 2.8 to 3.4 million jobs will be lost in the hotel industry, which is staggering when compared to the 470,000 jobs that were lost during the recession between 2007 and 2009.[1] The impact has already been seen in some jurisdictions where hospitality bankruptcies are up by 123%.[2]

Hotels in New York, the epicenter of the outbreak in the U.S., have been closed for weeks and are keenly aware of the impact on their business. Other east coast cities, including Boston, Philadelphia, and Washington D.C., have similarly seen their hotels closed for weeks. Many already face the inability to pay employees, vendors, taxes, and/or continued debt service. Loan defaults are almost inevitable and will lead to challenging discussions between hoteliers and their lenders to try to reach an acceptable workout plan. A significant consideration for both lenders and hoteliers during these discussions will be the possibility of a bankruptcy as a restructuring option for the hotelier. Lenders and hoteliers will need to evaluate the risks and potential benefits of a bankruptcy. Measures to consider include:

- **Evaluation of the Hotel's Position.** A significant starting point is evaluating the hotel's pre-pandemic and current financial condition by analyzing the hotels pre-pandemic RevPar (revenue per available room), CoR (cost per occupied room) and other key performance indicators, as well as the plan to return to pre-crisis levels. Lenders will be more likely to extend additional credit or enter into forbearance agreements if they believe there is a likelihood the business will be able to continue to operate after the crisis is over and less likely to do so if the business was already struggling before the crisis. Hoteliers will likely need to utilize a portion of their credit line or reserves to operate during a bankruptcy. They will need to analyze their reserves as well as the necessary pre- and post-bankruptcy expenses to ensure they are able to file and complete a reorganization before exhausting their reserves.
- **Cash Collateral Issues.** In addition to using reserves, the hotel will need the use of its income after filing a bankruptcy petition. However, the lender may have a lien against that income, which is generally determined by state law. A Uniform Commercial Code (UCC) search should confirm whether the lender has secured its interests. If the lender has correctly done so, the Bankruptcy Code specifically recognizes a lender's lien rights to the hotel's post-petition income.[3] If the business is to continue to operate, the hotelier will need to obtain the lender's consent and/or court permission to use its post-petition income.
- **Single Asset Real Estate Requirements.** A hotel may qualify as a single asset real estate (SARE) case under the Bankruptcy Code, [4] which provides some unique requirements.[5] This designation includes being subject to an expedited timeline for filing a plan for reorganization, limitations on the ability of a lender to seek relief from the bankruptcy automatic stay during the first 90 days after the case is filed, and potentially treating the lender's deficiency claim as a separate class for plan purposes. In addition, if the hotel is in a SARE bankruptcy case, it may avoid seeking consent from the lender to use cash collateral so long as it pays interest, at the non-default rate, to the lender.[6] There are benefits and burdens involved with making the election to be treated as a SARE. Either the hotel owner or the lender may make the election to have the case treated as a SARE, so both will need to evaluate how a SARE election would affect their interests.
- **Loan Adjustments.** Where the parties cannot resolve the lender's claims, the hotel owner may seek to "cramdown" the loan debt to the value of the collateral (i.e. the hotel) as of the effective date of the bankruptcy plan.[7] The amount of the debt that exceeds the

value of the collateral will be treated as an unsecured, deficiency claim. As part of a bankruptcy plan, it may also be possible to adjust the applicable interest rate and extend the term of the note.[8] Many hotels will see the value of their businesses drop significantly as a result of COVID-19. Reductions and/or adjustments to secured debt based on the value of the business through a cramdown can be a tremendous tool for borrowers primarily concerned with exiting bankruptcy and being able to restart and ramp up their business operations. Lenders may view the threat of bankruptcy as a reason to offer terms of forbearance in an effort to reduce the costs of administration of the loan.

These factors often form the backdrop for loan workout negotiations and pre-bankruptcy planning. The parties cannot afford to wait until a hotel bankruptcy is filed to consider these issues. Lenders will want to ensure they have properly secured their interests and consider the potential risks to their collateral prior to bankruptcy. Similarly, hotel owners will want to evaluate how a bankruptcy may be utilized so that they only go into a bankruptcy with a strategy for efficiently reorganizing and exiting the bankruptcy. With these issues in mind, both parties should enter negotiations looking to make compromises. However, where a resolution cannot be reached, both parties should be prepared to maximize their options in bankruptcy.

Stay tuned for Part Two of our hospitality industry series, which will explore restructuring and bankruptcy issues for retailers and restaurants.

Our Financial Restructuring and Bankruptcy Group advises business across various sectors, including both lenders to, and those in, the hospitality industry on loan workouts, financing options, Chapter 11 bankruptcy reorganizations and other issues. If you have questions or would like additional information, please contact Heidi Sorvino (sorvinoh@whiteandwilliams.com; 212.631.4417), Tom Pinney (pinneyt@whiteandwilliams.com; 215.864.6371) or James Vandermark (vandermarkj@whiteandwilliams.com; 646.837.5791).

As we continue to monitor the novel coronavirus (COVID-19), White and Williams lawyers are working collaboratively to stay current on developments and counsel clients through the various legal and business issues that may arise across a variety of sectors. Read all of the updates [here](#).

[1] [usatoday.com/story/travel/hotels/2020/03/20/coronavirus-half-us-hotels-could-close-amid-pandemic/2885071001/](https://www.usatoday.com/story/travel/hotels/2020/03/20/coronavirus-half-us-hotels-could-close-amid-pandemic/2885071001/)

[2] [reuters.com/article/us-health-coronavirus-sweden-bankruptcy/Swedish-hotel-and-restaurant-bankruptcies-sour-as-pandemic-hits-idUSKBN21J4D5](https://www.reuters.com/article/us-health-coronavirus-sweden-bankruptcy/Swedish-hotel-and-restaurant-bankruptcies-sour-as-pandemic-hits-idUSKBN21J4D5)

[3] 11 U.S.C. §§ 363(a) and 552(b).

[4] 11 U.S.C. § 101(51B)

[5] Resorts or full-service hotels may not qualify because of the significant income derived from non-real estate related services. See *Centofante v. CBJ Dev. (In re CBI Dev)*, 202 BR 467 (BAP 9<sup>th</sup> Cir. 1996)

[6] 11 U.S.C. § 362(d)(3).

[7] 11 U.S.C. § 1129(b).

[8] See *In re MPM Silicones, LLC*, 874 F.3d 787 (2d Cir. 2017).

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questions.