Hotel industry crisis: 8 Do’s and Don’ts for distressed hotels

19 March 2020

See how JMBM’s Global Hospitality Group® can help you.
Click here for the latest articles on distressed hotel loans and here for The Lenders Handbook for Troubled Hotels.

Hotel industry crisis: 8 Do’s and Don’ts for distressed hotels
by Jim Butler and Guy Maisnik
JMBM’s Global Hospitality Group®

As the COVID-19 crisis grows in the US and elsewhere outside China, hotels and restaurants are among the businesses hardest hit. In select markets like Seattle and San Francisco, hotels are reporting single digit occupancies and crushed ADRs. Many hotels do not have the cash flow to keep their doors open. The major hotel companies are talking of furloughs for tens of thousands of hotel employees and many properties are looking at closure or skeleton team maintenance operations.

This is a time for those with troubled hotel assets to “get back to the basics”. Here is our time-tested list of Do’s and Don’ts for distressed hotels and other special assets closely intertwined with operating businesses. There is a wealth of such materials available at HotelLawyer.com.

Here is our updated take on the 8 Dos and Don’ts for distressed hotels. If you just got a notice that your hotel asset is about to lay off staff and close, jump to #4 in the list below and then circle back.

1. Prevention.

Prevention is the first step in a well-planned approach to troubled hotel loans. Proper underwriting, documentation and provisions for access to information may help a lender facing a troubled loan. In the event the loan does get into trouble, the lender will be in a stronger position to protect its interests. Prevention includes careful underwriting of the collateral and the borrower. In underwriting the borrower, the lender should obviously look to the usual credit report and financial statements, but should often go beyond them to get a better feel for the borrower’s reputation, character, fortitude, expertise, consistency and creativity. The lender should ask: Has this borrower built or managed this kind of project before? Are the market and feasibility studies realistic? Are the projections consistent with these factors and do they provide adequately for a “worst case scenario”? Even on non-recourse loans, personal guarantees with “bad boy” carve-outs help assure borrow cooperation when things turn bad.

Once the credit decision has been made, the transaction should be fully and carefully documented with prevention in mind. Use the checklist approach to be sure nothing is overlooked. (JMBM’s Global Hospitality Group® uses our proprietary HIT List – acronym for “Hospitality Investment Task” list.) Be sure all desired title and liability insurance is in place, with endorsements to cover the lender’s interests. Particularly with construction loans, negotiate all necessary controls for the project – to cover both the ordinary course of building and the possibility of default. A lender will never have a better opportunity to protect its interests than the period before it has disbursed the loan proceeds.

Information control is paramount. A lender must carefully monitor its loans until they are paid off. All documents and information needs to be gathered in one centralized place for security, analysis and continuous monitoring. Early warning systems should be established to alert the lender to problems with the borrower, the collateral, or the project’s feasibility. Is the property considering closing or layoffs? Is the construction or marketing of the project being delayed? Is the property being wasted? Are materials disappearing from the job site? Have the demographics and economics of the market changed adversely? If trouble signs appear, the special asset group should be consulted at an early stage, even if the project stays in the hands of the loan servicing department.

Many institutions have been “bitten” by their good faith efforts in a workout situation. The pre-workout agreement is designed to minimize these risks.

3. Use a Special Assets Group for troubled assets.

The CMBS world figured this out and locked it down with special servicing. But other lenders should remember that, whatever the name and acronym, a specialized group should be used for handling troubled assets. A specialized division for working on troubled assets (for convenience we will refer to this group as a specialized asset group or “SAG”) brings greater objectivity in dealing with troubled loan issues, thereby minimizing the peril of an approach drawn from past dealings with the borrower that may be either too sympathetic or too harsh and raise lender liability issues.

The SAG should also bring (or will develop) specialized expertise in handling the unique problems of troubled assets. It should be provided with expedited access to senior management for policy decisions and allocation of resources. It should also have authority to implement crucial procedures and policies such as settling customer complaints, bringing in special counsel, hiring consultants, executing pre-workout documents and documenting negotiations to avoid liability for unsuccessful workouts. Bringing the SAG into the situation also provides notice to the borrower that the lender is serious about collecting the debt and that this is not “business as usual.”


The Special Asset Group with its experienced, detached personnel, should gather, analyze and summarize all relevant information on the loan, the borrower, the collateral and relevant documentation and history; update the borrower’s financial statements, tax returns, litigation history and credit rating. In addition to gathering all loan documents, promissory notes, guaranties, evidences of advances, notices, a complete written history of the loan should be prepared. When the history is compiled, care should be taken to protect as much as possible from discovery so that any candid descriptions of problems and proposed solutions to such problems will not be a part of the evidence at trial, should you choose litigation. This can be done by engaging outside counsel or involving the bank’s in-house legal department. Loan service personnel should be interviewed, and waiver and estoppel issues must be evaluated. Consider interviewing witnesses with counsel present, to protect sensitive information obtained from disclosure later on if litigation is filed. The impact of conversations, correspondence, and course of conduct must be given careful consideration. Appraisals, projections and feasibility studies should be updated as necessary. (See Hotel Law Blog, October 30, 2008: “The Comprehensive Situation Analysis.”

Two final cautions on information updates. First, the update of collateral information should include a physical inspection
of the premises. Walk the project! Don’t settle for a “drive-by” or the borrower’s guided tour. The physical inspection may suggest problems to be dealt with or new approaches to the project.

Second, the information, documents and summaries gathered by the Special Assets Group should be reviewed by counsel experienced in troubled loan matters and lender liability. This review should analyze the validity of the notes, security interests, guaranties and other important documents with an eye toward identifying defects that might be cured or curable. From this review lenders should also be able to determine the potential of any borrower defenses or counter claims. Counsel should find out from the lender if there are any potential tort or strict liability claims that may go along with any transfers of ownership in real property, such as an apartment owner’s duty to pay for tenant injuries or a landowner’s duty to pay the costs of cleaning up contaminated property.

5. Evaluate the information and alternatives.

All the gathered information needs to be evaluated by appropriate business and legal personnel. Fully armed with this information and evaluation, the lender can then assess whether to do nothing, commence a workout or restructure of the loan, seek a receiver, initiate foreclosure or initiate involuntary bankruptcy proceedings.

6. Pre-workout agreement.

Before commencing workout negotiations, a pre-workout agreement should be executed. Such an agreement offers the advantage of protecting the lender from liability from claims arising from the workout process itself. Many institutions have been “bitten” by their good faith efforts in a workout situation. They report that desperate debtors or their unscrupulous representatives have either misunderstood statements made in workout negotiations, or intentionally misrepresented positions taken. Whatever the motivation or cause of the problems, these institutions find themselves the victim of claims that oral agreements, representations, or waivers made in the course of a workout entitle the borrower to rights or damages never contemplated by the lender upon entering workout negotiations. The pre-workout agreement is designed to minimize these risks.

The pre-workout agreement typically recites that the parties are about the commence workout negotiations and that the agreement is a material inducement for the lender to participate. Loan documents can be attached as exhibits and acknowledged to be legally binding on the parties. It is usually agreed that the loan documents continue in full force, unless modified in the specific manner permitted by the pre-workout agreement. Sometimes, egregious problems which exist in the lender’s loan documentation can be corrected in a pre-workout agreement, when the borrower is usually in a very cooperative mood. The confirmation of the loan document’s binding effect, recital of loan history and acknowledgment of defaults may greatly simplify collection efforts later if the negotiations fail or the workout falls apart. Consider inserting a confidentiality provision in the pre-workout agreement, to try to prevent the borrower from using the media to increase its negotiating leverage, especially if the borrower is in a business that may attract media attention.

The key provision of the pre-workout agreement recites that discussions and negotiations between the parties may be lengthy and complex, however, no discussions or oral agreement have any effect whatsoever unless all parties execute a written agreement. This critical provision helps prevent a party from claiming a binding agreement was reached on certain issues in the absence of satisfactory resolution of all disputes in the workout process.
The pre-workout agreement should provide that only amendments in writing have any effect, state that the pre-workout agreement is the entire agreement of the parties on the subject matter, specify the governing law and provide for attorneys’ fees to the prevailing party in the event of any dispute. The agreement should also provide that no negotiations or other acts taken in the workout process constitute any waivers by the lender of its rights except to the extent specifically identified in writing. The pre-workout agreement should also confirm that the attorneys’ fees to be incurred by the lender in the workout will be reimbursed by the borrower.

The most controversial issues on pre-workout agreements usually involve whether to include a mandatory arbitration provision for any disputes concerning the credit (with corresponding waiver of jury trial and court process) and any release provisions. Some lenders say they would rather proceed with the “main event” if they cannot obtain an arbitration provision and release for any action up to that date. Others would rather engage in the workout process to cure defects in the loan documentation in exchange for concessions to the borrower and are less concerned with the benefits of arbitration or waivers.

7. Document the transaction completely

It goes without saying that once negotiations have resulted in a restructuring or workout, all aspects of the agreement should be thoroughly and fully documented promptly.

8. Develop a “Game Plan” and stick to it!

Once an alternative course of action has been selected, the lender should develop a game plan or blueprint for executing its course of action. There may be valid reasons to wait until specified events have occurred or time periods have elapsed. However, in general, once the course of action has been decided, delay is ill-advised. The most successful lenders are those who stick with their game plan, except as changed circumstances may warrant.

What does it all mean?

Understanding fundamentals allows you to put together a strategic game plan that allows players to move around the court, pass the ball and take shots, as well as defend their position. Whether you are a Lender or Borrower, you will want to make sure everyone on your team knows the “8 Dos and Don’ts” of handling troubled hotel mortgage loans before they play for your team.

This is Jim Butler, author of [www.HotelLawBlog.com](http://www.HotelLawBlog.com) and founding partner of JMBM and JMBM’s Global Hospitality Group®. We provide business and legal advice to hotel owners, developers, independent operators and investors. This advice covers critical hotel issues such as hotel purchase, sale, development, financing, franchise, management, ADA, and IP matters. We also have compelling experience in hotel litigation, union avoidance and union negotiations, and cybersecurity & data privacy.
JMBM’s Global Hospitality Group® has been involved in more than $87 billion of hotel transactions and more than 3,900 hotel properties located around the globe. Contact me at +1-310-201-3526 or jbutler@jmbm.com to discuss how we can help.

How can we help? Brochure Credentials Photo Gallery