Hotel receivership – an alternative to foreclosure?

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What's the Deal By Daniel Lesser

Daniel Lesser, president and CEO, LW Hospitality Advisors, New York City

(The views and opinions expressed in this blog are strictly those of the author.)

Nearly 18 months into the COVID crisis, this once-in-a-century worldwide pandemic has caused a swift and wide deep economic recession that has decimated key travel and leisure related industries. Although green shoots are emerging, the recent increase in performance metrics across the industry are closely tied to summer vacation travel. At this juncture, the burning question is whether or not corporate and group demand segments come off the sidelines during the fall season when leisure travel dissipates?

Numerous institutional investment firms have raised significant amounts of leverageable capital in anticipation of a coming wave of distressed commercial properties, including hotels. Thus far, during the pandemic there has not been as many distressed hotel investment opportunities as most had anticipated. Given the amount of available dry capital, until now, the most compelling hotel opportunities have been "bid up" and although numerous transactions were spurred on by distress, many have not necessarily reflected distressed pricing.

Subsequent to several fleeting weeks where it felt like the U.S. was reverting to normalcy, the recent rapid spread of the Delta variant has the pandemic roaring back and once again threatening government restrictions on travel and trade. Irrespective, during the near-term, hotel loan defaults and foreclosures are expected to increase as forbearance periods end. As more liquidity continues to emerge, some lenders will ultimately lose patience and demand recapitalization and/or enforcement of their remedies. When confronted with hotel loan defaults, lenders and servicers often rely on one of four common remedies: workouts, receiverships, deeds in lieu and foreclosures.

Receivership is a solution that provides an aggrieved party the option of placing an asset or business into legal custody, meaning that the court dispossesses the party in control of that asset or business and puts it into the hands of a court-appointed agent. During the past year, I have had the good fortune to serve as a court appointed receiver in connection with a sizeable portfolio of hotels located throughout the U.S.

A receiver is an appointed neutral judicial officer of a state or federal court and considered an impartial “arm of the court” to manage tangible assets and/or oversee businesses as going concerns when they are the subject of a legal dispute. A receiver can also be appointed to act as a liquidator of such assets or businesses. While a receiver does not take title to property, s/he has legal possession of property to efficiently preserve an asset in trust for all creditors.

A receiver is subject only to a court’s direction and control, and is a custodian and agent whose functions are limited to the care, management, protection and operation of property committed to its charge. The receiver owes its allegiance to the court that made the appointment. However, s/he may owe fiduciary duties to each of the receivership estate’s constituents, including the owner and/or secured creditors.

Although each jurisdiction may have very specific and widely different requirements to qualify, there are no universal eligibility requirements to be appointed a receiver. Generally, almost anyone can become a receiver, except for persons who are a party to a lawsuit against the company, attorneys of such a party or relatives of the judge. An individual with a business interest in the organization is also not eligible to become a receiver. As long as a receiver acts within the scope of authority given by the court, s/he enjoys immunity from claims relating to its management of the property. If, however, a receiver acts outside of this scope or fails to meet its fiduciary responsibilities, s/he may be held personally liable. Though some courts require a candidate have experience in the areas required for receivership and/or the asset class, many do not have such prerequisite.

Given the unique ownership and operational aspects of transient lodging facilities, it is imperative that an appointed receiver of a hotel be experienced, knowledgeable, fluent and connected with the sector. Lodging assets are unique in that they intertwine real estate and retail businesses which are highly dependent on property management skills. Unlike other forms of commercial real estate, such as office buildings which typically are encumbered with long-term and in many cases credit worthy tenancies, hotels lease guestrooms on a daily basis with continuous repricing of units. Additionally, full-service, convention and resort facilities generally derive income from multiple and varied revenue streams, including the sale of food and beverage.

A court order appointing a receiver identifies their powers and duties which are generally classified as either: (a) presumptive actions that can be performed without additional supervision, and (b) actions that require the court's consent. Because each receivership is different, and jurisdictional laws vary as to a receiver's powers, it is important that a court's order is comprehensive and detailed.

Skilled receivers stabilize the day-to-day operations of a business, provide transparency to lenders, identify specialized third-party asset managers to operate any on-site facilities, manage in-flow and outflow of monies or goods, identify claimants, or resolve and/or reduce those claims. The neutrality and transparency of a receiver allows a court, lenders and creditors to accurately evaluate how best to restructure and/or dispose of collateral and estate property. Depending on the circumstances warranted by each case and how best to optimize a receivership estate's asset value, a receiver's appointment may be short-term or endure for many years.

A receiver's compensation is negotiated with the secured lender either on an hourly basis, a stipulated monthly fee, a percentage of gross monthly collections, or some combination thereof. However, the appointing court retains jurisdiction to approve all fees paid and reserves the right to deny costs and/or expenses deemed improper, requiring a receiver return such monies. Although with proper disclosure a receiver may engage a related day-to-day management entity, many lenders desire to keep the functions separate.

Receivers commonly handle the following actions and responsibilities without disrupting the ongoing operation of the property or waiving the lender's rights against borrowers or guarantors (or vice versa).

- Secure and maintain physical property and establish itself as new oversight with the intent to maximize asset value.
- Obtain control of all property related bank accounts.
- Retain and oversee experienced day-to-day management.

- Provide the lender with transparency into ongoing operations.
- Allow for funding to complete necessary projects while limiting exposure to mechanics liens.
- Manage complex construction issues and make claims on completion bonds or other sureties.
- Renew, obtain, or forfeit governmental licenses and permits.
- Acquire, confirm, and/or reinstate insurance.
- Limit exposure to the lender by providing a shield against claims and by keeping the creditor off of title.
- Ability to sell real property "as is, where is," thus limiting liability to the lender/servicer and the receiver.

While accomplishing similar goals, compared with foreclosure, generally, a hotel receivership can save time and money and should be considered as an option for lenders looking to liquidate hotel real estate collateral. Successful hotel receivers are proficient in operating lodging businesses, preserving value and protecting assets that are subject(s) of a legal dispute and provide transparency in situations where the parties are not able to entirely trust each other.

8/11/2021