2020 ROADMAP FOR DISTRESSED HOSPITALITY ASSETS

Navigating COVID-19 and the Aftermath During These Troubled Times
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KEY CONTACTS IN THE PAUL HASTINGS HOSPITALITY & LEISURE PRACTICE GROUP

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PROLOGUE

The novel coronavirus (COVID-19) could cost the global hospitality industry hundreds of billions of dollars over the coming months. The coronavirus has infected hundreds of thousands of people worldwide and killed tens of thousands. As of this writing, the United States alone has over a hundred thousand confirmed cases of coronavirus, the most of any country in the world, and with increased access to testing, the number of cases and fatalities caused by the virus are expected to skyrocket in a matter of weeks.

Entire nations are imposing quarantines and travel restrictions on an unprecedented level. National emergencies have been declared and local and state governments are issuing edicts that dictate which businesses can operate, what services they can provide, and how many employees they can staff. The effects are chaotic, and it feels impossible to stay up-to-date on such a mercurial situation. As a result, hospitality providers are left confused about what decisions to make, or even which decisions can be made in compliance with shifting laws and regulations.

The coronavirus has already brought dramatic economic disruption, in particular to global supply chains and travel markets. Among other things, this pandemic has meant the cancellation or changing of major events by governments and private businesses across the country and beyond (e.g., Facebook, Google, Microsoft, and China’s Communist Party, among countless others, have already cancelled, or changed to “digital first”, planned summits and meetings, and the Tokyo Summer Olympics have been postponed for a year) resulting the closing of hundreds of hotels and thousands of restaurants, the stoppage of hotel and resort construction, the collapse of transactions that were near closing, and a paralyzed travel sector around the world. For both hotel owners and operators, the recently classified pandemic has created massive uncertainty around business operations, with many tossing the word depression around with increased regularity.

If you’ve been in the hospitality business for as long as I have, you remember the battle cry that we all lived by during the early nineties: “Stay Alive ‘til ’95!” And what did we do? Hotel and resort workouts,
foreclosures and bankruptcies - over and over and over again - for five long years. And we did it again after 9-11 and though the Great Recession. Well, we have indeed entered a similar era that I hope is not as long or deep as it was back in those days, but I fear it may be worse. We are all in this together and we must all represent our varied interests in this industry to the best of our abilities. To that end, we are pleased to prepare a guidebook on the foreclosure, workout and bankruptcy issues facing our clients and others who are in the hotel and resort sector affected by COVID-19.

How big could the decline be, and how fast can the hospitality industry recover? COVID-19 strikes at a time when hospitality supply is already greater than the demand, with occupancies down and continuing to fall. Historically, however, even after a severe decline, hotels and resorts have recovered occupancy rapidly. For example, following the SARS outbreak, some markets saw an approximately 35% decrease in demand virtually overnight, but demand recovered to near-normal levels within six months. COVID-19 is likely to follow a similar pattern. Until then, though, the hospitality market is in for some trying months.

During these months, however, I believe there are a number of actions you can take to secure the future of your business and your brand. The approach of this text is to adopt the view of an outsider looking in to a troubled hotel or resort asset — perhaps as a professional who has been given the responsibility to first close an asset and thereafter to review the project and give advice to the owner, a third-party capital provider or a purchaser of the asset or the debt that it secures.

With all of this in mind, we begin with the issues the owners and operators and capital providers are facing in the closure of hotels and resorts and, in particular, the issues facing all of the foregoing in the lay off or furlough of employees, the survival of all during these unprecedented periods of mass unemployment, and then back to the beginning of the end of this terrible crisis, and what everyone will do to move toward recovery, the first of which is understanding the hospitality asset itself (i.e., whether it is a limited service, upscale or luxury hotel or whether it has a mixed-use aspect) and then focus on the nature of the asset as an ongoing business in a declining market with reluctant patrons, with many moving parts, and with different stakeholders weighing competing interests.

Next we will turn our sights on the ownership entity. Most hotels today that are not owned by public companies or private REITs are in fact owned by joint venture vehicles, often a special purpose vehicle (with limited liability companies being the most common entity of choice). It is within the JV that a core problem may arise in the face of COVID-19 — a lack of capital caused by debt levels borrowed at the height of the capital markets of this decade, and exacerbated by a reduction of “RevPAR” (revenue per available room) and occupancy no one could have predicted and that cannot support the debt or loan-to-value ratio required by lenders.

Speaking of RevPAR and the financial performance of the hotel, it is the management agreement that will often dictate the value of the hospitality asset, so we must spend a few pages discussing the need for greater asset management during distressed times and, ultimately, the potential restructure, if not the termination, of the management agreement (depending, of course, on whether the management agreement was subordinated to the secured debt at the time executed) as a potent tool in the bid of an owner to create value or stave off foreclosure or bankruptcy.

Any discussion of the management of operating businesses would be incomplete without an analysis of labor issues and labor agreements. The area of labor and employment law is a minefield of potential liabilities, many of which fly under the radar of owners and managers. We touch upon the most common areas of concern in labor relations and regulations.

We follow by turning our attention to the potential purchase of the hospitality asset itself and take the reader through a due diligence review of the various, usually hidden, risks that he or she will have to identify and address through the negotiation of a purchase and sale agreement (“PSA”). We discuss how
escrowed holdbacks or, better yet, letters of credit, afford far better protection to the purchaser (as often indemnities are worthless when given by owners of bankrupt real estate).

We next discuss the issue du jour: acquiring the distressed debt. Given the complex layered capital structures utilized during this last cycle, potential purchasers will have many more options than in years past. These options, however, come with complications and increased price and risk, so we spend time discussing the diligence needed to decrease the risks to the purchaser.

If you’ve survived in this industry, you’ve had to be resourceful and innovative in your approach and strategy — adapting to new market realities and utilizing all the options at your disposal. Our discussion of troubled hospitality assets would not be complete without an in-depth discussion of what happens when you are facing receiverships and foreclosure.

Some lenders (or, for that matter, purchasers) will foreclose or perhaps acquire by deed in lieu assets that are currently under construction. This type of transaction deserves some attention as it presents a host of additional issues that are both complex and fraught with risks and require great care to consummate.

When there is no other alternative, bankruptcy is often the course of choice for the owners of hospitality assets — something that unfortunately will be more and more common with the effects of the outbreak of COVID-19 coming to fruition, no matter how lean owners try to be. The nuances of bankruptcy have changed in a number of very subtle ways since the early ’90s and it’s crucial to understand the implications to debtors and creditors alike.

By the way, as an alternative to reorganization, a Chapter 11 proceeding also permits the sale of the hospitality asset through a 363 sale procedure. A 363 sale can be a quick and efficient way in which to sell a hotel or resort free and clear of all known and unknown third-party claims and liabilities, but the purchaser must beware of being overbid without adequate protection (largely in the form of a breakup fee) in the event it is not the winning bidder.

Nearly all five-star hotels and resorts (as well as some four-stars) over the last decade were developed in tandem with for-sale real estate (e.g., vertical condominiums and other horizontal villas). This created the need for complex ownership regimes to which all constituents were a party (from both a use and a cost-sharing point of view). Because any workout involving these mixed-use assets will necessarily involve the other users and owners (including office, retail, theater and sports venues), we spend a fair amount of time discussing the most common issues faced when working through a workout, foreclosure or bankruptcy of mixed-use hotel and resort products.

Finally, many hotels and resorts have several liquor licenses and, particularly in Las Vegas and other gaming destinations around the world, at least one gaming license. Without licensure, there is no hotel, resort or casino, and we describe how to continue operation of the food and beverage and gaming operations while licenses are applied for, reviewed and issued, throughout the change-of-ownership period of foreclosures, bankruptcies and/or sales.

In that vein, we believe you will find our 2020 Roadmap for Distressed Hospitality Assets - How to Navigate COVID-19 and the Aftermath in These Troubled Times insightful and helpful. Please note that the laws as well as federal, state and local law, regulations and orders are changing not just daily but often hour by hour through this crisis, so nothing is this guidebook should be deemed unequivocal the second after it is published...but we do intend it to be a living, breathing tome that you can request and receive updates upon demand. So please stay in touch, stay safe and stay healthy as we navigate these unprecedented times together.

Rick S. Kirkbride, Global Chair: Hospitality & Leisure Practice Group
PAUL HASTINGS HOSPITALITY & LEISURE PRACTICE GROUP

The Paul Hastings Hospitality & Leisure (H&L) Practice Group is an active, full-service practice group focusing on the legal and business needs of real estate development companies, institutional lenders, investment banks, capital providers, owners and operators. With more than 75 lawyers servicing H&L clients in eighteen global offices across three continents, the H&L practice encompasses the development, acquisition and sale, finance, leasing, operation, management, licensing, branding, repositioning, roll-up, foreclosure, workout and restructuring of hotels, condo-hotels, resorts, branded condominiums, commercial and residential subdivisions, private residence clubs and timeshare projects, fractional jets, spas, restaurants, casinos, golf courses and country clubs, tennis stadiums, theme and amusement parks, yachts, fishing, shooting, and vineyard-based leisure activities, and other hospitality, recreational and real estate-based entertainment properties and businesses as well as mixed-use developments containing any combination of the foregoing components in North America, Latin America, the Caribbean, Europe, Asia and the Middle East.

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Rick Kirkbride is a partner in the Los Angeles office of Paul Hastings. Mr. Kirkbride is the Global Chair of the Hospitality & Leisure Practice Group, and he represents real estate development companies, institutional lenders, investment banks, opportunity funds and other capital providers, owners and operators. His practice encompasses the development, acquisition and sale, finance, leasing, operation, management, licensing, branding, repositioning, roll-up, foreclosure, workout and restructuring of hotels, condo-hotels, resorts, branded condominiums, private residence clubs and timeshare projects, fractional jets, spas, restaurants, casinos, golf courses and country clubs, tennis stadiums, theme and amusement parks, yachts, fishing, shooting and vineyard-based leisure activities, and other hospitality, recreational and real estate-based entertainment properties and businesses in 25 countries throughout North America, Latin America, the Caribbean, Europe, Asia and the Middle East.

Lauren Giovannone is a partner in the Hospitality & Leisure Practice in Paul Hastings’ Real Estate department and is based in the firm’s Los Angeles office. She represents real estate development companies, financial institutions, investors, and commercial lessors and tenants in all aspects of the acquisition, development and finance of hotels, condo-hotels, resorts, theme and water parks, and large mixed-use projects, including, without limitation, the negotiation of management, franchise, licensing and branding agreements, restaurant leases and management agreements, pre-opening, technical service and PIP agreements, marketing and sales agreements, subordination and non-disturbance agreements, executive compensation and consulting agreements, and celebrity chef joint venture and management agreements.

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Eric Landau is a partner and Chair of the Real Estate Department at Paul Hastings, based in the firm’s New York office. He has developed a real estate practice representing a diverse group of clients and interests, including sophisticated joint ventures, hospitality, borrowing, acquisitions, leasing, and mixed-use development transactions. In representing Millennium Partners, he calls on his experience in dealing with city and state agencies to form a public/private partnership necessary to develop large projects outside established core areas in today’s urban environment. Other clients who Eric regularly represents on their most complex real estate transactions include The Witkoff Group, Lightstone Development Group, Investcorp International, HFZ Capital, Nobu Hospitality, JMH Development, Junius Development, Madden Capital, Fisher Brothers, Morgan Stanley, and Related Fund Management.

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Peter Olsen is a partner in the New York office of Paul Hastings and is the Global Chair of the firm’s Real Estate Development Group. His practice includes construction and development; acquisitions and dispositions; financings and refinancings; restructurings, recapitalizations and workouts; ground leases; and complex joint venture agreements. Mr. Olsen represents major financial institutions, private equity funds, developers, and owners of real estate in connection with all types of real estate assets including office, hospitality and multi-family.

Elena Baca is the Global Chair of the Paul Hastings Employment Law Department, and leads a diverse group of more than 100 lawyers in 14 offices around the world. Ms. Baca has been leading the Employment Law Department’s efforts to assist employers navigating the host of Federal, State and local actions taken in response to COVID-19. Ms. Baca and her team, as part of Paul Hastings’ COVID-19 Task Force, are currently collaborating with employers and other Firm attorneys on issues arising from workplace safety, telecommuting, Federal and State agencies’ guidance, DOL/EEOC/OSHA requirements, reductions in force vs. furlough analyses, Shelter in Place Orders, Families First Coronavirus Response Act, the CARES Act, and other COVID-19 related legislation.

Eric F. Allendorf is a partner in the Real Estate Practice of Paul Hastings and is based in the firm’s New York office. Mr. Allendorf’s practice is concentrated in real estate lending with a national scope, with a particular emphasis on complex debt finance. He represents institutional lenders, alternative lenders, debt funds, and construction lenders in all aspects of real estate finance and restructurings. Mr. Allendorf’s experience includes representing lenders in originating loans intended for balance sheet, syndication, and securitization secured by commercial real estate projects of all asset types, including office, retail, hotel, multifamily, and industrial. He has extensive experience in structuring multi-stack deals with multiple layers of subordinate financing, representing both senior lenders and mezzanine lenders. Additionally, Mr. Allendorf has extensive experience in workouts and bankruptcies, having been involved in some of the largest restructurings in the latest real estate cycle.

John Simonis is a partner and Chair of the Orange County office of Paul Hastings and of the firm’s Real Estate Practice Group in Orange County. Mr. Simonis represents landowners, investors, developers, contractors and users in connection with real estate transactions and development matters, and has substantial experience in connection with real estate joint ventures, purchases and sales, leasing, master planned communities, mixed-use projects, construction and grading, infrastructure, development agreements, financings, and entity formation.
Michael Bradford is Of Counsel in the Los Angeles office of Paul Hastings. Mr. Bradford is a member of the Hospitality & Leisure Practice Group, and he represents real estate development companies, owners and operators in connection with the acquisition, sale, development, and finance of hotel, resort, mixed-use resort, mixed-use commercial, condo-hotel, fractional interest, timeshare, condominium, common interest and other similar projects.

Ted Smith is a partner in the Real Estate Department of Paul Hastings and is based in the Atlanta office. He focuses his practice in the areas of portfolio and project acquisitions for investment funds and REITs, management, and divestitures, and real estate-based lending, loan restructures and workouts. His lending practice has involved borrower and lender representation in syndicated loans, mezzanine lending, and securitized lending for projects and portfolios of various sizes. His workout experience includes troubled debt restructures, note sales, receiver appointments, foreclosures, and transfers in lieu of foreclosure. Mr. Smith’s portfolio and project experience has involved multiple facets of real estate work, including the negotiation of portfolio purchase or contribution agreements, the negotiation of limited liability company and limited partnership agreements, multi-property borrower representation, resolution of subdivision and zoning issues, and the negotiation of large industrial and office leases.

Charles Patrizia is a partner in the Litigation Practice of Paul Hastings and is based in the firm’s Washington, D.C. office. He has 30 years of experience in environmental and energy law, including federal regulatory and permitting requirements, and state regulatory and permitting requirements. He has an active litigation and counseling practice involving environmental, energy, project development, and permitting, as well as other commercial matters and government contracts. He represents clients in a range of international and national transactions involving energy, the environment, chemical and hazardous substances, and biotechnology. Since joining the firm in 1985, Mr. Patrizia has represented clients on permitting, enforcement, regulatory, and legislative issues under the Federal Power Act, Public Utility Holding Company Act, Natural Gas Act, Clean Air Act, Clean Water Act, Superfund, and Resource Conservation and Recovery Act. He regularly advises clients on liability and related issues in enforcement proceedings and as part of business transactions; he leads the firm practice in relation to the interplay between projects and federal review requirements, including the National Environmental Policy Act, Endangered Species Act, and the National Historic Preservation Act. Mr. Patrizia has been the partner responsible for leading permitting and related development efforts for major greenfield and brownfield projects, working closely with client and Paul Hastings teams in the negotiation and organization of sites, contracting issues, bond financing (including industrial development and pollution control bonds), state and local incentives, and permitting.

Chris Dickerson is a partner in the Corporate Practice at Paul Hastings, the vice-chair of the Firm’s Global restructuring practice and a member of the Special Situations Group. His practice includes the representation of a variety of clients in complex business reorganizations, debt restructurings, and insolvency matters, including purchasers of and investors in distressed companies and lenders to and creditors of such companies and other special situations. Mr. Dickerson has assisted numerous large corporations both inside and outside chapter 11, including Ameriserve, Antioch Holdings, Atlas Energy, Babcock & Wilcox, Blackjewel L.L.C., Caesars Entertainment, Circuit City Stores, CIT Group, Diamond Brands, Delphi Automotive, Inc., Edison Mission Energy, Inc., Extreme Plastics Plus, Goss Graphics, Global Cloud Xchange, Harnischfeger, HomePlace Stores, Jitney Jungle Stores, One Aviation Corporation, Orius, Refco, US Airways, Vanguard Natural Resources, and Zenith Electronics. He has also assisted numerous investors in and acquirers of distressed assets including Angelo Gordon, Black Diamond Capital Management, Deerfield Capital Management, Guggenheim, HIG Capital, Hilco Global, Macquarie Capital, Madison Industries, Silverpoint Capital, Victory Park Capital Advisors, and Versa Capital Management. Mr. Dickerson also often assists both institutional and alternative lenders in workouts and other situations including Bank of America, BMO Harris, BNP Paribas, Citibank, Credit Suisse, Deutsche Bank, JPMorgan Chase, Morgan Stanley, Monroe Capital, THL Credit, and Wells Fargo.
Stephen Harris is a Partner in the Employment and Labor Practice of the Los Angeles office of Paul Hastings, focusing his practice in executive compensation, employee benefits and workforce restructuring matters. Mr. Harris regularly advises clients regarding plan design, administration, and fiduciary issues and represents clients in benefits litigation.

Thomas Wisialowski is a Partner in the Tax and Real Estate Practices of the Palo Alto office of Paul Hastings, focusing his practice on providing advice regarding structuring of major corporate venture capital, and real estate transactions. Mr. Wisialowski represents many public and private pension plans and their advisors with respect to investments in private equity, venture capital, and real estate funds.

DISCLAIMER:

This 2020 Roadmap for Distressed Hospitality Assets was prepared by members of the Hospitality & Leisure Practice Group at Paul Hastings LLP (“PH”). However, real estate transactions, particularly those pertaining to distressed or troubled assets, present complex issues that are specific to each transaction, asset, period of time, jurisdiction, sequence of events and party involved, among others factors. To that end, the contents hereof do not in any way constitute legal advice and should not be relied upon as such, nor do they purport to comprise a comprehensive list of potential issues or absolute advice as to how to deal with the specific situation presented by an asset or portfolio of assets. Instead, the information contained herein is intended for the sole purpose of assisting readers in identifying a few of the numerous potential issues that could arise in the course of a hotel or resort acquisition, disposition, foreclosure, bankruptcy or other court proceeding and perhaps providing some guidance as to how to get started in your transaction.

PH in no way intends for the contents hereof to be relied upon or viewed by any potential reader as legal or any other type of advice. All readers agree that the information contained herein is provided for informational purposes only. PH strongly urges readers to seek the advice of counsel regarding each reader’s specific circumstance and contemplated transaction.
Paul Hastings is the only law firm in the United States whose hospitality practice has been ranked in Band 1 in the National Leisure & Hospitality category by Chambers USA every year since it started rankings in this field in 2007.

Our Hospitality & Leisure practice group brings together a global roster of lawyers dedicated to the legal and business needs of development companies, institutional lenders, owners and REITs, investment banks, capital providers, and operators in all aspects of the hospitality sector. We assist our clients with the development, acquisition, sale, finance, leasing, operation, management, licensing, branding, repositioning, roll-up, foreclosure, workout and restructuring of hotels and resorts and other hospitality, recreational, and real estate-based entertainment properties and businesses in markets around the world. We advise our clients on every type of hospitality and leisure project including:

- Hotels
- Condo-hotels
- Resorts
- Branded condominiums
- Private residence clubs and timeshare projects
- Spas
- Restaurants
- Casinos
- Golf courses and country clubs
- Tennis stadiums
- Theme and amusement parks
- Yachts
- Fishing, shooting, and vineyard-based leisure activities

As a result, we have deep expertise in the structuring and negotiation of every type of legal document involved in hospitality from purchase and sales contracts to management, franchise and technical service agreements, ground, restaurant, club/lounge and recreational leases, joint venture agreements, loan documents, condominium, subdivision and hotel branding and license agreements, construction and architectural contracts—and everything in between.

Leading Hotel Investors and Developers Seeking Our Advice:  

Band 1 in Southern California Real Estate & Band 2 in Nationwide Real Estate  
Chambers USA, 2011-2019

Band 1 for National Leisure and Hospitality  
Chambers USA, 2007-2019
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Hospitality Practice Group of the Year

Law360, 2019