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The Role of an Impartial Hotel Receiver



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By David Butler, President Post Script Hospitality/hotelAVE

According to a May 2022 article published by Trepp, close to 9% of all CMBS loans in the hospitality asset class were in special servicing. Although the year-over-year default rate has improved, there may be signs of trouble ahead.

An earlier Trepp article noted that \$38 billion in hotel loans are scheduled to mature by the end of 2024. With tightening capital markets, ease of re-financing may be uncertain. Moody's also weighed in, reporting that a handful of once-delinquent hotels have stopped making payments due to "problems and issues" unique to those hotels. This led to a slight uptick in default rates from 7.7% in February 2022 to 7.8% in March 2022. Nevertheless, with possible recessionary pressures on future hotel demand, lenders may be exposed to an increase in hotel defaults. This means that special servicers could need a receiver to help preserve the property's value while the lender and borrower work through the default, restructuring or foreclosure process.



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A receiver's role is to collect revenue, maintain and repair the property relative to physical or personal threats to safety, manage the existing operation, ensure that bills are paid, and otherwise take all actions necessary to preserve the property's value.

Here are a few items that are best worked through an independent, impartial receiver.

Cash and Deposits

The receiver requires borrower or borrower's counsel to deliver all cash, security deposits and other property assets within the borrower's control, as indicated in the receiver appointment letter. If the bank accounts are in the manager's name (rather than that of the owner), the receiver will likely request that the manager and owner abstain from using these funds without receiver approval. Furthermore, the receiver will also mandate that "view access" be obtained on all accounts until funds are transferred to a receiver-controlled account.

In most cases, the incoming manager or operator is only concerned with operating funds and working capital outlined in their hotel management agreement (HMA) and is thus not motivated to secure the borrower's funds. Hotel cash flow relies on daily deposits via credit card (ACH) receipts; in most cases the credit card processors may take up to three weeks to move the deposits over to the new account controlled by the receiver.

Other unique cash circumstances include automatic deposits from the brand for third-party commissions or automatic withdraws from food vendors. These items must be reconciled before closing down the prior operating accounts. It is critical to move quickly and transparently as the outgoing manager/borrower might attempt access to these funds to cover reserves, fees and other all-inclusive costs. Again, these cash-control nuances are better managed by an impartial receiver.

Accounts Payable

The receiver is responsible only for payables that occur during the receivership period and is not obligated for payables generated prior to the appointment. However, for the hotel to maintain normal operations, the receiver might be best positioned to help negotiate payment arrangements, discounted payoffs or agreements made with vendors, such as food suppliers, elevator maintenance companies or laundry providers.

Most operators who provide receivership services have long-standing relationships with some of these vendors and might unknowingly pay them. This could contractually obligate the receiver in assuming the remaining terms of any contract or agreement entered into under the borrower's entity.

Brand and Capital Requirements

Prior to the appointment of a hospitality receiver, the borrower has potentially stretched cash flow to make debt service, payroll and utilities. The borrower has also likely deferred capital, maintenance projects and brand standards required by the franchise or license agreement.

On or before the appointment, the receiver should independently walk the hotel to understand and reveal issues that could impact guest and employee safety, and to identify deferred maintenance that impacts the useful life of expensive major mechanical systems. The receiver should also ensure the new operator incorporates these items into short-term capital planning.

It's also essential that the receiver review the comfort letter (a written document that provides assurance that an obligation will be met), which grants the lender certain rights to maintain the franchise under certain conditions. These conditions can include deferred maintenance or defaults (such as settling past-due franchise fees). In most cases, deficiency items can be negotiated, while some of the brands can expect a payment plan for owed fees.

Though qualified operators can assist with this process, not all have the same negotiating leverage with brands. It's up to the receiver to negotiate these items in good faith and in the best interest of the receivership estate.

Taxes and other Municipality Obligations

The receiver determines whether the operator or owner is responsible for paying and filing tax obligations. Taxes are usually filed and paid by the management company on behalf of the business entity. Depending on the county, the receiver might have to settle any previously owed taxes by the owner.

The receiver should also request outstanding invoices directly from the local municipality, otherwise unpaid amounts could show up in a lien search. Another issue of note is that occupancy taxes might have been filed by not paid. This could mean that unpaid sales and occupancy taxes could "pierce the corporate veil," and have recourse to the borrower. Additionally, any unpaid city taxes can interfere with the hotel's ability to obtain licenses and permits including the liquor license.

When it comes to other outstanding municipal or county balances, the receiver establishes a procedure to track and ensure timely payment of real estate and personal property taxes. This calls for research on the receiver's part (along with engaging tax consultants), as there could likely be multiple parcels involved.

It's important to select a hotel receiver that is impartial to a manager's or owner's interest and acts as a fiduciary to both lender and borrower. An effective receiver is able to objectively address the unique nuances that exist in hospitality, while maintaining the receivership's integrity and enhance the asset's value for all parties.

David Butler, President Post Script Hospitality and hotelAVE, has over 30 years of experience in the hospitality industry with a specific concentration in receivership. David and his team use their expertise to improve operational efficiencies by conducting area-specific analyses and observing how employees conduct their daily activities to improve overall workflow and remove process constraints.