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Coronavirus and hotel financing, the impact of COVID-19 on hotel re-financing

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COVID-19 has had a catastrophic impact on the hotel industry with many hotels across the UK being forced to close their doors.

We have previously commented on how COVID-19 might impact existing borrowings and the steps that borrowers can take to try to avoid breaching their existing facility agreements in our articles, Coronavirus: establish your position in the UK by reviewing your Facility Agreements and Coronavirus: steps to help sustain, maintain or even progress your business in these uncertain times .

However, some hotel owners will have the term of their existing loan coming to an end during the next 3 – 6 months, and so we wanted to look at refinancing in the current environment.

Clearly where the hotel asset is not currently trading, and with building uncertainty surrounding valuations, this is a very tough time to be seeking finance, and especially from new lenders.

Most owners will already have considered and/or implemented the following:-

1. extending the term of any existing loan and/or requesting an interest repayment holiday to ease cashflow concerns;
2. taking out a new loan to supplant the existing one. Some banks will consider this, depending on the strength of their relationship with the owner, LTV and past performance;
3. reaching out to other lenders with whom it has existing relations; and
4. checking whether it can take advantage of the Government loan schemes which have been established to support UK businesses. Please refer to our article on these schemes here.

What steps can be taken to ensure a smooth refinancing of a hotel asset?

Lenders will want to understand an owner's strategy during these unprecedented times; including how the owner's business is able to adapt to the current climate (for example, restaurants may consider increasing their takeaway capabilities), as well as focusing on how debt will be serviced once this period of disruption has come to an end.

With COVID-19 having differing impacts on individual locations and market segments (for example the likely destruction of MICE business for much of 2020), past performance will be no guarantee of a quick return to profitability once lockdown ends.

A strong business plan will also be crucial for small to medium sized businesses looking to take advantage of the Government backed Coronavirus Business Interruption Scheme Loan, where business viability is a critical question in determining eligibility.

Some other key matters to consider ahead of engaging with your lender are:

1. **Hotel management agreement**

Hotels managed by an operator under a hotel management agreement can present challenges for lenders as their collateral is controlled by a third party (the operator) rather than the borrower. In due diligence, a well advised lender will want its legal advisors to conduct a detailed review of the HMA, including:

- Subordination – a provision requiring the operator to subordinate its rights under the HMA to the lender's rights under the finance documentation. These are quite rare given the lender is often not involved or have any influence at the negotiation stage of the HMA – but can be particularly useful for a lender where it needs to defer payment of fees under an HMA to preserve available cash in the hotel operating account. We would suggest that stopping fee payments to operators, the key party delivering cashflow for any given property, may not be the best approach;
- Non-disturbance – many HMAs require that any incoming lender enters into a non-disturbance agreement with the hotel operator which ensures that the lender will recognise and not terminate the HMA on enforcement – this reduces flexibility for the lender on enforcement of security and may affect marketability of the hotel on any forward sale. Most major hotel brands will insist on owner obtaining this protection from the lender (and we saw them adopt a firmer stance on this post 2008);
- Restrictions on borrowing – some HMAs will have other requirements or restrictions on borrowing (e.g. relating to LTV or debt service ratio levels);
- Provisions relating to assignment/ charging of the HMA – a lender will want to make sure a hotel owner/borrower is not prohibited from assigning and/or charging their interest in the HMA. Some HMAs may also impose restrictions on what is an 'acceptable lender';
- Information/reporting obligations – these should be consistent with the borrower's obligations under the loan documentation; and
- any COVID-19-related amendments put in place with the operator – examples to consider are the impact of current circumstances on performance tests, performance guarantees, hotel closure arrangements and CapEx works.

2. **Cash management arrangements** – what accounts is a lender likely to want a charge over and is it appropriate for all accounts to be charged/swept in favour of a lender? Any accounts which need to be maintained in the joint name of the landlord and tenant (e.g. FF&E accounts where the landlord has invested significant capital in the fit out/establishment of a hotel) should be considered.

3. **Standing of the Hotel in its market** – understanding the performance of the hotel relative to its competitive set, the suitability of its offering in the post-COVID-19 world, and the impact of any new local supply dynamics (possibly withdrawals as well as additions) will be key to developing an understanding of how resilient the hotel's trading will be.

4. **Insurance provisions** – on leasehold properties, the insurance terms of the lease should be considered, particularly where the lease requires insurance to be maintained in the joint names of the landlord and the tenant. Many lenders require that they are co-insured as well as named as first loss payee on the buildings insurance and so you will need to understand whether the lease allows this and/or if any consent of the landlord is required.

5. **Underlying due diligence** – on any refinancing, there is a perception that the due diligence process should be easy given that due diligence reports will have been produced in connection with the previous financing. This assumes that (a) there have been few changes to the title of the property and (b) that all relevant information was reported on in a way which meets the incoming lender's requirements. This is not necessarily the case and at the start of any refinancing transaction, care should be taken to check that all relevant information is available and included in any due diligence report – this will (hopefully!) avoid last minute disclosures.

6. **Ongoing Construction** – lenders will be focussed on contractual mechanics relating to claims for loss and expense and extensions of time. Contractors are more likely to be seeking relief under their contracts given the current circumstances and lenders will be more cautious about funding projects with less certainty surrounding the timing or cost of project delivery. What steps can borrowers take to alleviate these concerns?

- Prepare a project strategy demonstrating how work may be able to continue during the lockdown period, therefore minimising delay to the project and limiting significant cost increases.
- Engage with contractors, professional teams and supply chains to cultivate a collaborative approach to completing the project. More frequent interim payments, waivers of cash retentions and/or liquidated damages may be sensible solutions to ease financial pressures in the supply chain on a temporary basis. Lenders will currently have a reduced appetite for risk and so will be reluctant to finance a project rife with impending disputes.
- Analyse its construction contracts and understand how each of them deals with extensions of time and loss and expense claims.

Our Hotels and Hospitality Team can provide specialist advice on all of the above, help you clarify your options and implement your refinancing strategy in a timely and cost-effective manner.

If you have any questions please do not hesitate to contact:

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Click here to read more insights on how we can weather the coronavirus outbreak with you.

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