

Insights

U.S. COVID-19 IMPACTS: EMERGENCY REPURPOSING OF HOTELS

Apr 02, 2020

As the pressure mounts on hospitals and healthcare facilities throughout the country to confront the overflow of patients affected by the COVID-19 virus, State and local governmental agencies are contracting with hotel owners and operators to temporarily repurpose their hotels to attend to those affected by the pandemic. Many hotels, commercial lodging establishments and short-term rentals in many locales throughout the U.S. have closed or are continuing to experience a dramatic reduction in occupancy as a result of the pandemic as the virus and its spread cause previously unseen challenges throughout the hospitality sector, both from a financial and an operational standpoint.

As hotel owners and operators and their lenders and stakeholders consider these opportunities, they must carefully evaluate the risks and rewards with these arrangements – having a source of revenue that would not otherwise be available during this extraordinary period, while providing a humanitarian service to the public, must be balanced and weighed against the exposure to potential liability and possible health risks associated with repurposing a hotel for these purposes.

Below are some key points that should be considered when evaluating these arrangements:

- Generally, most of the agreements being proposed by State and local governmental agencies are very basic and do not include the typical bells and whistles that you would see in an arms-length market lease. For instance, in many cases, these agreements do not contain any specific use provisions (or, perhaps more importantly, prohibited use restrictions), there are no subordination clauses and there are no lessee indemnities in favor of lessor.
- Due to the lack of indemnification provisions mentioned above, hotel owners/operators may, among other things, face exposure from hotel employee claims of being exposed to the virus while providing the services required by the lessee. Even when a governmental agency is willing to indemnify a hotel owner/operator for claims arising out of using the hotel for these purposes, questions of sovereign immunity have to be considered when evaluating the recovery under such indemnities.

- There is little flexibility in negotiating these agreements. Given the current climate, as well as urgent need for additional space and lack of resources, government agencies have been presenting these on a “take it or leave it” basis and any effort by hotel owners/operators to significantly negotiate these agreements can be seen as being non-cooperative.
- Some other items to be mindful of when evaluating the proposed documentation are the length of the term of lease (and whether the hotel owner/operator has the right to terminate same), lessee’s right to use, and obligation to dispose of, any biohazardous materials and decontaminate the hotel upon the end of the lease, lessee’s insurance requirements and lessor’s obligations to provide housekeeping services, security services (e.g. a manned front desk) and utilities.
- Hotel owners and operators should be aware of the covenants and restrictions contained in any franchise agreement, financing documents, management agreement, ground lease and any other encumbrances that the hotel is subject to in order to avoid any unintentional default under these documents.
- Hotel owners and operators should discuss with their insurance consultants how a change in use may affect their insurance coverage and what possible additional insurance may be available to mitigate the potential liability risks mentioned above.
- Although in many instances governmental agencies have agreed to provide decontamination and cleaning services upon the expiration or termination of the lease in accordance with CDC standards, additional consideration should be given to how future customers may feel about staying in a hotel that was previously used as a temporary medical facility.
- From a lender’s perspective, these agreements contain material economic terms that need to be evaluated and typically run through what may be a lengthy underwriting process coupled with loan modification terms required by the lender, however they are being presented to lenders on an “emergency basis.” Given the current environment, a lender’s typical underwriting is impractical and may put lenders at risk of being viewed as uncooperative or unsympathetic. Whether these matters are addressed in a consent response letter or a more substantive loan modification is something to be discussed with the lender and will vary based on, among other things, the type of asset, financial strength of the borrower and/or guarantor(s) and timing constraints.

Notwithstanding the humanitarian good intentions which this initiative clearly provides, while these arrangements will help to create some revenue for hotel operators (and in turn potentially prevent borrowers from defaulting under their loans and paying other operating expenses), it remains to be seen what types of long-term costs and liabilities arise out of these arrangements.

RELATED CAPABILITIES

- Commercial Real Estate
- Real Estate
- Hotels & Hospitality

MEET THE TEAM



Eugene P. Balshem

Co-Author, Miami

eugene.balshem@bclplaw.com

+1 786 322 7391



Victoria I. Goldson

Co-Author, St. Louis

tory.goldson@bclplaw.com

+1 314 259 2567



Natalie Prager

Co-Author, Miami

natalie.prager@bclplaw.com

+1 786 322 7380



Steven M. Stimell

Co-Author, New York

steven.stimell@bclplaw.com

+1 212 541 2042

This material is not comprehensive, is for informational purposes only, and is not legal advice. Your use or receipt of this material does not create an attorney-client relationship between us. If you require legal advice, you should consult an attorney regarding your particular circumstances. The choice of a lawyer is an important decision and should not be based solely upon advertisements. This material may be “Attorney Advertising” under the ethics and professional rules of certain jurisdictions. For advertising purposes, St. Louis, Missouri, is designated BCLP’s principal office and Kathrine Dixon (kathrine.dixon@bclplaw.com) as the responsible attorney.