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Industry Spotlight: Dealing with the Insolvent or Near-Insolvent Hotel Debtor — Debtor and Creditor Perspectives, Actions and Opportunities

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ABI ASM – Hotel Insolvency Panel Presentation Outline

I. STATE OF THE INDUSTRY

A. Impact of COVID-19 on Hotel Operations

1. In 2020, more than 670,000 jobs were lost in the direct hotel industry operations sector (hospitality industry lost more than 4 million jobs overall).
2. Hotel occupancy dropped to a historic low of 24.5% in April 2020 and annual occupancy fell to roughly 44% in 2020, a historic low.
3. RevPAR (Revenue per available room), which is one of the key metrics of the hotel industry, decreased from \$95.74 to \$45.48, a 47.5% decline.
4. In December 2020, U.S. hotel occupancy was 36.7%, a 32.3% year over year decrease

B. Impact of COVID-19 on Gaming Industry

1. In 2020, the gaming industry lost an estimated \$105 billion
2. Almost 1,000 casinos closed and the industry lost more than 650,000 jobs, some of which may never return
3. In Nevada, visitor volume decreased by 24.6% and gross gaming revenue declined by 21.7%

C. The Short-Term Outlook is Positive, But Growth Will Be Slow

1. According to the American Hotel & Lodging Association, hotels will add 200,000 direct hotel operations jobs in 2021, but will remain nearly 500,000 jobs below the industry's pre-pandemic employment level
2. Hotel employment is unlikely to reach pre-pandemic levels until at least 2023
3. Hotel occupancy is expected to rise to 52%, but still well below the 2019 average of 66%
4. In 2021, room revenue is anticipated to reach just 65% of pre-pandemic levels
5. Business travel will be down 85% from 2019 and will only increase slightly over the next 2 years

II. OVERVIEW OF HOTEL INDUSTRY STRUCTURE

A. Hotel Structure

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1. Typical hotel is owned by an individual, an institutional investor or investor group. Hotel owner is usually the borrower on the loan secured by the hotel.
2. Hotel is managed by a separate entity in which the owner may have an interest.
3. Hotels can be independent (i.e., not franchised and/or no major brand affiliation) or “flagged” (franchisee of a major brand, [or less commonly, owned by a major brand])
4. Other complications include “user agreements” or perhaps leases that provide access for hotel guests to golf, tennis, marina, spa or other facilities.
5. Licenses may include cabaret and business licenses, liquor licenses, gaming licenses and many other permits.

III. LENDER NEGOTIATIONS

A. Forbearance Agreements

1. In many cases, borrowers and lenders have entered into forbearance agreements, whereby the lender agrees to forbear in exercising its rights under the loan documents if certain conditions are met, with the hope the Borrower can make it through the market downturn.
2. Forbearances are only temporary measures to get through periods of uncertainty and, in these cases, the uncertainty will only continue well past the expiration of the forbearance period.
3. Given the uncertainty, it is not yet clear how long lenders are willing to forbear – will they wait until there is better visibility or seek to resolve sooner?

B. Diligence of Collateral

1. State of the market and need for protection has forced many Lender’s to reexamine their collateral. Together with the financial vulnerability of Borrower’s, the two parties have worked together to provide extra security to Lender’s and additional flexibility to Borrowers.

C. Loan Workouts

1. What loan modifications terms are lenders accepting? With the uncertainty in the hospitality industry, some lenders are allowing access to reserves to fund debt service, suspending capital expenditure reserve requirements, and providing other terms to help borrowers with immediate cash flow issues.

IV. LIQUIDITY AND FINANCIAL NEEDS

A. What does the Lender Actually Have a Perfected Security Interest In and/or Lien on?

1. This question is of particular importance in gaming where a Lender cannot have control over the casino's cash under existing regulations.

B. Use of Cash Collateral

1. Given valuation concerns and uncertainty of market, debtors may struggle to provide adequate protection. Further, the question of what constitutes adequate protection may be difficult to determine.
2. Debtors are concerned with use of cash collateral because of the need to make payments in ongoing operation of their business and to cover operating losses.

C. Uncertainty Issues

3. The uncertainty of the market begs the question of how much longer revenues will remain low and when will travel increase in a meaningful way.

V. LEASING ISSUES

Many hotels and adjoining convention centers are the subject of ground leases where the land is leased by an institutional owner or municipality to the hotel owner for a small amount of money each year (e.g. 90-year lease at \$100 per year), but has several restrictions and other requirements under the lease that could be triggered during the pandemic. One issue for hotel owners is how to deal with those leases in and out of bankruptcy.

A. Force Majeure Clauses

1. Many contracts have a "force majeure" clause that operated to temporarily delay, or excuse certain obligations when the business is shuttered. Whether COVID-19 related issues fall into these clauses is up to debate in many cases.

B. Benefits of Bankruptcy to Tenants

1. Hotel owners may be able to obtain relief on curing non-monetary defaults such as generating a certain level of business for a convention center or operating continuously as a full-service hotel

VI. SARE

A. Requirements of SARE Determination

1. Single Property or Project
2. Substantially All of the Income of the Debtor
3. No Other Substantial Business Activity

B. Legal Significance of SARE Status

1. Compliance with § 363(d)(3) to avoid relief from the automatic stay. This section requires that within 90 days either (1) the debtor file a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or (2) the debtor commence making monthly, interest-only payments to the secured creditor at the then-applicable non-default contract rate of interest on the value of the creditor's interest in the SARE.

VII. CONFIRMATION AND RESTRUCTURING ISSUES

A. Valuation

1. Knowing whether a plan is “fair and equitable” to pass muster under the bankruptcy code's cramdown provisions can present valuation questions that are difficult in light of the industry outlook and related uncertainties.

B. 363 Sale

1. A § 363 sale offers debtors the distinct advantage of selling their hotel free and clear of any franchise agreement. This can be advantageous because it allows a purchaser to renegotiate a franchise agreement that reflects the climate in the industry today.
2. Management contracts can also be rejected under § 365, allowing the buyer to put in its own management company or become an owner-operator

C. Feasibility of Plan

1. How can feasibility be determined where it is not possible to know when revenues will increase and by how much? Debtors are likely to push for lower valuations to cram down Lenders, but will still need an accepting class.
2. As stated earlier, outlook is positive, but growth will be slow. Whether business will return to pre-crisis levels earnings and occupancy projections is unknown and determining the feasibility of a plan becomes more difficult.
3. Given the outlook, evaluating the significance of RevPar, CoR, and other key performance indicators similarly becomes more difficult.

4. Finally the uncertainty surrounding free independent travel and group travel further adds to the difficulty of determining the feasibility of a plan of reorganization.

D. Union Contracts

1. § 1113 of the Bankruptcy Code permits debtors to reject troublesome CBAs and union contracts. In states such as New York, where hotel workers are part of a union, this will be an issue for hotel insolvencies

VIII. OPPORTUNITIES OF COVID

1. Debtor's with deep pockets may weather the storm long enough to see the upside of a growing demand.
2. Unregulated lenders may take advantage of owner's current circumstances and slow growth of the industry through loan to own arrangements, but regulated lenders are less likely to take this route given the need to fund basic operating costs out of pocket.
3. Overall, the industry has good prognosis because of pent-up demand for travel. However, this is largely limited to leisure travel and most analysts agree it will take 2-3 years for business travel to increase meaningfully.
4. Whether any given hotel owner can survive long enough to realize this opportunity remains to be seen.

Faculty

Dawn M. Cica is an attorney with Carlyon Cica Chtd. in Las Vegas and has more than 30 years of experience working on transactions of all types, including transactional aspects of bankruptcy and creditors' rights such as strategic resolutions, workouts, restructurings, settlements, debtor-in-possession financings and asset-purchases/sales. In addition to her transactional experience, she has built a renowned bankruptcy practice representing creditors, committees, affiliated parties and debtors. Ms. Cica has been involved in many influential Nevada bankruptcies in various industries, including the Aladdin Resort, Station Casinos, Riviera Hotel & Casino, Jerry's Nugget, Las Vegas Monorail, Lake Las Vegas, South Edge, Consolidated Resorts, Viansa Winery, Tower Homes, Village at Centennial Springs, CommPartners, Global Axxess, MEGO Financial, Integrated Financial Associates, USA Capital, Rodeo Creek Gold, Martifer Solar USA, Nevada Cancer Institute, Cal-Neva Lodge, LLC, New Cal-Neva Lodge, LLC, Nevada Gaming Partners, LLC, John Ritter, DC Solar and Lucky Dragon Hotel and Casio. She has also participated in bankruptcies and assignments for the benefit of creditors in California and New York. Ms. Cica has received numerous industry and peer recognitions, including the National M&A Advisory Award for Real Estate Deal of the Year – Chapter 15 Sale of the Veris Gold Mine (2015), and as one of the Nevada and Top 50 Women *Mountain States Super Lawyers*. She received her B.S. in finance and B.A. from the University of Nevada, Reno in 1984 and her J.D. from the University of California, Los Angeles School of Law in 1987, where she was a member of the *UCLA Law Review* and participated in a moot court.

Scott S. Markowitz is a partner and co-chair of Bankruptcy and Corporate Restructuring Practice of Tarter Krinsky & Drogin LLP in New York. His practice focuses on debtor and creditors' rights, bankruptcy and out-of-court workouts. Mr. Markowitz counsels clients on chapter 11 reorganizations and chapter 7 proceedings, financial restructurings, strategies for dealing with financially troubled entities, buying and selling troubled entities in chapter 11 and outside of bankruptcy, out-of-court debt-composition and settlements, preference and fraudulent-conveyance litigation, and dealing with leases and executory contracts in bankruptcy proceedings. He has a diverse portfolio of clients, including public and private middle-market companies, as well as creditors' committees. During the real estate recession between 1989 and 1992, he represented more than 100 real estate entities in bankruptcy court restructurings. In addition to his work with corporate clients, Mr. Markowitz counsels individual clients with regard to complex individual debt restructuring. He was lead bankruptcy counsel to the Christian Brothers, a Catholic religious order, which filed a chapter 11 case before Hon. Robert D. Drain to deal with an avalanche of sexual abuse litigation filed in numerous states around the country. He also represented the Martinique Hotel, a famous landmark hotel in New York City, in a contested chapter 11 case that resulted in a confirmed plan and payment of 100 percent, plus interest, to unsecured creditors. Prior to joining Tarter Krinsky & Drogin, Mr. Markowitz was a partner for 10 years at the bankruptcy law firm of Todtman, Nachamie, Spizz & Johns, P.C. He received his B.S. in 1985 and his J.D. with honors in 1988 from the University of Florida.

David M. Neff is a partner in the Chicago office of Perkins Coie LLP, where he focuses on both litigation and transactions and represents debtors, lenders, individual creditors and creditors' committees in all types of bankruptcies throughout the country. In 2012, he argued for the petitioner in front of the U.S. Supreme Court in *RadLAX Gateway Hotel v. Amalgamated Bank*. That same year,

he also obtained a damage claim of almost \$125 million for a client in the *MSR Resorts* bankruptcy case after two trials. Mr. Neff is a Fellow of the American College of Bankruptcy and an adjunct professor at Northwestern University Pritzker School of Law. He has been designated an *Illinois Super Lawyer* from 2005-17, and *Chambers USA* has listed him as one of the leading Chicago bankruptcy lawyers from 2007-17. Mr. Neff is a past president of the Chicago Bar Association Bankruptcies and Reorganization Committee and has spoken often at the Norton Bankruptcy Litigation Institute and for ABI. He has particular experience in the hotel industry, where he has represented major parties in more than 50 hotel bankruptcy cases throughout the country and many out-of-court restructurings. He also has a specialty in professional partnership dissolutions and bankruptcies and has represented five law firms in such matters. In addition, he has authored law review articles on hotel bankruptcies, professional partnership bankruptcy and dissolution matters, and landlord/tenant bankruptcy issues. Mr. Neff received his B.S. in journalism from Northwestern University in 1982 and his J.D. from DePaul University College of Law in 1985.

Mark D. Podgainy, CTP is a managing director with Getzler Henrich & Associates LLC in New York and has more than 20 years of experience working with healthy, underperforming and distressed middle-market businesses, both as an advisor and as a member of the management team. He has provided operations restructuring, business plan analysis, performance improvement, cash and vendor management, bankruptcy consulting and interim-management services. Mr. Podgainy has also worked with law firms on forensic and litigation support assignments in bankruptcy cases. His clients have included business owners, boards of directors, private-equity firms, lenders, creditors' committees and law firms, and he has worked primarily in the manufacturing and distribution, consumer products, building products, food, hospitality, retail, apparel and textile, and real estate sectors, among others. Mr. Podgainy also has experience with both the nonprofit and education sectors, including ConnectEdu and The College of New Rochelle, and he has experience in successfully guiding middle-market companies through the workout and restructuring processes, both in court and out of court. He has served as CRO, interim CFO, treasurer or financial advisor in a variety of companies and situations. Outcomes have included improved operational and financial performance, successful reorganizations, enterprise and asset sales, wind-downs and liquidations. In each situation, he has been able to address thorny financial, legal, organizational and governance issues to maximize recoveries for the parties-in-interest. Mr. Podgainy is a board member of Neighborhood Housing Services of New York City Inc., a nonprofit that revitalizes underserved neighborhoods, and the New York City Chapter of the Turnaround Management Association. He is a member of ABI, the Turnaround Management Association and the Cornell Hotel Society, and he has written frequently on mergers and acquisitions, real estate and related topics for numerous industry trade publications. Mr. Podgainy received his Bachelor's degree from Cornell University's School of Hotel Administration and his M.B.A. from Columbia University.

Nicholas J. Zluticky is a partner with Stinson LLP in Kansas City, Mo., in the firm's Bankruptcy and Creditors' Rights Division, where he represents lenders in all aspects of debtor/creditor relationships. His experience includes the representation of secured and unsecured lenders in bankruptcy cases, as well as Kansas and Missouri foreclosures, collection actions against borrowers and guarantors, workouts, participation disputes and lender-liability defense. He also has experience representing clients in all aspects of bankruptcy matters, including debtors (*e.g.*, Interstate Bakeries Corp., Bistate Bistro Associates, L.P. and Gas-Mart USA, Inc.), liquidating trustees (*e.g.*, Blue Sun St. Joe Refining LLC), bankruptcy trustees (Social Networking Technology Inc.) and creditors' committees (*e.g.*,

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Blue Sun St. Joe Refining, LLC). Most recently, Mr. Zluticky was counsel for the debtors in the jointly administered bankruptcy case of *In re John Q. Hammons Fall 2006, LLC*. The debtors owned and operated 35 hotels throughout the country, more than 30 parcels of undeveloped real estate in 11 states, several commercial real estate properties throughout Missouri, the Federal Courthouse in Springfield, Mo., golf courses, real estate leased to restaurants, a minority interest in a casino, and the rights to the film *The Great American West*. Mr. Zluticky received his B.A. in political science in 2005 from the University of Kansas and his J.D. in 2008 with honors from Washburn University, where he was a staff member on the *Washburn Law Journal*.