

Struggling Hotels Can Provide Turn-Down Service, Can't Be Turned Down for Subchapter V Bankruptcy

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Subchapter V of Chapter 11 of the Bankruptcy Code, which took effect in February 2020, creates a more streamlined and less expensive Chapter 11 reorganization path for small business debtors.

It has proven popular during the COVID-19 pandemic, with over 1,800 cases filed. Hotel owners have been particularly hard hit during the pandemic, with occupancy rates plummeting over the past year. But Subchapter V is not available for "single asset real estate" debtors. Can a hotel reorganize under Subchapter V or must it go the cumbersome, more expensive, and time-consuming traditional Chapter 11 route? According to a recent decision from a bankruptcy court in Florida, a hotel is not a single asset real estate debtor because it provides services beyond renting rooms and, for that reason, can avail itself of Subchapter V.

The case involved a dispute between a 79-room Econo Lodge Inn & Suites and its primary creditor – State Bank of Texas. The bank was under-secured, so it held both secured and unsecured claims against the debtor. The bank sought to prevent the Econo Lodge from proceeding under Subchapter V because it contains provisions allowing a debtor to retain property without creditor support even if the debtor does not pay 100% of its unsecured claims.

Under the Bankruptcy Code, single asset real estate is “real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor who is not a family farmer and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental thereto.”

According to the Bankruptcy Court, the three elements of single asset real estate are (1) the ownership of real property constituting a single property or project, (2) that generates substantially all of the debtor’s gross income, and (3) on which no substantial business is conducted aside from operating the real property and related incidental activities.

The Bankruptcy Court pointed out that besides owning and maintaining the property, the debtor had 15 employees, cleaned rooms every day, served breakfast, maintained a swimming pool, fitness center, and business center, and provided laundry, internet, and phone services. These were additional services beyond

"operating the real property and activities incidental thereto."

The Bankruptcy Court contrasted hotels with apartment buildings, where tenants sign leases and require little additional assistance. Hotels involve substantially more day-to-day activities than apartments - from 24-hour reception desks, to turn-down service, to maintenance, to updating and refurbishing rooms to comply with franchise requirements. These additional amenities and services, even if they don't generate additional income, will remove a hotel from the single asset real estate category.

The takeaway is that, at least according to one bankruptcy court, hotel and motel owners contemplating bankruptcy may file under the more debtor-friendly Subchapter V. Banks and other creditors in the lodging industry should remember this in pre-bankruptcy negotiations and workouts.

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