This article brought to you by ***Commercial Investment Real Estate***, the magazine of the **CCIM Institute**.

To read the entire issue or find out more about the Institute, go to **www.ccim.com**.

Seeking Comfort

Hotel brands provide lender assurance — for a fee.

by Rori Malech

When providing loans on branded hotel properties, mortgage lenders usually seek a "comfort" or "recognition" letter from the brand's licensor or franchisor. A comfort letter is a tri-party agreement among the owner, the lender, and the licensor. Its purpose is to provide a lender with reasonable assurances that in the event of a foreclosure, the lender will be able to maintain the hotel brand's license.

A Change in Purpose

Prior to the beginning of the economic downturn in 2008, the vast majority of lenders providing hotel financing obtained comfort letters as a "check the box" requirement. The letters provided "comfort" from the licensor that the lender would have certain rights if the hotel owner defaulted under the loan agreement.

However, over time, comfort letters have shifted from protecting lenders to imposing obligations on lenders and potentially exposing them to liability for the benefit of the franchisors.

A hotel with a national brand affiliation has either a license agreement, whereby the name is solely licensed to the hotel owner, or a management agreement, which states the brand is also responsible for the day-to-day management of the hotel. In many instances, the brand is an essential benefit to the hotel that the lender may want to preserve in the event it forecloses on the hotel. Accordingly, lenders customarily require a comfort letter prior to or simultaneously with the closing of any financing secured by a hotel.

Comfort letters are issued by the brands on their standard form and are largely non-negotiable; however, lenders that do a substantial amount of repeat business with a brand may have their own negotiated forms. The primary benefits of a comfort letter to a lender are the following:

- notice of owner defaults under the license agreement and an opportunity to cure such defaults (usually coupled with an additional cure period beyond the owner's cure period);
- the right to enter into a new license agreement with the licensor following a foreclosure; and
- the licensor's waiver of the application fee (and sometimes renovation requirements) when the lender enters into such new license agreement.

In the current market, in exchange for these benefits of the comfort letter, brands have imposed onerous conditions on the lenders, including the following:

- before exercising a cure right, a lender may be required to pay all fees due to the licensor from the licensee;

nazdravie/Getty Images

- before seeking appointment of a receiver, a lender may be required to cure all licensor defaults in a proscribed time period, provide a bond to guarantee the obligations of the receiver, and negotiate a short-term interim license agreement with the licensor for the receiver to operate the hotel during the receivership period;
- if a foreclosure follows a prior license termination due to a licensee default, a lender may be obligated to comply with the terms of the license agreement with respect to de-identifying the hotel and to indemnify the licensor from any liability arising from the operation of the hotel under the licensor's brand; and
- the lender may be required to notify the licensor in advance before exercising various remedies against the owner, including commencement of foreclosure proceedings and a petition for appointment of a receiver.

Lenders often focus on the benefits they may get from a comfort letter without focusing on the obligations imposed by the brand. Because the lender is not a party to the license agreement, in the absence of a comfort letter, the lender is not bound by any of its terms. Though the lender risks losing the brand in the event of a foreclosure, if a hotel is well positioned in its market and the licensor values the hotel, the lender will likely be able to negotiate a new or interim franchise agreement whether or not it has obtained a comfort letter.

A comfort letter puts the power in the lender's hands to determine whether it wants to maintain the license, but the conditions contained in a comfort letter may bind the lender in connection with the exercise of its rights. Lenders must weigh the benefits, including, among other things, the value of keeping the brand in place, the waiver of fees and renovation requirements, and notice and cure rights, against the obligations imposed on lenders.

Key Takeaways

- Comfort letters may impose obligations on lenders and potentially expose them to liability in connection with exercising their rights under their loan documents and the comfort letter.
- Lenders and their counsel should weigh the benefits of obtaining a comfort letter against the obligations imposed on a lender in the comfort letter.
- If a hotel is well positioned in its market and desirable to the current brand and/or other brands in the market, the lender may be able to achieve its goals regardless of the existence of a comfort letter.

Rori Malech is a partner with Hunton & Williams LLP in Washington, D.C. Contact her at rmalech@hunton.com.

This article presents the views of the author and do not necessarily reflect those of Hunton & Williams LLP or its clients. The information presented is for general information and education purposes. No legal advice is intended to be conveyed; readers should consult with legal counsel with respect to any legal advice they require related to the subject matter of the article.