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# Hotel Financing Series, Part 2: Covenants


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In Part 2 of our series on hotel financing in the wake of COVID-19, we take a look at some of the most common covenants in a typical hotel financing transaction, with the understanding that each set of agreed covenants is tailored and specific for each transaction.

**Financial covenants**

As with all real estate financing, loan-to-value ratio (a measurement of the total loan outstanding against the value of the property) is an essential financial covenant in hotel financing. In addition, the other key financial covenant is the interest cover. Unlike traditional real estate financing, where the historical rent and/or projected rent is used, in hotel financing, the interest cover (or, if applicable, debt service cover) is worked out using the cashflow of the hotel, which is usually a formulation of EBITDA as agreed between the lender and the borrower, against the interest for the same period. In addition, there can be other restrictions, such as an annual limit on capex (unless topped up by the sponsor), or in some instances, where the bank has placed some emphasis on the sponsor's financial backing, a net worth covenant on the sponsor.

**General covenants**

In addition to the general property covenants, hotel financing usually include a few additional specific covenants, such as:

- maintenance of property to also extend to adhering to brand standards;
- capital expenditure is monitored closely, as hotels often require frequent upgrades and refurbishments. There should be pre-agreed budget and capex expenditure and refurbishment plan as agreed with franchisor each year;
- restriction on amending key hotel documents without lender's prior consent; and

- restriction on terminating and/or appointing new hotel manager without lender's prior consent.

**Information covenants**

With hotels managed under the franchising model, the franchise agreement usually stipulates a detailed set of ongoing monitoring and inspections conducted by the franchisor on a periodic basis. It is extremely useful for the lender to keep a close eye on these and obtain the results of the periodic inspections via the reporting covenants. Not only are these reports usually quite comprehensive, which includes information such as vacancy rates, average rate yielded for each hotel room, etc., but they are also the first place where lenders can spot any issues or first warnings of deterioration of the business, such as not obtaining a particular star rating on reviews or not meeting the latest upgrade/refurbishment requirement. The lender can then discuss or obtain updates from the borrower as to how these are being addressed with the help of the franchisor.