PAUL HASTINGS

STAY CURRENT

March 2020

Follow @Paul_Hastings

PH COVID-19 Client Alert Series: Overview of CARES Act and its Applicability to the Hospitality and Leisure Industry

By **Rick Kirkbride**, **Ted Smith**, **Charles Patrizia**, & **Sara Kalis**

On March 27, 2020, the Coronavirus Aid, Relief and Economic Security Act (the "CARES Act") was signed into law. The CARES Act provides more than $2 trillion of federal economic relief to businesses, governmental entities, and individuals affected by COVID-19. While the scope of the CARES Act is extensive, this summary is intended only to provide a high level discussion of the key provisions most likely to benefit owners and operators of hospitality and leisure properties.

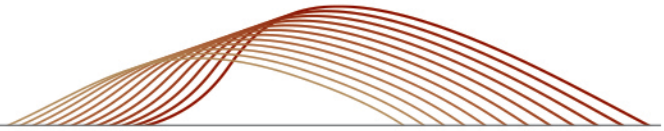
TITLE I - SMALL BUSINESS INTERRUPTION LOANS

Title I of the CARES Act modifies the Small Business Act, 15 U.S.C. §656, to allow for widespread and readily available lending to small businesses in the wake of the COVID-19 crisis. Under Title I (denominated as the "Keeping American Workers Paid and Employed Act"), a qualifying business that has suffered a significant disruption due to COVID-19 may apply for a small business loan intended to address cash-flow shortfalls resulting from the crisis (each, a "Small Business Interruption Loan"). The CARES Act appropriates $349 billion towards Small Business Interruption Loans, with the stated intent of providing support for the continuation of business of business payrolls.

A. *Eligibility*

Subject to notable exceptions discussed below, virtually any business operating in the United States with not more than 500 employees will be eligible to receive a Small Business Interruption Loan. For purposes of determining an applicant's number of employees, all employees of a given applicant and its affiliates, as broadly defined, are aggregated (subject to the waiver of affiliation for the hospitality and food services industries as discussed below). Under the Small Business Act as in place prior to the CARES Act, the aggregation of employees and annual receipts among affiliates would often preclude many businesses from qualifying for small business loans.

Of great significance for the hospitality and industry, the CARES Act contains a waiver of the affiliation provisions of the Small Business Act, with the waiver being expressly applicable and limited to business concerns having a NAICS code 72 ("accommodation and food services"). This waiver allows the 500 employee limitation to be applied on a location-by-location basis with respect to hotels and food service businesses, without any aggregation among affiliates operating at other locations.



Accordingly, so long as a given hotel location employs not more than 500 employees, the subject business will be eligible for a Small Business Interruption Loan.

Aside from the accommodation granted under the CARES Act to the hospitality and food services industries, many of the general limitations on eligibility under the Small Business Act remain in place and will be applicable with respect to Small Business Interruption Loans. Businesses that are generally ineligible include passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds (subject to existing exceptions).

B. *Maximum Loan Amount*

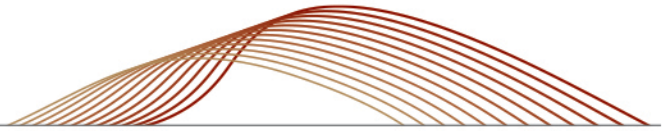
Under the CARES Act, the maximum loan amount for a Small Business Interruption Loan will be the lesser of (1) $10 million and (2) 2.5 times the average monthly payroll costs incurred by the applicant over the one-year period before the loan is made (with seasonality-based adjustments and adjustments for new businesses being available). Additional proceeds may be available if a previously existing small business loan is being refinanced in connection with a Small Business Interruption Loan. Payroll costs are extensively defined under the CARES Act, and it should be noted that compensation in excess of $100,000 to any single employee cannot be included in calculating the maximum loan amount available to an applicant.

As the CARES Act was intended, at least in part, to provide relief to the hotel industry, we expect that the payroll calculation provision will be construed to take into account typical ownership and employment arrangements utilized with respect to hotels. Accordingly, employees of a property manager that are assigned to a given location, with the hotel owner being responsible for payroll costs on a pass-through basis, should be considered to be employees of the applicant – noting that the applicant may be the fee owner of a hotel that has engaged a property manager or an operating company (in a REIT context) that holds a leasehold interest in a hotel pursuant to an operating lease, with such operating company having engaged the property manager.

C. *Uses*

Small Business Interruption Loans may be used for any purposes allowed under Section 7(a) of the Small Business Act, as amended. The permitted uses and limitations on use of proceeds of small business loans are set forth in the implementing regulations at 13 C.F.R. 120. Typically, small business loans may be used for a purpose benefitting the recipient's businesses, but payments to or on behalf of affiliates and speculative investment are generally prohibited. We expect the implementing regulations for the CARES Act to provide some additional clarity as to any restrictions on use for Small Business Interruption Loans. For clarity, and given that certain uses are required in connection with potential loan forgiveness (as discussed below), the CARES Act specifically allows the use of proceeds for the payment of the following costs (although such uses are not listed as exclusive): (1) payroll costs, (2) costs for continuation of employee benefits, (3) employee salaries, commissions, and other similar compensation, (4) interest on mortgage obligations, (5) rent, (6) utility charges, and (7) interest on other debt obligations incurred prior to the covered period (defined as February 15, 2020 to June 30, 2020).

D. *Origination and General Terms*



Small Business Interruption Loans will be administered pursuant to the Small Business Administration's Section 7(a) loan program, as modified by the CARES Act. The loans will be originated and serviced by existing banks and lenders presently enrolled in this program, as well as any other lenders designated by the Small Business Administration and the Secretary of the Treasury (the "Secretary"). A list of the 100 most active SBA 7(a) lenders through December 31, 2019 can be found at https://www.sba.gov/article/2020/mar/02/100-most-active-sba-7a-lenders. To promote the widespread and ready availability of Small Business Interruption Loans, all such loans will be fully guaranteed by Small Business Administration. The deadline to apply for Small Business Interruption Loans will be June 30, 2020.

General terms of Small Business Interruption Loans as applicable to borrowers are to be as follows:

(1) The loans will be unsecured and will not require a loan guaranty;

(2) To the extent any portion of a loan remains outstanding following debt forgiveness (as discussed below), a maximum maturity of ten years will apply;

(3) A maximum interest rate of 4% will apply; and

(4) Principal, interest, and fee payments with respect to the loan will be deferred for not less than six months and not more than one year.

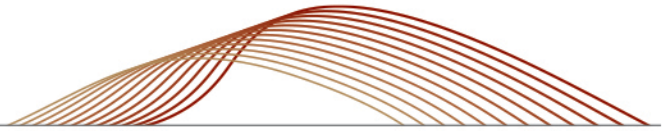
Additional regulations and guidance with respect to terms and conditions of the Small Business Interruption Loans are to be provided within fifteen days following the effectiveness of the CARES Act. It is generally expected, however, that regulations will be published more quickly.

E. *Loan Forgiveness*

A centerpiece of the Small Business Interruption Loan program is the availability of loan forgiveness up to the entire principal amount of the loan. As discussed below, such forgiveness is (1) conditioned upon the use of loan proceeds for certain eligible costs, and (2) subject to reduction based upon reductions in payroll. Borrowers will not recognize any cancellation of indebtedness income for federal income tax purposes with respect to forgiveness of any portion of a Small Business Interruption Loan.

In order for any portion of a Small Business Interruption Loan to be eligible for forgiveness, a borrower must make an application for forgiveness and confirm that the proceeds (or portion thereof for which forgiveness is sought) were used within the eight-week period following the loan funding to pay any of the following: (1) payroll costs, (2) interest (and not principal) with respect to a pre-existing mortgage obligation, (3) rent, or (4) utility costs.

Regardless of the use of the loan proceeds, a borrower seeking loan forgiveness must also confirm the levels of employment, salaries, and wages during the eight-week period following the funding of the loan. Subject to the overriding provisions of the following paragraph, the portion of the principal amount of the loan eligible for forgiveness will be reduced based on the ratio of (1) the average number of full-time equivalent employees employed during the eight-week period following loan funding, to (2) the average number of full-time equivalent employees employed prior to the COVID-19 crisis (calculated, at the borrower's election, as the average number of employees either during the period from February 15, 2019 to June 30, 2019, or the period from January 1, 2020 to February 29, 2020). In addition, the portion of the principal amount of the loan eligible for forgiveness will be subject to reduction by an amount equal to the sum of all reductions of more than 25% in salaries and



wages for employees as effective during the eight-week period following the loan funding (with reductions to be calculated on an employee-by-employee basis with reference to the most recent full quarter of employment for the given employee, and calculated without reference to employees paid at a rate of more than $100,000 per year during 2019 (calculated on an annualized basis for any pay period during 2019)).

The reductions in the amount of available loan forgiveness referenced in the preceding paragraph will not apply if (1) the reduction in the number of employees or the reduction in salaries and wages occurred during the period from February 15, 2020 to April 26, 2020, and (2) the reductions are eliminated by June 30, 2020. The text of this override provision is fairly convoluted and appears to require the complete elimination of any reduction in the number of full-time equivalent employees and the complete elimination of any reduction in salaries and wages. Clarity on this matter may come through regulation. Regardless, an applicant that has already closed its property or significantly reduced its workforce should be mindful of these provisions in assessing the degree to which a Small Business Interruption Loan will be subject to forgiveness.

The application for loan forgiveness will involve a fair degree of detail. Determinations regarding forgiveness are to be made within 60 days of a lender's receipt of a completed application.

F. *Other Considerations*

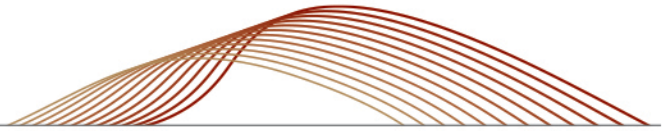
Any applicant for a Small Business Interruption Loan should be mindful of any restrictions with respect to other indebtedness as contained in loan documents or other agreements to which such applicant is now subject. Such restrictions are common in mortgage loan documents and may apply regardless of the amount of a Small Business Interruption Loan and regardless of the fact that the Small Business Interruption Loan is unsecured and subject to forgiveness. Preliminary discussions with institutional lenders and major loan servicers suggest that existing lenders may impose escrow requirements to ensure that the proceeds of Small Business Interruption Loans are properly and timely applied. Also, given the anticipated volume of requests to senior lenders regarding Small Business Interruption Loans, applicants should be aware of potential delays, timing considerations surrounding re-openings, and the need to bring employees back into the workforce as a condition to loan forgiveness.

Any applicant that obtains a Small Business Interruption Loan under Title I will be unable to qualify for the Employee Retention Credit set forth in Title II of the CARES Act, which provides a payroll tax credit in an amount equal to 50% of the wages paid to an employee, up to $10,000.00 per employee.

TITLE IV - CREDIT SUPPORT FOR AFFECTED BUSINESSES (OTHER THAN SMALL BUSINESSES)

A. *Emergency Relief Funds*

Under Title IV of the CARES Act (denominated as "Economic Stabilization and Assistance to Severely Distressed Sectors of the United States Economy"), the Secretary is authorized to make loans, guarantees and other investments in support of eligible businesses, states, and municipalities in an amount not to exceed $500 billion. The CARES Act specifically provides up to $454 billion (in addition to any amounts not utilized for the other industry specific relief referenced in Title IV) for loans and loan guarantees to, and other investments in, programs or facilities established by the Board of Governors or the Federal Reserve that support lending to businesses, states, and municipalities. The CARES Act and Federal Reserve guidance contemplate a Main Street Lending Program to be



established by the Federal Reserve to support lending to small and mid-sized businesses, but no additional details on the program have been provided as of the date of this summary. Given the significant impact of the crisis on hospitality properties, it is possible that lending programs established under Title IV will have some applicability to owners and operators of hotel portfolios or large hospitality and leisure properties.

B. *Direct Loans to Mid-Sized and Large Businesses*

The Secretary will endeavor to implement a program or facility that provides financing to banks and other lenders that make direct loans to eligible businesses with between 500 and 10,000 employees. Any such loans shall have an interest rate not to exceed 2% per annum and shall be subject to a payment holiday for both principal and interest for the first six months (or such longer period as the Secretary may determine). Additional provisions applicable to such loans will likely include the following:

(1) Except to the extent required by a pre-existing contractual agreement, the recipient will not pay dividends with respect to the common stock of the eligible business, or repurchase its (or its parent's) equity interests;

(2) A recipient must certify that it is organized in the United States and has significant operations in, and a majority of its employees are based in, the United States;

(3) Loan proceeds must be used to retain at least 90% of a recipient's work force, at full compensation and benefits, through September 30, 2020;

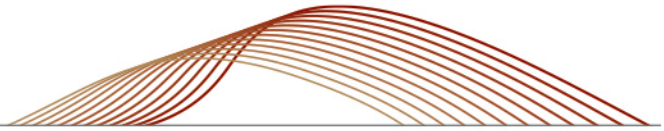
(4) A recipient must intend to restore not less than 90% of the workforce that existed as of February 1, 2020 to full compensation and benefits no later than four months after the termination date of the public health emergency;

(5) A recipient must not outsource or offshore jobs or abrogate collective bargaining agreements, in each case, for the term of the loan and the two year period following repayment of the loan (see the below note on this item); and

(6) A recipient must remain neutral in any union organizing activity during the term of the loan (see the below note on this item).

With respect to the above item (5), the import is that any recipient could not determine whether there is continuing support for an incumbent union through an employer-initiated decertification petition, also known as an RM petition. Further, any recipient likely also gives up its right to file a motion under Section 1113 of the Bankruptcy Code to reject a collective bargaining agreement. While the full reach of the requirements of item (5) are still unknown, if an employer engages in an unfair labor practice that is found to have evaded the terms of the collective bargaining agreement, query whether this will be deemed to abrogate, in part, the collective bargaining agreement.

With respect to the above item (6), this requirement, obviously, could have significant implications for the hospitality and leisure industry. Although silence by the employer may not be required, any messaging during a union organizing campaign would presumable have to contain only view-point neutral content. Further, supervisors may feel stifled in their ability to communicate about their own experiences, which communications would otherwise be lawful. This provision does not appear to require an employer to enter into a neutrality agreement with any union seeking to organize its



employees – noting that the terms of a neutrality agreement can vary drastically, ranging from on-site access for a union's agents to complete silence by an employer.

In general, unlike Title I loans, Title IV loans will not be subject to loan forgiveness and borrowers may be required to provide collateral. The Secretary's authority to make loans and investments under Title IV will terminate on December 31, 2020. Note that the Title IV funds will be subject to congressional oversight, which oversight congressional committee will officially terminate on September 30, 2025.

ADDITIONAL TAX MATTERS

Please also see our PH COVID-19 Client Alert: Business Tax Provisions of the CARES Act, prepared by members of our Tax Department. This communication describes certain tax matters that may be of interest or benefit to owners and operators of commercial real estate.

If any of the information contained in this summary is of use to you, or you would like to discuss this material, please contact any of: Rick Kirkbride, Lauren Giovannone, Derek Roth, Sara Kalis, Chuck Patrizia, or Ted Smith.

✧ ✧ ✧

If any of the information contained in this summary is of use to you, or you would like to discuss this material, please contact any of the following Paul Hastings lawyers:

Atlanta

Ted E. Smith III
1.404.815.2244
tedsmith@paulhastings.com

Theresa S. Clark
1.404.815.2310
theresaclark@paulhastings.com

Los Angeles

Rick S. Kirkbride
1.213.683.6261
rickkirkbride@paulhastings.com

Washington, D.C.

Charles A. Patrizia
1.202.551.1710
charlespatrizia@paulhastings.com