CLIFFORD CHANCE

CORONAVIRUS: THE PAYCHECK PROTECTION PROGRAM AND US REITS

Part of Title I – Keeping American Workers Paid and Employed Act

The Coronavirus Aid, Relief and Economic Security (CARES) Act creates a new $349 billion lending program that will provide low-interest, government-guaranteed loans to small businesses. The program is called the "Paycheck Protection Program" or "PPP." The PPP will be administered by the Small Business Administration (SBA) as an extension of Section 7(a) of the Small Business Act.

We think that the PPP will be of interest to our REIT clients because it should be a resource for tenants and borrowers to obtain funding that is expressly designed to be used to pay rent and debt service. Additionally, REITs may wish to use funding under the PPP for their own payroll expenses. Although the amount of a loan under the PPP is limited to $10 million, the PPP does not subject borrowers under the program to the restrictions on dividends, compensation and share buybacks that will apply to recipients of funding under the Federal Reserve programs that are covered by Title IV of the CARES Act, under which larger amounts of funding are available.

Companies benefiting from the PPP (as well as other taxpayers) also receive significant tax relief under the CARES Act, summarized briefly below.

Highlights of the PPP

- Allocates $349 billion for the SBA to make loans, "Paycheck Protection Loans" or "PPLs," to small businesses during the period from February 15, 2020 to June 30, 2020 (the "Covered Period").
- PPLs are 100% backed by the SBA (rather than 75%-85%, the typical backing for an SBA loan).
- PPLs are low rate (no higher than 4%) and unsecured. No personal guarantees are required. The maximum principal amount of a PPL is $10 million.
- Borrowers can use PPLs to pay payroll costs, rent, debt service and utility payments – an expansion of the permitted uses of proceeds of regular SBA loans.

- Borrowers who use PPLs for covered purposes and maintain head count and employee salaries at certain levels will be eligible for loan forgiveness of up to 100% of the principal amount of a PPL.
- Special rules for companies in the hotel and food services businesses should allow larger companies to obtain multiple PPLs for hotels or restaurants owned by subsidiaries if they meet the eligibility criteria at the individual hotel or restaurant level.
- SBA will cover lenders' costs and pay them a fee. Expect the pool of eligible lenders for PPLs to be greatly expanded beyond existing SBA lenders.

Who is eligible for PPLs?

Any business concern, non-profit organization, veterans organization or Tribal business concern that employs not more than the greater of:

(i) 500 employees, which include employees employed on a full time, part time or other basis, or

(ii) if applicable, a size standard established by the SBA for a particular industry.

We refer to these as "Eligible Participants."

- Sole proprietorships, independent contractors and certain self-employed individuals can be Eligible Participants.

Special Eligibility Rules for Businesses in the Accommodation and Food Services Industries

Regular SBA 7(a) loans are subject to affiliation restrictions that apply to commonly controlled borrowers.[1] These rules are being waived with regard to businesses in the accommodation and food service industries. A business concern in the accommodation or food service industry can be an Eligible Participant if it employs not more than 500 people per physical location.

- This should enable larger hotel companies and restaurant companies to receive PPP funding. If they own their hotels or restaurants through individual subsidiaries that do not have more than 500 employees per hotel/restaurant, then each hotel or restaurant should be able to obtain its own PPL.
- The affiliation restrictions may continue to present challenges for portfolio companies of private equity firms.

How much can an Eligible Participant Borrow?

The maximum size of a PPL is generally equal to the lesser of:

(i) 2.5x an Eligible Participant's average total monthly Payroll Costs during the 1-year period before the PPL was made and

(ii) $10.0 million.

[1] See https://www.law.cornell.edu/cfr/text/13/121.301 for the SBA affiliation regulation as it pertains to SBA's 7(a) business loans.

- There are some different formulations not detailed here for seasonal employers and companies that were not in business as of February 15, 2019.

What are Payroll Costs?

"Payroll Costs" means the sum of any compensation payment that is a:

(i) salary, wage, commission or similar compensation;

(ii) cash tip;

(iii) payment for vacation, parental, family, medical or sick leave;

(iv) allowance for dismissal or separation;

(v) payments required for providing group health care benefits, including insurance;

(vi) payment of any retirement benefit; or

(vii) payment of State or local tax assessed on employee compensation.

provided, however, that Payroll Costs do not include any such amounts in respect of an individual employee paid at an annual rate in excess of $100,000 for the Covered Period, or any amounts for an employee whose principal place of residence is outside the United States.

What can PPLs be used for?

A PPL can be used for purposes other than capital expenditures (which are traditionally what SBA loans can be used for). A PPL may be used for:

(i) Payroll Costs;

(ii) costs related to continuing group health benefits during period of leave and related insurance premiums;

(iii) employee salaries, commissions or similar compensation;

(iv) payments of mortgage interest (but not principal payments or prepayments);

(v) rent;

(vi) utilities; and

(vii) interest on other debt obligations incurred before February 15, 2020.

Other Terms of PPLs

- PPLs are nonrecourse to the borrower, except to the extent the borrower uses PPL proceeds for an unauthorized purpose.
- PPLs are unsecured. No collateral or personal guarantee is required.
- Interest payments will be deferred for at least 6 months and up to 1 year.
- No fees are payable to the SBA for a PPL.

- After any loan forgiveness (discussed below) is applied, the remaining PPL balance will have a maximum maturity of 10 years from the date on which the borrower applies for loan forgiveness.
- The borrower must provide certain certifications to the SBA. The borrower does not have to certify that it is unable to obtain credit elsewhere.
- PPLs are not subject to prepayment penalties.

Treatment of PPLs by Lenders

PPLs will be made through lenders that participate in the SBA's 7(a) loan program. There is an extensive network of banks that make 7(a) loans, and the SBA is expected to expand its list of authorized lenders of PPLs to include non-bank lenders and fintech companies. Some features of the PPP for lenders are:

- PPLs will have a risk weight of zero percent;
- Lenders will not have to treat any modification of a PPL as a troubled debt restructuring;
- The SBA will reimburse lenders between 1-5% of the balance of a PPL within 5 days after the PPL is disbursed.

Secondary Sales of PPLs

- PPLs may be sold on the secondary market.
- If a PPL is sold during the Covered Period and the purchaser fails to provide the borrower with payment deferral, the SBA shall purchase the PPL so that the borrower receives the deferral.
- More guidance on secondary market sales is to be published within 30 days after enactment of the bill.

PPL Forgiveness

- A PPL will be eligible for forgiveness in an amount equal to the sum of the following costs incurred and payments made during the Covered Period (the "Potential Forgiveness Amount"):
  - (i) Payroll Costs;
  - (ii) interest payments on a mortgage that was incurred before February 15, 2020;
  - (iii) payments of rent under a lease that was in force before February 15, 2020; and
  - (iv) payments for utilities services that had begun before February 15, 2020.
- Lenders will treat the forgiven amounts as canceled indebtedness, but the borrower will not have to recognize cancellation of indebtedness income for tax purposes.

- The Potential Amount of Forgiveness will be reduced to the extent the borrower does not retain employees or reduces salaries below certain levels, as follows:

  Reduction of Potential Forgiveness Amount based on number of employees: divide (x) the average number of full-time equivalent ("FTE") employees per month during the Covered Period by (y) either (at borrower's election) (1) the average number of FTE employees for the comparable period of 2019 or (2) the average number of FTE employees per month during January and February 2020. Multiply the resulting quotient (expressed as a percentage) by the Potential Forgiveness Amount. For example, if you retain 80% of the FTE Employees, 80% of the Potential Forgiveness Amount will be forgiven.

  Reduction of Potential Forgiveness Amount based on Salary Reduction: Reduce the Potential Forgiveness Amount by the amount of any reduction in total salary or wages of any employee, other than employees paid at an annual rate greater than $100,000 in 2019, during the Covered Period that is in excess of 25% of the total salary or wages of the employee during the most recent full quarter during which the employee was employed before the Covered Period.

  There are certain other favorable adjustments in the Act designed to encourage the rehiring of employees who may have been let go due to the virus crisis.

Tax Relief Highlights

Businesses, including those that receive PPLs, benefit from several tax relief measures under the CARES Act. Key provisions include:

Increased Interest Deductions

- The limit on the deduction for interest expense has been increased to 50% of a business's EBITDA, for 2019 and 2020.
  - Under prior law, the limit was 30% of EBITDA.
  - A business can elect to measure the limit for 2020 as 50% of its 2019 EBITDA (rather than 2020 EBITDA).
  - These rules apply to all business interest expense, including interest on PPLs.

Increased Use of NOLs

- In 2018, 2019 and 2020, a taxpayer can use net operating losses (NOLs) to offset 100% of its income.
  - Under prior law, NOLs could offset only 80% of income.
- A taxpayer can carry back NOLs incurred in 2018, 2019 and 2020 to the preceding 5 years.
  - Carrybacks were not permitted under prior law.

  - As a result of the CARES Act, taxpayers now can claim refunds by carrying back NOLs.
  - However, under the new law, a REIT is not allowed to carry back an NOL to a prior year in which it was taxed as a REIT.

Payroll Taxes

- Employers are entitled to a refundable payroll tax credit, for 50% of wages paid to their employees through the end of 2020, up to $10,000 of qualified wages per employee.
  - The employer is entitled to the credit if its operations have been suspended or shut down due to COVID-19, or its gross receipts for a calendar quarter have declined by more than 50% when compared to the same quarter in the prior year.
- Employers' payment of FICA taxes for periods from March 13 through the end of 2020 is deferred, with 50% due December 31, 2021 and the rest due December 31, 2022.

Other Business Tax Relief

- Qualified improvement property (e.g., restaurant equipment, and other interior improvements to nonresidential real property) is now eligible for immediate expensing.
- Refundability of corporate alternative minimum tax credits (resulting from the repeal of the corporate AMT in 2017) has been accelerated.
- Selected aviation excise taxes (including the ticket tax and cargo tax) are suspended until January 1, 2021.

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The SBA is required to publish implementing regulations within 15 days after enactment of The CARES Act. Treasury Secretary Mnuchin has publicly stated that he wants PPL's to start being disbursed in the next week or two.

The PPP is just one part of the CARES Act. Midsize companies that do not qualify for the PPP may be eligible for the Main Street Lending Program designed for companies between 500 and 10,000 employees that has also been authorized under the Act, but has not yet been described in detail.

C L I F F O R D
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CONTACTS

Jay Bernstein
Partner

T +1 212 878 8527
E jay.bernstein
@cliffordchance.com

Andrew Epstein
Partner

T +1 212 878 8332
E andrew.epstein
@cliffordchance.com

Jake Farquharson
Partner

T +1 212 878 3302
E jacob.farquharson
@cliffordchance.com

Larry Medvinsky
Partner

T +1 212 878 8149
E larry.medvinsky
@cliffordchance.com

Jason Myers
Partner

T +1 212 878 8324
E jason.myers
@cliffordchance.com

Kathleen Werner
Partner

T +1 212 878 8526
E kathleen.werner
@cliffordchance.com

www.cliffordchance.com

Clifford Chance, 31 West 52nd Street, New York, NY 10019-6131, USA

Clifford Chance US LLP