

Landlords Should Not Waive Small Businesses' Rent

By **Deborah Riegel** and **Alexander Lycoyannis** (April 16, 2020, 5:28 PM EDT)

The effect of the COVID-19 pandemic on the American economy has been profound.

As social distancing and bending the curve have become urgent imperatives, approximately 95% of Americans are under stay-at-home orders issued by state governors. These measures have caused far-reaching economic disruption, a widespread and dramatic decrease in business activity, and a dramatic swelling of unemployment rolls around the country.

In response to the pandemic and its potentially severe economic impact, Congress enacted the Coronavirus Aid, Relief, and Economic Security Act, which President Donald Trump signed on March 27. The CARES Act includes a broad small business lending program known as the Paycheck Protection Program.

The PPP is designed to provide interim relief to small businesses to enable them to continue to pay their employees during the pandemic and, among other purposes, to pay their rent, so that their businesses remain viable when the crisis concludes. As discussed below, PPP loans are eligible for forgiveness to the extent they are used for certain designated purposes.

However, the forgiveness of the portion of a PPP loan that may be utilized for the payment of rent could unintentionally be jeopardized if owners waive rent or do not properly structure a deferral of rent, either of which could prevent commercial tenants from realizing the full benefit of the CARES Act.

For the period from Feb. 15 to June 30, the CARES Act authorizes the Small Business Administration to provide 100% federally backed loans to help eligible businesses pay operational costs. The most attractive feature of PPP loans is that, subject to certain conditions discussed below, they are forgivable.

Under the CARES Act, PPP loans are available to businesses, nonprofits and veterans' organizations (among others) that had 500 or fewer employees prior to the covered period. Businesses in the hospitality and dining industries with multiple locations but fewer than 500 employees at each location are also eligible for PPP loans, as are small businesses in industries for which the SBA has set a higher employee threshold. All employees, whether full-time or part-time, count toward the 500-employee limit.



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For most small businesses, the maximum amount for a PPP loan will be the lesser of (1) \$10 million, or (2) 2.5 times the average total monthly payroll costs incurred in the one-year period before the loan is made. The proceeds of a PPP loan may be used for (1) payroll costs, as defined in the statute (including, among other things, salaries, wages, commissions, and similar compensation of up to \$100,000 per employee, as well as certain employee benefits and state and local payroll taxes); (2) rent and utility payments; (3) certain group health care benefits; and (4) interest payments on mortgage and other debt obligations incurred before the covered period.

The key feature of the PPP is its loan forgiveness mechanism.

Indebtedness under a PPP loan will be forgiven and excluded from the borrower's gross income to the extent the following costs are incurred and payments are made during the eight-week period commencing upon loan origination: (1) payroll costs, as defined in the statute; (2) payments on mortgage interest obligations incurred prior to the covered period; (3) any payment on any covered rent obligation, i.e., rent obligated under a leasing agreement in force before Feb. 15; and (4) utilities due under service agreements entered into prior to the covered period.

Although not contained in the statute, the SBA's interim final rule announcing implementation of certain sections of the CARES Act provides that 75% of both the loan amount and the forgiveness amount must be expended on payroll costs. It should also be noted that while no restrictions exist on applying loan proceeds to rent obligations, rent due under a lease signed after Feb. 15 cannot be forgiven.

Pursuant to a formula set out in the law, the forgiveness amount may be reduced for headcount or wage reductions imposed by the borrower. However, to the extent that employees are rehired or wages are restored prior to June 30, any reduction in the forgiveness amount will be eliminated.

To the extent that loan proceeds are not applied toward permissible costs as detailed above, the loan must be repaid. The SBA rule provides that the interest rate on PPP loans is 1%; loans will have two-year terms; and loan payments will be deferred for six months in order to permit borrowers to apply for debt forgiveness before payment comes due. No collateral or personal guaranty is required, and prepayment is allowed without penalty.

Qualifying small businesses can apply for PPP loans at any lending institution approved to participate in the SBA's 7(a) lending program and any other lender approved by the U.S. Department of the Treasury.

Notably, Congress has allocated \$349 billion for the PPP program and loans are processed and funded on a first-come, first-served basis. Therefore, while the application deadline is June 30, and we believe that Congress and the president will make more funding available if necessary, PPP loan applications should be submitted as soon as possible.

With April 1 having just passed, commercial landlords throughout the country are facing the reality of small business tenants that are unable to pay rent and are struggling to survive as going businesses. Given the flurry of applications thus far, it is clear that PPP loans are viewed as extremely attractive to small businesses and could provide the relief intended by the CARES Act.

However, a potential pitfall lurks that may ensnare both owners and tenants. Some owners are considering or may already have entered into forbearance agreements. Some owners have publicly announced that they will waive commercial rents in some instances or otherwise refrain from seeking

rent during the current economic downturn. Albeit completely well-meaning, any such arrangements could actually undermine tenants' ability to obtain loan forgiveness to the full extent permitted by the CARES Act.

As referenced above, loan proceeds applied toward a covered rent obligation, i.e., rent obligated under a leasing agreement in force before Feb. 15, during the forgiveness period may be forgiven under the PPP. However, as part of the loan forgiveness process, a representative of the borrower must certify that the borrower applied the proceeds as required for forgiveness under the CARES Act.

Thus, any tenant seeking forgiveness of its covered rent obligation must certify that it actually paid that rent. Thus, if an owner agreed to waive rent during the forgiveness period or to defer it until some later date, the tenant was arguably not obligated to pay the rent during the forgiveness period, and could be at risk of falsely certifying its forgiveness application.

Accordingly, if a commercial tenant is planning to apply for a PPP loan, the owner should not agree in writing with the tenant that rent will be waived or deferred during the forgiveness period. The owner, rather, should (1) reaffirm that rent remains due, but (2) encourage the tenant to promptly apply for a PPP loan so that the proceeds can be applied to rent obligations due during the forgiveness period, as intended by the CARES Act. Whether a particular tenant requires additional assistance after the forgiveness period can, and should, be addressed at that time.

The PPP loan process offers commercial tenants a critical lifeline that will help them to weather the COVID-19-induced economic storm and keep their businesses intact until normal business resumes. The extraordinary relief provided by the PPP loan program may well avoid painful furloughs of employees, and prevent, to a lesser extent, rent defaults. However, tenants and owners must be careful not to inadvertently negate the relief afforded by the CARES Act, even in their legitimate efforts to maintain relationships with their tenants and to minimize vacancies.

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