A question has been raised regarding whether a timeshare Homeowners Association (“HOA”) is eligible to borrow funds under the Paycheck Protection Program (“PPP”). The Coronavirus Aid, Relief, and Economic Security (“CARES”) Act created the Paycheck Protection Program to enable certain business concerns to borrow money from commercial banks under loans guaranteed by the Small Business Administration (“SBA”) containing specific terms and conditions and meeting certain eligibility requirements. If used and documented as SBA prescribes, all or a significant portion of these loans can be forgiven, transforming them into grants.

Prior to the passage of the CARES Act, it was required pursuant to 13 C.F.R. §§ 120.100(a) and (b) that all small business loan applicants “must be an operating business (except for loans to Eligible Passive Companies)” and “be organized for profit.” Therefore, nonprofit companies were not traditionally eligible for SBA Section 7(a) loans. Timeshare HOAs are typically non-profit companies organized under state not-for-profit laws and so were previously not eligible for an SBA Section 7(a) loan.

The PPP is an additional type of loan available under the existing SBA Section 7(a) loan program, and it expands the types of business concerns eligible to borrow under the Section 7(a) loan program. As a result, the laws, rules and regulations underlying the Section 7(a) loan program apply to the PPP even if they are not specified in the CARES Act or its implementing regulations.

In addition to those previously eligible under the Section 7(a) loan program, the CARES Act provides that any business concern, nonprofit organization (under Section 501(c)(3) of the Internal Revenue Code), veterans organization or Tribal business concern (defined in the Small Business Act) is eligible if the organization employs no more than (i) 500 employees or (ii) a greater number as established for certain industry classifications in SBA size standard regulations.

It is clear that the CARES Act expands eligibility for Section 7(a) loans to “nonprofit organizations,” which are specifically defined by the CARES Act as entities that qualify under Section 501(c)(3) of the Internal Revenue Code. Most timeshare HOAs, while established as not-for-profit corporations, generally do not qualify under Section 501(c)(3) of the Internal Revenue Code as nonprofit organizations. It is our understanding that most banks have concluded that because the definition of “nonprofit organizations” under the CARES Act is limited to Section 501(c)(3) entities, the intent was to exclude all other not-for-profit entities. Assuming a timeshare HOA can get past this issue, however, the question still remains as to whether a timeshare HOA can qualify as a “business concern” in order to be eligible for PPP loan under the CARES Act.

The CARES Act recognizes that certain industries have been decimated by the COVID-19 pandemic, and it provides enhanced eligibility for them. Any business concern that employs not more than 500 employees per physical location and is assigned a North America Industry Classification System (“NAICS”) code beginning with 72 (accommodation and food services sector) at the time of disbursement is eligible.

The number of employees a business has factors into whether a business is eligible under the Section 7(a) loan program, and the rules count not just the business’ employees but also those of its affiliates. Affiliates
can include indirect owners if they can control the business. Counting other business’ employees can disqualify a business even if the business itself has a small number of employees.

The CARES Act provides a special exemption from these affiliation rules for any business concern with 500 or fewer employees (total—not at any one physical location) with a 72 NAICS code. A business with a 72 NAICS code with 500 or fewer employees itself need not count the employees of its affiliates when determining eligibility under the PPP.

We have found that these two special CARES Act provisions can benefit businesses in the timeshare industry as some have 72 NAICS codes.

Although the CARES Act expands the types of business concerns which would otherwise not be eligible to borrow under the Section 7(a) loan program, the CARES Act does not expand eligibility to any and all businesses.

To determine whether a timeshare HOA (not otherwise disqualified because of its status as a non-Section 501(c)(3) not-for-profit entity) is eligible, however, one must look not only at these special CARES Act provisions but also the general underlying Section 7(a) loan program rules. 13 CFR §120.110 and Chapter 2 Part II(D) of the Section 7(a) loan program Standard Operating Procedure Manual (“SOP”) provide that “passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds (except Eligible Passive Companies)” are ineligible to borrow Section 7(a) loan program funds.

The rules do not define with specificity what a passive business is. However, the SOP gives some examples of passive businesses which are ineligible for Section 7(a) loans, including (i) a business “primarily engaged in subdividing real property into lots and developing it for resale,” (ii) “businesses that are primarily engaged in owning and purchasing real estate and leasing it for any purpose,” and (iii) “businesses that have entered into a management agreement with a third party that gives the management company sole discretion to manage the operations of the business, including control over the employees, the finances and the bank accounts of the business, with no involvement by the owner(s) of the Applicant’s business.”

The SOP also states that:

“Apartment buildings and mobile home parks are not eligible. But, hotels, motels, recreational vehicle parks, marinas, campgrounds, or similar types of businesses are eligible if more than 50% of the business’s revenue for the prior year is derived from transients who stay for 30 days or less at a time.”

The ineligible business rule for developers and landlords is arguably intended to address loans that are used to acquire or improve assets, and would arguably be inapplicable to a loan under the PPP which is intended to assist business owners in meeting payroll for employees and maintaining operations. ARDA has made the argument in a joint trade association letter to the Secretary of the Treasury and to the Administrator of the SBA, that the ineligible business rule is preempted by the CARES Act for any business with 500 employees or less. However, the SBA will still need to issue guidance to eliminate the confusion and confirm that designated passive businesses are eligible for funding under the PPP.

Unless and until further guidance is forthcoming from the SBA, ARDA believes that the existing SOP rules regarding passive businesses must continue to be followed. The existing SBA guidance does not mention HOAs explicitly. Generally, a timeshare HOA is a not for profit company under applicable state law that primarily manages a specific timeshare resort and may own and sell timeshare inventory and rent such timeshare inventory on behalf of itself and its members. Timeshare HOAs do not generally engage in an active trade or business as their primary business. Although some cases may differ depending on the
specific facts and circumstances applicable to a particular timeshare HOA, on balance, it would appear that timeshare HOAs are passive concerns akin to other passive concerns like real estate lessors, those who acquire and subdivide unimproved land or have management agreements with third parties that manage the operations of the business. It is likely the SBA would conclude that a timeshare HOA is ineligible to borrow as a “business concern” under the PPP because the timeshare HOA is (i) a not-for-profit entity that does not qualify under Section 501(c)(3) of the Internal Revenue Code, or (ii) a passive business as contemplated by the SOP.

Although we are aware of one timeshare HOA which has applied for and received funding under the PPP, ARDA cautions that specific facts and circumstances applicable to it might demonstrate that it qualifies as a “business concern” under the CARES Act by engaging in activities outside the passive realm including having its own employees and control over its finances and bank accounts among other things. Each borrower must certify that it is eligible and lenders have been excused by the SBA from performing their traditional level of due diligence and authorized to rely on such certifications. HOAs should consult with legal counsel to determine whether they are eligible to apply for a PPP loan.