Bankruptcy Newsletter

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Bankruptcies Are on the Rise in the Wake of the COVID-19 Pandemic: An Industry-By-Industry Assessment

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The COVID-19 pandemic's impact on the U.S. economy is unprecedented in its magnitude, severity, and swiftness. The first confirmed COVID-19 case in the U.S. was discovered only two and a half months ago on January 21, 2020, and the first confirmed case in Massachusetts was reported on February 1, 2020. Since then, all but seven states have issued "stay at home" orders causing thousands of businesses to close and putting millions of people out of jobs. In March, the U.S. lost over 700,000 jobs, and, according to the Bureau of Labor Statistics, the overall unemployment rate rose to 4.4%, up from 3.5%. April's job loss is expected to be even grimmer.

Bankruptcy filings rose 18% in March, and are expected to rise higher in April and May. This dire prediction could be tempered somewhat by last week's enactment of the Coronavirus Aid, Relief and Economic Security Act (the "Cares Act"). Funding under the Cares Act, coupled with business and consumer efforts to restructure debt, and rent may push a surge in bankruptcy filings into the third and fourth quarters. As a practical matter, even though the bankruptcy courts remain open, many are faced with reduced staffing levels, and almost all court hearings are being conducted via telephone or video conferencing.

Less publicized are the Cares Act revisions to the U.S. Bankruptcy Code ("Code") to provide more effective and less costly bankruptcy relief to small businesses and individuals. A Chapter 11 bankruptcy has not been an economically viable option for many small businesses. The new Code revisions are intended to streamline and expedite the debt restructuring process for subchapter V (a subchapter of Chapter 11) of the Code for small businesses, including a temporary increase in the debt eligibility threshold from $2.725 million to $7.5 million.

Although it is too soon to make any firm predictions about when and to what extent bankruptcy filings will increase, and for how long, and which businesses may be impacted the most, the following provides a brief bankruptcy tolerance assessment of key industries.

Airlines

COVID-19 has caused worldwide seat capacity to drop almost 80% from last year, and half of the world's airplanes are now grounded. Highly leveraged legacy airlines like American Airlines (which previously filed for Chapter 11 in 2011) are particularly vulnerable and may be edging closer to bankruptcy. Other carriers like United Airlines, which carry less debt, may successfully avoid bankruptcy but will have scaled-down fleets and operations. The $58 billion airlines bailout – providing payroll grants for workers and loans to the airlines – will most benefit those who have properly managed cash and most quickly reacted to the precipitous drop in airline traffic. The prediction is that the airlines that do survive will be in "recovery mode" for at least a year or more.

Retail

Large retail chains have been particularly hard hit, especially since all but seven states have currently issued "stay at home" orders. Some large retailers have already fallen victim to COVID-19. Art Van Furniture, a large furniture retailer, filed for bankruptcy on March 9, Modell's Sporting Goods filed on March 11, and Pier 1 Imports filed on March 17. The Pier 1 and Modell's bankruptcy filings should be of particular interest to commercial landlords and tenants. In March, Modell's bankruptcy judge stayed the case until the end of April and allowed it to forego rent and other required payments during the stay period. Pier 1 is making the same request in its bankruptcy case. The Modell ruling is significant because, generally speaking, even in bankruptcy, debtor/tenants are expected to pay rent on time. Now, retailers both in and out of bankruptcy are informing their landlords that they are cutting or withholding rent.

Also, last week, it was reported that the Neiman Marcus Group had stepped up preparations for a bankruptcy filing, and JCPenney's bankruptcy risk increased recently due to additional store closures. Rudy's Barber Shop – with 25 locations across the U.S. – shuttered all of its locations, filed for bankruptcy, and furloughed most of its 600 employees.

Finally, according to Bloomberg Business, within the last week, 50,000 retail stores have closed, leaving over 600,000 people unemployed. Experts are predicting that many of these businesses may never reopen, and Cares Act stimulus funding may, for many, be a case of too little and too late.

Real Estate

The impact COVID-19 will have on the real estate industry remains unclear. Housing prices were up 4.1% year-over-year in February and continued to rise during the first half of March – but then dropped precipitously. Requests to suspend or reduce mortgage payments increased by more than 3000% in March! COVID-19 has also reduced or eliminated the ability for people to physically tour homes since most states have issued "stay at home" orders.

Before the COVID-19 pandemic began, housing inventory was low, and values were high. However, with unemployment rising and the economy heading downward, home prices are likely to drop in the second and third quarters.

On the commercial side, expect to see more chain retailers and restaurants filing for Chapter 11 bankruptcy and seeking a stay of rent and other payments similar to Pier 1 and Modell's. However, it is not clear that every bankruptcy court will allow businesses to skip rent payments, especially since the Code affords landlords priority treatment for unpaid rent.

Health Care

Even before COVID-19 hit, U.S. hospitals had been losing profitable elective procedures while still treating patients without adequate insurance coverage. As hospitals are forced to cancel elective procedures to make room for COVID-19 patients, revenue margins will be squeezed further. One of the first victims, Quorum Health, which operates 23 hospitals in 13 states, filed for bankruptcy on April 7, 2020. HCA Health Care, Inc., one of the nation's largest hospital operators, has already closed clinics and outpatient facilities and has cut employees' hours.

Overall, hospitals are rapidly burning through huge amounts of cash. Given the stock market's downward slide, their investment portfolio values, which could ordinarily be used to fund deficits, have substantially diminished.

Insurance

According to Deloitte, the COVID-19 pandemic has put additional pressure on claims handling as a result of "stay at home" orders, especially for property and casualty claims. In addition, according to the Wall Street Journal, lawmakers in several states have proposed legislation to force insurers to pay billions of dollars for business losses tied to the "stay at home" orders. Regulators in other states are pushing insurers to expand coverage to allow employees to use their own cars to deliver takeout meals, and to lower premiums now that many workers are working remotely from home. The National Association of Mutual Insurance Companies claims that such legislative and regulatory efforts may create a "second crisis: insurance insolvencies and impairments."

Hospitality

According to the American Hotel and Lodging Association, as of March 25th, seven out of 10 hotel rooms across the U.S. were empty, and the hotel industry is on a pace to lose approximately $3.5 billion weekly. Already, five large restaurant chains have filed for bankruptcy, and others are likely to file soon. According to Fitch Ratings, Checkers & Raleigh's Steak 'N Shake, and large Pizza Hut and Wendy's franchisees are facing a much greater risk of Chapter 11 filings.

Conclusion

The weeks and months ahead will be challenging, but this is not a time for panic. Cares Act stimulus funds are available for those eligible businesses and individuals who promptly apply for funding, and a second stimulus plan is currently being considered in Washington. Lenders, landlords, and other creditors will likely be receptive to reasonable restructuring and forbearance proposals from borrowers, tenants, and customers. Small businesses will have an easier path through Chapter 11 bankruptcy as a result of the Cares Act's revisions to the Code. Businesses that survive will likely be smaller but financially more stable.

This summary is brought to you by Bernkopf Goodman LLP's Bankruptcy and Creditor's Rights Practice Group.

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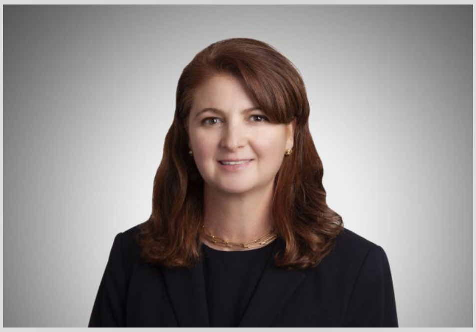

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