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BUSINESS LOAN PROGRAMS IN THE CARES ACT: WHAT BUSINESSES NEED TO KNOW

by Nancy Bostic, Wes Dorman, Amy Lott and Lynsey Hyde
March 31, 2020

The Coronavirus Aid, Relief and Economic Security (CARES) Act was signed into law by President Trump on March 27, 2020. Its commercial lending provisions are intended to provide a lifeline to the economy in the form of loans to eligible businesses (Borrowers) to fund payroll costs and other operating costs described below. Its scope greatly exceeds the stimulus in the wake of the 2008 financial crisis. This alert summarizes the following loan programs in the CARES Act: (i) the Paycheck Protection Program (PPP), which provides loans of up to $10 million per Borrower, with certain portions subject to complete forgiveness if certain conditions are satisfied, (ii) Economic Injury Disaster Loans (EIDLs), which provide low interest, long-term working capital loans of up to $2 million to Borrowers in declared disaster areas, (iii) advances for up to $10,000 on EIDLs (an Emergency Advance), payable within three days of submitting a completed loan application and (iv) the Subsidy for Certain Loan Payments, which provide for the SBA to pay interest, principal and associated fees on certain SBA loans existing at the time of the enactment of the CARES Act. Borrowers are eligible to apply for an EIDL (including an Emergency Advance) as well as a PPP loan so long as they do not use them for duplicative purposes and they meet the other requirements described below.

PAYCHECK PROTECTION PROGRAM

The CARES Act expands the ability to obtain loans under Section 7(a) of the Small Business Act (SBA) by adding a new $349 billion PPP to cover certain payroll, health care, mortgage interest, rent, utility and pre-existing debt costs. These loans do not require any guaranty of the borrower's obligations and are non-recourse to any member, partner or shareholder of the Borrower, provided that the loan proceeds are used as directed by the CARES Act. Of significance, Borrowers will not be required to attempt to obtain credit from other lenders prior to applying for these loans. Loans have a maximum interest rate not to exceed 4 percent if not forgiven. The principal is subject to partial or full forgiveness if the terms described below are satisfied.

Who is Eligible for a Loan?

From February 15, 2020 to June 30, 2020 (the Covered Period), small business concerns and other business concerns, nonprofits, and veterans organizations or tribal business concerns are generally eligible for a covered loan if the business employs (i) no more than 500 employees, including full and part time employees, or (ii) if applicable, the larger employee size standard established by the SBA for that industry. For information on potentially larger employee size standards, click here.

Individuals who operate as a sole proprietorship or as an independent contractor and eligible self-employed individuals are also eligible for these loans, as are businesses which have a North American Industry Classification System beginning with 72 (the Hospitality Entities), meaning the Accommodation and Food Services Sector, including restaurants and hotels, if they employ no more than 500 employees per physical location at the time that the loan is disbursed.

Do the Affiliation Rules Disqualify Your Business from Eligibility?

In the absence of the CARES Act, the Affiliation Rules would apply a set of criteria to determine if an entity qualified as a small business concern, including by counting employees of the entity's affiliates in determining if the entity exceeded the 500 employee limit to qualify for a loan. The CARES Act waives these affiliation rules during the Covered Period for any business concern that (i) is a Hospitality Entity, (ii) is operating as a franchise that is assigned a franchise identifier code by the SBA or (iii) receives financial assistance from a company licensed under Section 301 of the Small Business Investment Act.

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What is the Maximum Loan Amount?

For non-seasonal Borrowers in business during the Covered Period, the maximum loan amount is the lesser of:

i. $10 million, or
ii. The sum of (a) 2.5 *times* the average total monthly Payroll Costs (defined below) incurred during the 1-year period before the date on which the loan is made *plus* (b) the outstanding amount of an EIDL made under Section (7)(b)(2) of the SBA between January 31, 2020 and the date on which covered loans under Section 7(a) are made available to be refinanced under the covered loan.

"Payroll Costs" means:

i. Salary, wages, commissions or similar compensation; payment of cash tips or the equivalent; payment for vacation, parental, family, medical or sick leave; allowance for dismissal or separation; payment required for the provisions of group health care benefits, including insurance premiums; payment of any retirement benefit; and payment of state or local taxes on employee compensation; and
ii. Payments of any compensation to or income of a sole proprietor or independent contractor that is a wage, commission, income, net earnings from self-employment or similar compensation and that is in an amount not more than $100,000 in 1 year, as prorated for the Covered Period.

Notably, Payroll Costs do not include certain items, such as the compensation of an individual employee (a) in excess of an annual salary of $100,000 as prorated for the Covered Period or (b) whose principal place of residence is outside of the United States.

How Can Loan Proceeds Be Used?

PPP loan proceeds can be used for the following costs (PPP Approved Expenses):

i. Payroll Costs;
ii. Continuation of group health care benefits during periods of paid sick, medical or family leave, and insurance premiums;
iii. Employee salaries, commissions or similar compensation;
iv. Interest payments on a covered mortgage (excluding any prepayment or payment of principal);
v. Covered rent and utilities; and
vi. Interest on any other debt obligations incurred before the Covered Period.

Do I need to Prove that My Business Has Been Impacted by COVID-19?

Borrowers will need to certify as to certain matters, including (i) that it is the uncertainty of current economic conditions that makes the loan necessary to support its ongoing operations and (ii) the funds will be used to retain workers and maintain payroll or make mortgage interest payments, lease and utility payments.

Will a Personal Guaranty or Collateral Be Required?

Borrowers are not required to pledge collateral for PPP loans. The loans are 100 percent federally guaranteed. The managers, partners and shareholders of eligible recipients are not required to provide a guaranty, and the loans are nonrecourse to those equity owners so long as the loan proceeds are used in the manner described in the CARES Act.

Can the Loan be Forgiven?

The principal amount of a loan is eligible to be forgiven in an amount not to exceed the following costs incurred and payments made during the eight-week period beginning on the date of the loan origination: (i) Payroll Costs; (ii) interest payments on a covered mortgage obligation (excluding prepayment of or payment of principal); (iii) covered rent; and (iv) utility payments.

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Loan forgiveness is subject to limitations, including:

i. The amount that may be forgiven cannot exceed the loan principal.
ii. Subject to certain rehiring provisions, the amount of loan forgiveness is reduced by multiplying the amount otherwise forgivable by a fraction, the numerator of which is the number of full-time equivalent employees per month employed by the borrower during the above eight-week period and the denominator of which is the average number of full-time equivalent employees per month employed by the borrower during the period (a) beginning February 15, 2019 and ending June 30, 2019 or (b) beginning January 1, 2020 and ending February 29, 2020. Seasonal employers are required to use period (a), but all other borrowers can elect which period applies.
iii. Subject to certain rehiring provisions, the amount of loan forgiveness is reduced by the amount of any reduction in total salary or wages of an employee that exceeds 25 percent of the employee's total salary or wages during the period from February 15, 2020 to April 26, 2020. This applies to employees whose salary or wages in any pay period in 2019 were not at an annualized rate over $100,000.
iv. If an employer decreases the number of its employees or any salary or wages during the period from February 15, 2020 to April 26, 2020, this decrease will be disregarded as long as it's eliminated (i.e., increase in employees or pay) by June 30, 2020.

<u>Is the Portion that's Forgiven Taxable Income?</u>

PPP loans during the Covered Period that are forgiven are excluded from gross income.

<u>What if the Loan Is Not Forgiven?</u>

Any unforgiven loan amounts will continue to be guaranteed by the SBA and have a maximum maturity of 10 years from the date on which the borrower applies for loan forgiveness.

<u>Can You Defer Paying?</u>

Lenders are required to allow Borrowers to defer payment obligations for not less than 6 months for principal, interest and fees.

<u>Who Are the Lenders, and What Is the Application Process?</u>

Borrowers can apply to obtain PPP loans directly through SBA-approved lenders.

<u>Can Existing SBA Loans Be Refinanced?</u>

An EIDL made under Section 7(b)(2) of the SBA (described below) during the period beginning on January 31, 2020 and ending on the date when the covered loans are made available may be refinanced as part of a covered loan.

<u>Other Considerations</u>

Borrowers should review their existing credit facilities and intercreditor agreements to ensure that obtaining the loans under the PPP would not cause a breach of those agreements.

<u>Other SBA Loans</u>

A recipient of an EIDL under Section 7(b)(2) of the SBA from January 31, 2020 to the date when a covered loan can also obtain a PPP loan so long as the EIDL was for a purpose other than paying PPP Approved Expenses. To avoid duplication, EIDL borrowers can use EIDL loan proceeds to purchase inventory, pay vendors, address additional supply chain costs caused by COVID-19 and pay other operating costs not otherwise included in the definition of PPP Approved Expenses.

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ECONOMIC INJURY DISASTER LOANS AND EMERGENCY ADVANCES

Section 7(b)(2) of the Small Business Act provides working capital loans of up to $2 million to eligible borrowers who suffer substantial economic injury in declared disaster areas. EIDLs carry a maximum interest rate of 4 percent with terms of up to 30 years. Under the default rules, borrowers must be (i) a small business concern, meaning the borrower has less than $750,000 to $38.5 million in annual receipts and fewer than 100 to 1,500 employees, depending on industry, (ii) a private nonprofit organization or (iii) a small agricultural cooperative, and borrowers must not be able to obtain credit elsewhere. In addition, loans above certain thresholds require collateral and personal guaranties.

However, Section 1110 of the CARES Act amends Section (7)(b)(2) of the SBA by expanding the definition of eligible borrowers during the covered period – January 31, 2020 to December 31, 2020 (the EIDL Covered Period) – to include businesses that *are* able to obtain credit elsewhere and certain businesses that would otherwise exceed the SBA size standards.

In addition, applicants can obtain an Emergency Advance of up to $10,000 on an EIDL application that is payable within 3 days of the SBA's acceptance of a completed EIDL loan application. If the application is denied, the applicant is not required to repay the $10,000 advance.

<u>Who Is Eligible?</u>

EIDLs are already available to small business concerns, private nonprofit organizations and small agricultural cooperatives who qualify. The CARES Act expands this list to allow the following borrowers (collectively, the Eligible Businesses) to qualify to apply for an EIDL during the EIDL Covered Period:

i. A business with not more than 500 employees;
ii. Individuals who operate as a sole proprietor or independent contractor;
iii. Cooperatives with not more than 500 employees;
iv. ESOPs with not more than 500 employees; and
v. Tribal business concerns with not more than 500 employees.

All 50 states and U.S. territories have been declared disaster areas as a result of COVID-19 for purposes of Section 7(b)(2) loans. Accordingly, any Eligible Business that has suffered a substantial economic injury due to COVID-19 during the EIDL Covered Period may apply for an EIDL and may use the proceeds of such loan to, among other things, pay fixed debts, payroll, accounts payable and other bills that cannot be paid due to such disaster. As noted above, an EIDL borrower cannot also obtain a PPP loan if it plans to use the EIDL proceeds for a PPP Approved Expense.

During the EIDL Covered Period, borrowers are not required to show they cannot not obtain credit elsewhere. As a result, many well-established businesses with 500 or fewer employees can now obtain credit on more favorable terms than their existing debt facilities. Note, however, that existing loan agreements may prohibit the borrower from obtaining additional debt without the lender's approval and any new loan may constitute a default under the existing loan.

Employers who terminated employees as a result of COVID-19 are not required to rehire those workers to qualify for an EIDL.
Finally, an applicant's business must have been in operation on January 31, 2020; otherwise the borrower must have been in business for the one-year period preceding the disaster.

<u>How Much Can I Borrow?</u>

Eligible Borrowers can borrow up to $2 million, with the actual loan amount determined by the SBA based on the economic injury suffered. In addition, during the EIDL Covered Period, an Eligible Business that applies for an EIDL in response to COVID-19 may request an Emergency Advance not to exceed $10,000 that is payable to the borrower within three days after the SBA receives a completed application, regardless of whether the application is approved.

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How Can I Use the Borrowed Funds?

EIDL borrowers are not subject to the same restrictions on loan proceeds as borrowers under the PPP. EIDL borrowers can use EIDL proceeds (whether from the initial Emergency Advance or the remaining principal) for general working capital, as well as to (1) provide paid sick leave to employees unable to work due to the direct effect of COVID-19; (2) maintain payroll to retain employees during business disruptions and slowdowns; (3) pay increased costs due to interrupted supply chains; (4) pay rent and mortgage payments; and (5) repay debt obligations that cannot be met due to revenue losses. However, if a EIDL borrower also wants to obtain a PPP loan, the proceeds of the EIDL must be used for something other than a PPP Approved Expense, such as making debt payments on a piece of machinery, paying suppliers or satisfying other accounts payable.

Borrowers are not required to use the proceeds of an EIDL or an Emergency Advance to rehire previously terminated employees.

What Additional Loan Terms Apply?

EIDLs have terms of up to 30 years, depending on a borrower's ability to repay the loan. EIDLs have an annual interest rate of 3.75 percent for small businesses and 2.75 percent for nonprofits.

The CARES Act waives existing rules related to the personal guarantee on advances and loans of not more than $200,000 during the EIDL Covered Period from January 31, 2020 through December 31, 2020. The CARES Act does not expressly mention collateral requirements for EIDLs. The existing collateral requirements for EIDLs provide that collateral is generally required for loans of more than $25,000.

Are the Loans Forgivable?

Partially. Borrowers are not required to repay Emergency Advances of $10,000 even if a borrower refinances its EIDL under the PPP and/or its EIDL application is subsequently denied.

The remaining balance of an EIDL is required to be repaid over the term of the loan, which may be up to 30 years as noted above. Borrowers may also refinance an EIDL under the PPP. Once refinanced, borrowers may receive loan forgiveness for amounts spent in accordance with that program; provided, however, if the borrower received an Emergency Advance, the amount of such advance will be reduced from the forgivable amount because it was already excluded from the amount required to be repaid.

How Do I Apply?

EIDL applications consist of a two-page Business Loan Application (SBA Form 5) and a one-page form titled Economic Injury Disaster Loan Supporting Documentation (SBA Form P-019). Applicants are also required to provide a Personal Financial Statement (SBA Form 413) and a Schedule of Liabilities (SBA Form 2202). All forms and easy to read instructions for completing and filing them are available by clicking here.

General partners and owners of 20 percent or more of an applicant's outstanding equity are also required to complete an application and related schedules. Completed applications can be submitted to the SBA electronically via the website above or, alternatively, by mailing hard copies to U.S. Small Business Administration, Processing and Disbursement Center, 14925 Kingsport Rd., Ft. Worth, TX 76155-2243. The SBA estimates it takes two hours to complete the application paperwork.

During the EIDL Covered Period, the SBA may approve an applicant based solely on its credit score, and applicants are not required to provide tax returns or tax return transcripts.

Can Payment be Deferred?

The CARES Act does not provide for deferment of payment obligations under EIDLs.

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SUBSIDIES FOR LOANS MADE BEFORE THE CARES ACT WAS ADOPTED

Congress has provide that all borrowers are presumed to be adversely affected by COVID-19 and relief payments by the SBA are appropriate for all borrowers. As a result, the CARES Act provides that the SBA will pay principal, interest and fees on covered loans as follows:

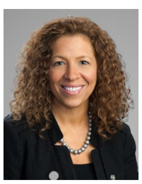
<u>Loans in Regular Servicing Status</u>

For loans that are guaranteed by the SBA under Section 7(a) of the SBA (excluding PPP loans) and certain other loans, the SBA will pay principal, interest and associated fees that are owed on such a loan as follows:

i. If the loan is in regular servicing status and was made before the date that the CARES Act was enacted and is not on deferment, the six-month period beginning with the next payment due on the covered loan;
ii. If the loan was made before the date that the CARES Act was adopted and is on deferment, the six-month period beginning with the next payment due on the covered loan after the deferment period; and
iii. If the loan was made during the period beginning on the date that the CARES Act was enacted and ending on the date six months thereafter, the six-month period beginning with the first payment due on the covered loan.

Any payment made by the SBA under this provision relieves the borrower of the obligation to pay that amount.

ABOUT THE AUTHORS



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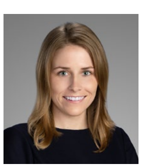

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Lynsey focuses her legal practice on corporate governance and transactional matters. During law school, Lynsey received seven CALI Academic Awards for earning the highest grade in her class, including Contracts II, Federal Income Taxation, Payment Systems (Commercial Paper) and Professional Responsibility. She was also a member of the Phi Delta Phi International Fraternity and Order of the Lytae.