BANKING & CREDIT ALERT

Small Business Loan Relief Provided Under the CARES Act

April 2020

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act), which was signed into law and became effective on March 27, 2020, provides new and enhanced financial tools to help small business owners and employees through this unprecedented period of economic contraction caused by the COVID-19 pandemic.

This newly enacted federal statute provides two forms of relief for eligible small businesses:

1. The Paycheck Protection Program; and
2. The Economic Injury Disaster Loan Emergency Advance Program.

The United States Small Business Administration (SBA) is working through local lenders to get these monies distributed to small businesses and into the economy. While the application window is now open (until June 30, 2020), there is concern that some lenders cannot process loan applications and others are only accepting applications from current customers. Given that funds could run out sooner than expected, businesses are advised to act quickly. Your professional advisers can work with you on the complicated requirements to understand whether your business is an “eligible small business” and assist you with the application process.

BRIEF OVERVIEW

The Paycheck Protection Program (PPP) is a $349 billion, 100% federally guaranteed loan program for eligible small businesses. The CARES Act established the PPP as a new 7(a) loan option to be overseen by the Treasury Department and backed by the SBA, which is authorized to provide a 100% guarantee to lenders on loans issued under the program. The

CARES Act provides for loans up to $10 million per borrower to cover payroll and other costs. The PPP also allows for loan forgiveness if certain conditions are met.

The Economic Injury Disaster Loan Program (EIDL) & Grants provides the SBA with $10 billion of additional funding to help mitigate disastrous economic injury. Small businesses can receive a $10,000 cash advance within three days of applying for up to $2 million of an EIDL.

Businesses may borrow through both programs, but there are restrictions, as discussed below.

PAYCHECK PROTECTION PROGRAM

PPP loans may be used to cover the costs of:

- payroll costs, including benefits;
- interest on mortgage obligations (excluding principal), incurred before February 15, 2020;
- rent, under lease agreements in force before February 15, 2020; and
- utilities, for which service began before February 15, 2020.

At least 75% of the money must be used on payroll.

Per the U.S. Treasury Department, "payroll costs" include:

- salary, wages, commissions, or tips (capped at $100,000 on an annualized basis for each employee);
- employee benefits including costs for vacation, parental, family, medical or sick leave; allowance for separation or dismissal; payments required for the provisions of group health care benefits including insurance premiums; and payment of any retirement benefit;
- state and local taxes assessed on compensation; and
- for a sole proprietor or independent contractor, wages, commission, income, or net earnings from self-employment, capped at $100,000 on an annualized basis for each employee.

The CARES Act expressly excludes qualified sick and family leave wages for which a credit is allowed under sections 7001 and 7003 of the Families First Coronavirus Response Act (FFCRA) (Public Law 116-127).

On April 2, 2020, the SBA issued interim final rules for PPP loans that are effective immediately, notwithstanding a 30-day public comment period. These rules provide greater clarity for lenders as they process loan applications for PPP loans. That's good news for eligible borrowers.

Who Qualifies?

A small business with fewer than 500 employees that was in business on or before February 15, 2020 will qualify. A business can be formed as an S Corp, C Corp, LLC, sole proprietorship or independent contractor. It also includes certain nonprofits, tribal groups and veteran groups. When obtaining the PPP loan, you need to certify that your business has been economically affected or that economic uncertainty makes the loan necessary.

How Much Can a Small Business Borrow?

A business can obtain a loan of up to $10 million, based on its payroll costs. The loan amount is determined by calculating 2.5 times the average monthly payroll costs (based on the prior 12 months).

PPP loans are unsecured loans requiring no collateral, no personal guarantee and no showing that credit is unavailable elsewhere. A PPP loan, to the extent not forgiven, has a maximum two-year term and a 1% annual interest rate. PPP loans will be made available through SBA-approved lenders, who must offer a 6-12 month deferment on payment of principal, interest and fees.

Are PPP Loans Forgiven?

A borrower of a PPP loan is eligible for loan forgiveness for amounts spent during the eight-week period after the origination date, subject to proper documentation, on:

- rent;
- defined payroll costs;
- mortgage interest; and
- utilities, not to exceed the loan principal.

The PPP loan forgiveness amount may be reduced if the borrower reduces the number of employees or salaries and wages (for employees with annual salaries less than $100,000) during the eight-week period following the loan origination loan. However, this reduction penalty doesn't apply to the extent the borrower restores their workforce count and salaries/wages by June 30, 2020.

Debt forgiveness is typically taxed as income (as listed on a 1009-C), however the new law specifically states that forgiven PPP loans will not be considered forgiveness of debt income.

More information about the PPP, including the borrower application and guidance, can be found here on the SBA website.

ECONOMIC INJURY DISASTER LOAN EMERGENCY ADVANCE PROGRAM

Another option for small businesses is the SBA's existing EIDL program, which was expanded by the CARES Act and provides for longer-term loans with favorable borrowing terms. Companies in all 50 states, the District of Columbia and some U.S. territories are eligible for EIDL loans relating to economic injury caused by the COVID-19 pandemic. While there are no loan forgiveness provisions applicable to EIDL loans, companies that have applied for or received EIDLs due to economic injury attributable to the COVID-19 pandemic can seek to refinance their EIDL loans under the PPP to take advantage of the PPP's loan forgiveness provisions. Additionally, while companies may be eligible for loans under both programs, they cannot seek recovery under the EIDL loan for the same costs covered by a PPP loan.

Who Qualifies?

The CARES Act expanded EIDL eligibility for the period between January 31, 2020 and December 31, 2020, to include:

- any business with not more than 500 employees;
- any individual operating under a sole proprietorship or as an independent contractor; and
- any cooperative, ESOP or tribal small business concern with not more than 500 employees.

Subject to guidance from the SBA, these applicants would also appear to still be subject to the SBA's affiliation rules governing financial assistance programs. Entities previously eligible to receive SBA EIDLs, including small business concerns, private nonprofit organizations and small agricultural cooperatives, remain eligible for such loans under the more favorable terms authorized by the CARES Act.

To qualify for an EIDL, the applicant must have suffered "substantial economic injury" from COVID-19. EIDL loans are based on a company's actual economic injury determined by the SBA (less any recoveries such as insurance proceeds) up to $2 million.

Loan Purpose and Terms

EIDL loans may be used to cover payroll, increased costs due to supply chain interruption, obligations that cannot be met due to revenue loss and other business-related costs.

The interest rate on EIDL loans is 3.75% fixed for small businesses and 2.75% for nonprofits. The EIDL loans have up to a 30-year term and amortization (determined on a case-by-case basis).

The CARES Act also permits applicants to request an advance (expected to be paid by the SBA within three days) of up to $10,000 to pay allowable working capital needs. This advance is essentially a grant and need not be repaid, even if the application is denied. However, the advance amount must be deducted from any loan forgiveness amounts under a PPP loan, described above.

EIDLs up to $200,000 do not require personal guarantees. EIDLs over that amount require personal guaranties by owners of more than 20% of the borrower. Owners of less than 20% are not required to give a personal guaranty. The borrower requirement demonstrating an inability to obtain credit elsewhere is waived. However, unless changed by the SBA, it appears that the collateral requirement on EIDL loans over $25,000 would still apply, and, in processing a borrower's application, the SBA must determine that the applicant can repay the loan. Further, the SBA can approve a loan based solely on the applicant's credit score or other means of determining the applicant's ability to repay the loan, without requiring the submission of tax returns, which should expedite approval of EIDLs during the covered period.

Given the very favorable terms of these two SBA loan programs and the potential for loan forgiveness under PPP loans, eligible small businesses economically affected by the COVID-19 pandemic should strongly consider taking advantage of these loan programs.

CONTACT

If you have questions concerning loan relief that may be available to your small business, please contact a member of our Banking & Credit Practice.