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CORPORATE ADVISORY

CARES Act: Key Provisions Regarding SBA Disaster Relief

On March 27, 2020, President Trump signed an economic stimulus act titled the "Coronavirus Aid, Relief, and Economic Security Act" also known as the "CARES Act." This update addresses the options now available to small businesses seeking disaster relief due to the COVID-19 pandemic through Small Business Administration (SBA) programs.

KEY TAKEAWAYS

The CARES Act allocates approximately $377 billion to enable the SBA to provide disaster relief to:

- Existing SBA borrowers through six months of loan forgiveness
- New SBA borrowers through the Economic Injury Disaster Loan (EIDL) Program and the Paycheck Protection Program (PPP)

Read our quick reference guide HERE to learn more about the differences between the new PPP and the modified EIDL program that eligible borrowers should consider when determining which disaster relief program options are right for them.

WHAT'S NEXT

As with any new legislation, there are several key details to be filled in by additional Treasury and SBA regulations. Be sure to check our COVID-19 Resource Hub to stay up-to-date on new regulations and supplemental guidance regarding the CARES Act.

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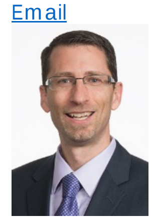

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SUMMARY

Disaster Relief for Existing SBA Borrowers. The CARES Act includes $17 billion to provide six months of immediate debt relief to small businesses with existing SBA loans, including the 7(a), 504, Community Advantage, and Microloan programs. Under the CARES Act, the SBA will forgive all loan payments (principal, interest, and fees) for existing SBA borrowers for six months. Current SBA borrowers should reach out to their SBA lenders to coordinate loan relief now.

Disaster Relief for New SBA Borrowers. The CARES Act allocates $349 billion for a new Paycheck Protection Program (PPP) to expand the SBA's existing 7(a) loan program. Under the PPP, small businesses and other eligible entities can receive up to $10 million in deferred, low-interest loans, with up to eight weeks of loan payment forgiveness if the business retains its employees and maintains salary levels equal to 75% or more of pre-February 15, 2020 levels.

The CARES Act also separately allocates $10.5 billion to supplement the SBA's Economic Injury Disaster Loan Program (EIDL) by: (i) creating a new Emergency Economic Injury Grant program that provides an EIDL loan applicant with an up-to-$10,000 grant that the applicant does not have to pay back unless borrowers receive forgiveness under the PPP, in which case the $10,000 will be credited to the amount forgiven, and (ii) expanding and relaxing restrictions for the existing EIDL program, which provides up to $2 million in deferred, low-interest loans to small businesses that have suffered economic injury. Borrowers may apply for both the EIDL loans and grants and for the PPP loans if the funds are used for different purposes, and businesses may refinance existing EIDL loans into PPP loans only if the EIDL loans were made before April 3, 2020.

Additionally, the CARES Act authorizes the SBA to provide six months of debt forgiveness to small businesses that apply for traditional SBA loans by September 27, 2020. So businesses that were already planning to borrow under traditional SBA programs (with their borrower restrictions, requirement to show need, and traditional collateral requirements) may still want to do so. Applying for a traditional SBA loan, however, will prohibit borrowers from applying for PPP funds, and for most borrowers the PPP is the better option. The chart HERE highlights the primary differences between the new PPP and the modified EIDL program that eligible borrowers should consider when determining which disaster relief program options are right for them.

Paycheck Protection Program Summary. The CARES Act provides nearly $350 billion in funding to create the Paycheck Protection Program (PPP). Though the PPP uses the framework of the SBA's existing 7(a) lending program, the PPP substantially reduces the fees and relaxes the eligibility requirements for borrowers. The primary purpose of the PPP is to prevent workers from losing their jobs, and the PPP accordingly provides a formula under which the loan amount available to a borrower is tied to certain payroll costs previously incurred by that borrower. The PPP represents a substantial expansion of the SBA's lending authority and will be a high-demand product, especially given the lack of collateral or personal guarantees required. Small businesses must apply for PPP loans through a SBA-approved bank or financial institution by June 30, 2020.

Eligible Borrowers. All small businesses, 501(c)(3) nonprofit entities, veterans groups, and tribal groups with fewer than 500 employees and other SBA qualified small businesses (using the SBA's size and industry requirements in its "Table of Size Standards") that incurred payroll costs on or before February 15, 2020, are eligible. For purposes of determining whether a borrower has fewer than 500 employees, the SBA will include a borrower's affiliates, including subsidiaries and commonly controlled companies. In addition to businesses with less than 500 employees, PPP loans will be available to accommodations and food service businesses with more than one location provided that such businesses employ less than 500 employees per physical location. Affiliation rules also are waived for certain franchisees and businesses that receive financing from SBICs. Unlike with traditional 7(a) loans, a PPP borrower does not need to prove that it is unable to obtain credit elsewhere.

Maximum Loan Amount. The PPP loans will equal 2.5 months of the borrowers' average monthly payroll costs, up to a maximum amount of $10 million. Average payroll costs include salary, wages, and commission, paid leave, benefits, and state and local taxes, plus any payments to employees not in excess of $100,000 annually. The SBA has issued guidance that average payroll costs should be calculated using the 4/1/19 to 3/31/20 timeframe. Businesses that were not in operation in 2019 should calculate average payroll costs over 1/1/20-2/29/20.

Term, Interest, and Payments. While the CARES Act authorized loans of up to 10 years, the SBA has issued preliminary regulations that set the term at two years. Similarly, while the CARES Act capped interest at 4%, preliminary SBA regulations set the interest rate at 1%. Payments of principal and interest can be deferred for six months (though interest will accrue through deferment). There are no prepayment penalties.

Collateral/Guaranty. The SBA and affiliated lenders will not require a small business to provide any collateral for the PPP loan, and small-business owners are not required to provide personal guarantees.

Loan Forgiveness. One of the biggest advantages of the PPP is that the SBA will forgive all payments of PPP loan proceeds up to an amount equal to eight weeks of such business's expenses on eligible payroll, mortgage interest, rent, and utility payments, and such forgiven indebtedness need not be included on a small business's taxable income. Eligible payroll costs include: salary, wage, commission, or other compensation, payments of cash tips, payments for vacation, parental family, medical, or sick leave, allowance for dismissal, healthcare benefits (including premiums), retirement benefits, and payroll taxes, but exclude compensation to any individual employee in excess of $100,000/year and compensation to employees with primary residence outside of the United States. The SBA's preliminary regulations state that at least 75% of loan forgiveness costs should be used for payroll costs.

To encourage businesses to retain workers, however, the SBA will reduce the amount of loan forgiveness proportionately if a borrower eliminates employees or reduces payroll by greater than a certain percentage (in most cases 25%), compared to the number of employees and payroll in 2019 or early 2020. Businesses that have already terminated employees or downsized, may avoid the reduction in loan forgiveness by subsequently rehiring employees and eliminating the payroll deductions by June 30, 2020, to pre-February 15, 2020, levels.

Uses. The CARES Act authorized PPP funds to be used for the forgivable uses described above AND interest on other debt incurred before February 15, 2020. The current PPP application, however, requires a borrower to certify that it will only use the funds for the forgivable uses.

Application Process. Preliminary SBA regulations state that SBA-approved lenders should distribute PPP loans on a first-come, first-served basis. We encourage all eligible borrowers to apply as soon as possible. SBA-approved banks and financial institutions will manage the applications for, and approval of, PPP loans. Normal 7(a) SBA loan fees have been waived, and unlike traditional 7(a) loans, a borrower does not have to show any economic necessity or absence of other available credit to obtain funding. To apply, businesses will need to provide their lender with, among other things, a good-faith written certification that: (i) the uncertainty of the current economic conditions makes the loan request necessary, (ii) PPP funds will be only used to retain workers and to make existing mortgage, rent, and utility payments, and (iii) the borrower does not have an existing 7(a) SBA loan for the same purpose.

How to Apply. To apply for the PPP program, reach out to an SBA-approved lender for details on their application process. The SBA's new regulation and new PPP application were released on April 2, 2020, and we're hearing that several lenders will start accepting applications on April 3, 2020, with many accepting applications beginning the week of April 6, 2020.

Economic Injury Disaster Loan Program Summary. The CARES Act provides additional funding to allow the SBA to provide businesses up to $2 million in EIDL loans to be used to pay for disaster expenses, including payroll and other operating expenses, and expands on who may apply for EIDL funds. The CARES Act has provisions that make it easier for small businesses to obtain EIDLs, but because many EIDLs require borrowers to pledge available collateral and require business owners to provide personal guarantees, small business owners should carefully evaluate whether EIDL loans are right for them before applying.

Eligible Borrowers. Only qualified small businesses (using the SBA's size and industry requirements in its "Table of Size Standards"), small agricultural cooperatives, sole proprietors, independent contractors, most private nonprofit operations, tribal businesses, and ESOPs with fewer than 500 employees that have demonstrated economic injury from the COVID-19 pandemic may apply for EIDL funds. The CARES Act waives the requirements that (i) borrowers be in business for at least a year, so long as the borrowers were in business before January 31, 2020, and (ii) borrowers prove that they are unable to obtain credit elsewhere.

Maximum Loan Amount. EIDL loans provide up to $2 million for working capital funding for businesses. The SBA will determine the exact amount a business can borrow based on cash-flow projections and demonstrated need.

Term, Interest, and Payments. Up to 30 years, with interest rates currently set at 3.75% for businesses and 2.75% for nonprofits. SBA officials have indicated automatic deferral of all principal and interest payments for EIDLs for all of 2020, and deferment is available for up to one year for most borrowers (though interest will accrue during deferment). There are no prepayment penalties.

Collateral/Guaranty. Loans greater than $25,000 will require the pledge of available collateral, and loans greater than $200,000 will require personal guarantees, from owners of greater than 20% of the business, and potentially pledges of personal assets from business owners if the business's collateral is not sufficient to provide adequate coverage. That said, given the incredible demand for this program and the limited ability of the SBA to review collateral documents, the SBA is waiving or delaying the collateral requirements for many borrowers, especially those that have no unencumbered collateral to pledge.

EIDL Grants. One of the biggest changes to the EIDL program made by the CARES Act, is that Congress allocated $10 billion for SBA to use to provide prompt advance payments or "grants" of up to $10,000 to small businesses that demonstrate sufficient need in their EIDL applications. Such grants do not need to be repaid, even if the grantee is subsequently denied an EIDL. Preliminary SBA regulations, however, state that if an EIDL grant recipient receives a PPP loan, the $10,000 grant will be credited against the maximum amount forgivable under the PPP loan. The grants are projected to be paid to borrowers within three business days of submitting their applications and will act as a type of bridge loan while borrowers wait for their EIDL applications to be processed. These grants may be used to provide paid sick leave to employees, to maintain payroll, to meet increased production costs due to supply chain disruptions, or to pay certain business obligations including rent, mortgage payments, and certain other debts. The CARES Act gives the SBA the authority to provide such grants until December 31, 2020.

Uses. EIDL proceeds may be used for any expenses incurred in connection with the ordinary course of business, but may *not* be used to pay down or refinance long-term debt or make distributions to owners. The SBA requires owners to track uses of EIDL proceeds for three years.

Application Process. The EIDL is a direct lending program where borrowers apply for funds directly through the SBA. The SBA has been inundated with applications to date, so small business owners should provide as much financial information as possible in their applications to enable the SBA to make its determination. We also recommend including a cover letter with your application detailing the applicant's projected economic loss and the amount of the loan requested, as the form application does not include this information. The application process typically takes three weeks, plus an additional five days for funding, but will likely take longer given current demand.

How to Apply. To apply for the EIDL program, click HERE to access SBA resources and apply online, or apply by phone at 1.800.659.2955 through the SBA Customer Service Center.

QUESTIONS

Please reach out to any member of our team with questions about any of the options or the application processes now available to small businesses dealing with COVID-19 disaster relief.