

Business Owners' Guide to SBA Loan Opportunities Under the Coronavirus Aid, Relief, and Economic Security (CARES) Act*

04.03.20

The Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act") was signed into law on March 27, 2020, providing emergency assistance to businesses, families and individuals impacted by the COVID-19 pandemic. The CARES Act provides significant relief for small businesses by providing \$350 billion in Small Business Administration ("SBA") loan funding, subsidies and guaranties, and an additional \$10 billion for the existing Economic Injury Disaster Loan program.

As outlined below, various lending institutions will begin to offer Paycheck Protection Program Loans in late March and early April. In addition, companies can elect to apply for Economic Injury Disaster Loans and a \$10,000 grant directly through the SBA immediately. The SBA has been given authority to pass emergency regulations in order to implement the CARES Act within 15 days after its enactment. Thus, both the SBA and participating lending institutions are expected to develop and refine processes over the first two weeks of April. Winstead's attorneys have experience assisting clients with understanding and applying for the assistance programs discussed below.

Paycheck Protection Program

The CARES Act updates Section 7(a) of the Small Business Act in order to create a new loan category referred to as the Paycheck Protection Program (the "PPP"). The PPP provides loans of up to \$10 million ("PPP Loans") on a "first-come, first-served" basis to eligible entities for business costs, which may include payroll and salary costs, employee benefits and leave, certain rent, mortgage and utility payments, and interest on debt obligations. PPP Loans shall be made available through existing SBA-certified lenders, as well as additional lenders that the SBA determines have the necessary qualifications. The period in which PPP Loans may be requested runs from February 15, 2020 through June 30, 2020. PPP Loans shall be subject to forgiveness under certain circumstances. It is important to note that certain SBA processes and interpretations may not yet have been established, and the interpretations of eligibility, uses of proceeds and forgiveness may be modified as the PPP is made effective.

Applications for a PPP Loan should be made through a participating lending institution. Applicants must submit SBA Form 2483 (Paycheck Protection Program Application Form) and such documentation as necessary to establish eligibility, such as payroll processor records or payroll tax filings. Borrowers without such documentation must provide other supporting documents to demonstrate the qualifying payroll amount. Interested borrowers should also have readily available their most recent Federal Income Tax Returns, financial statements and similar relevant materials.

Eligible applicants for PPP Loans generally include businesses with less than 500 employees, self-employed individuals, independent contractors, sole proprietorships, businesses in the accommodation and food services industry with less than 500 employees per physical location, and 501(c)(3) nonprofit organizations. The assessment of the number of employees includes full time and part-time employees, as well as those employed on other bases. The act waives general SBA affiliation rules with respect to businesses in accommodation and food services industries, entities with a franchise identifier code, and businesses licensed under Section 301 of the Small Business Investment Act. As of April 2, 2020, the SBA still intends to issue additional guidance with regard to the applicability of other affiliation rules for PPP Loans.

In determining eligibility for a PPP Loan, a lender will consider whether the applicant (i) was in operation on February 15, 2020, and (ii) whether the applicant had employees for whom the applicant paid salaries and payroll taxes or paid independent contractors as reported on a 1099. Note, however, that pursuant to guidance issued on April 2, 2020, independent contractors do not count as employees for purposes of calculating loan amounts or for loan forgiveness.

Additionally, your company will be ineligible for a PPP Loan if you, or any business controlled by you or any of your owners, has ever obtained a guaranteed loan from the SBA or any other Federal agency that is currently delinquent or has defaulted within the last seven years and caused a loss to the government.

The CARES Act specifically authorizes the use of PPP Loans for the following uses:

- Payroll costs (including compensation, vacation and leave payments, allowance for dismissal or separation, cash tips, healthcare benefits, retirement benefits, state or local taxes based on compensation, and similar items)
- Employee salaries, commissions, or similar compensation
- Payments of interest on any mortgage obligation (specifically excluding any principal and prepayments)
- Rental payments
- Utility costs
- Interest on any other debt obligations (incurred prior to covered period)

In order to obtain a PPP Loan, an applicant must make a good faith certification (i) that current economic conditions make the loan necessary to support ongoing obligations, (ii) acknowledging that funds will be used to retain workers and maintain payroll or to make mortgage, lease or utility payments, and (iii) that the applicant does not have an existing application pending with the SBA for (or has not received) a loan for the same purpose.

The amount of an approved PPP Loan shall be in an amount that is calculated by multiplying the average total monthly payments for payroll costs during the one-year period before the PPP Loan is made by 2.5 (although a PPP Loan shall be in the maximum amount of \$10,000,000). Certain adjustments may apply for seasonal businesses and entities that were not in business for the entire previous year. PPP Loans will have a two-year term, and interest rates are set at 1.0%. Borrowers will not have to make any payments for six months following the date of the loan, but interest will continue to accrue.

The CARES Act further smooths the application process for prospective applicants by waiving certain fees, prepayment penalties, the requirement to provide a personal guarantee or provide collateral, or the requirement that the applicant is unable to obtain credit elsewhere.

It is important to note that certain payroll costs and salaries shall be excluded from the permitted uses for a PPP Loan, including compensation for individuals in excess of \$100,000 (prorated), federal employment and withholding taxes. 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 in an amount exceeding \$100,000 in one year shall not be permitted.

It appears that potential borrowers may obtain both a PPP Loan and an EID Program Loan (as discussed below), so long as the loans do not duplicate the same purpose. Furthermore, the refinance of an EID Program Loan made after January 31, 2020 is a specific permitted use of PPP Loan funds. Finally, a company that already has an existing EID Program loan that is unrelated to COVID-19 may apply for a new PPP Loan, with an available option to refinance its existing EID Program Loan into the new PPP Loan. Potential borrowers that may qualify for both types of loan programs should carefully review their options, particularly as new SBA regulations and further guidance from lending institutions are developed.

Loan Forgiveness for PPP Loans

PPP Loans will be very attractive to potential borrowers, due to the loan forgiveness provisions included in the CARES Act provisions. To incentivize borrowers obtaining PPP Loans to use funds for the purposes specifically designated in the CARES Act, borrowers will be eligible for loan forgiveness in an amount equal to the amount spent by a borrower during the 8-week period after the loan origination date (not to exceed the amount of the PPP Loan) on the following items:

- Payroll costs (not including compensation above \$100,000 for any individual)
- Interest payments on mortgages incurred prior to February 15, 2020 (specifically excluding any payment of principal)
- Rental payments under leases in force prior to February 15, 2020
- Utility payments for service beginning prior to February 15, 2020

Due to likely high subscription to the PPP program, not more than 25% of the forgiven amount shall be for non-payroll costs. Further, the amount forgiven shall be reduced in proportion to any reduction in employees retained by the borrower compared to the prior year, and also based on any reduction in pay of any employee beyond 25% of such employee's prior year compensation. However, companies that re-hire workers that were previously laid off will not be penalized for

having a reduced payroll at the beginning of the period. Additionally, borrowers with employees that receive tips may receive forgiveness for additional wages paid to those employees.

In order to qualify for forgiveness, a borrower must apply with the lender servicing the PPP Loan, and the Lender shall have 60 days in which to review the request and make a determination. Any portion of the PPP Loan that is not forgiven will have a maturity of not more than 10 years following the borrower's application for forgiveness, and the remaining balance would continue to be guaranteed by the SBA. In addition, for tax purposes, no cancellation of indebtedness income shall be recognized upon forgiveness.

Note that to the extent a borrower has obtained a \$10,000 grant under a EID Program Loan, as discussed below, the amount of such grant shall be deducted from the forgiveness amount available under the PPP.

The SBA will be issuing additional guidance on PPP Loan forgiveness in the coming weeks.

Economic Injury Disaster Loans

In addition to making PPP Loans available, the CARES Act provisions (set forth in Section 1110 of the CARES Act) also expand the SBA's existing Economic Injury Disaster Loan Program (the "EID Program"). The existing EID Program (operating under Section 7(b) of the Small Business Act) provides for low interest, long-term loans to small businesses and non-profits that are located in areas designated as geographic disaster zones.

According to SBA guidance:

"The SBA will work directly with state Governors to provide targeted, low-interest loans to small businesses and non-profits that have been severely impacted by the Coronavirus (COVID-19). The SBA's Economic Injury Disaster Loan program provides small businesses with working capital loans of up to \$2 million that can provide vital economic support to small businesses to help overcome the temporary loss of revenue they are experiencing."

In response to the COVID-19 pandemic, small business owners in all U.S. states, Washington D.C., and territories are eligible to apply for EID Program Loans. Such loans may be used in order to pay fixed debts, payroll, accounts payable and other costs. They are not intended to replace lost sales or profits, to refinance debt, to make payments on loans owed to another federal agency, to pay tax penalties, to repair physical damages or to pay dividends to stockholders. Eligible businesses that may apply for EID Program Loans include small businesses, employee stock ownership plans, and tribal businesses (in each case with 500 or fewer employees), as well as private nonprofit organizations, small agricultural cooperatives, individuals operating as sole proprietors or independent contractors. Interest rates are set at 3.75% for small businesses and 2.75% for non-profits. EID Program Loans may be requested in an amount up to \$2 million, with a maximum term of 30 years. The terms of an EID Program Loan are determined on a case-by-case basis. Following the passage of the CARES Act, personal guarantees are waived on loans below \$200,000. Furthermore, there is no requirement for applicants to have been in business for a one-year period before the COVID-19 disaster (although an applicant must have been in business as of January 31, 2020), nor is there a requirement for the applicant to demonstrate that it is not able to access "credit elsewhere."

Applicants for EID Program Loans are entitled to request a \$10,000 emergency grant, which shall be distributed to the applicant within three days of submitting the application. The applicant is not required to repay this grant, even if its application for an EID Program Loan is subsequently denied. These funds may be used to address any permitted purpose for an EID Program Loan, including providing paid sick leave, maintaining payroll, rent payments and similar purposes. Note that to the extent an applicant receives an emergency grant hereunder while it is also applying for a PPP Loan, and to the extent the applicant later receives a PPP Loan, the amount of such advance will be "reduced from the loan forgiveness amount of a loan for payroll costs" made as a PPP Loan.

Potential borrowers are not able to receive EID Program Loans in addition to PPP Loans if the purpose for the loans is duplicative. However, a company that already has an existing EID Program loan that is unrelated to COVID-19 may apply for a PPP Loan, with an available option to refinance its existing EID Program Loan into the new PPP Loan. It appears that borrowers may apply for both types of loans so long as the use of the EID Program Loan does not duplicate the use of the PPP Loan. As noted above, applicants should carefully consider their options, particularly as updated SBA regulations are provided.

To apply for an EID Program Loan, potential borrowers should begin an application online at

<https://www.sba.gov/disaster/apply-for-disaster-loan/index.html> prior to December 31, 2020. Certain forms are available

as part of the online application, and are included below for reference. The documentation that should be provided in order to request an EID Program Loan will typically include at least the following (although certain waivers may be permitted on a case-by-case basis):

Completed SBA Loan Application (SBA Form 5)

Completed copies of the most recent Federal Income Tax Return

Tax Information Authorization (IRS Form 4506T) for the applicant, and all principals and affiliates

Schedule of Liabilities (SBA Form 2202)

Personal Financial Statement (SBA Form 413)

For additional information directly from the SBA, please contact the SBA disaster assistance customer service center by phone (1-800-659-2955), email (disastercustomerservice@sba.gov) or online (<https://www.sba.gov/disaster/apply-for-disaster-loan/index.html>).

A recently published quick guide to the SBA's emergency loan programs prepared by the U.S. Chamber of Commerce is included below.

**Updated as of April 3, 2020. This alert may be updated from time to time as additional rules, regulations and guidance are set forth.*

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