

COVID-19: UPDATED Q&A FOR SBA EMERGENCY LOANS

Date: 26 March 2020

Public Policy and Law Alert

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On March 22, 2020, Senate Majority Leader McConnell released a draft of the Coronavirus Aid, Relief, and Economic Security ("CARES") Act, which would amend the Small Business Act (15 U.S.C. Section 636(a)) ("SBA Act") to provide emergency loan relief to certain eligible borrowers. The following questions and answers are based on the CARES Act, which the Senate unanimously passed on March 25, 2020. The House is scheduled to consider the legislation on Friday, 27 March, though it is unclear whether any meaningful changes will occur prior to House consideration and eventual passage.

QUESTION:

WHAT ARE THE SBA EMERGENCY LOANS?

Answer:

SBA emergency loans are being offered pursuant to a new "Paycheck Protection Program" added to the SBA Act. This program is specifically designed to get cash to small and medium-sized businesses to cover immediate losses resulting from government-mandated closures, supply chain interruption, and lack of staffing. These loans, referred to as "Covered Loans," are to be disbursed by SBA lender participants (including governmental-approved funding sources, such as the Empire Zone in New York), broker-dealers, financial institutions, community credit capital corporations, credit unions, and other SBA-approved lenders ("SBA Lenders"). The proceeds of the Covered Loans may be used for certain specified purposes during the "Covered Period," which begins on February 15, 2020, and ends on June 30, 2020. The total amount of loans to be supported by the SBA, including the loans for the Paycheck Protection Program, is \$349 billion.

QUESTION:

HOW MUCH CAN BE BORROWED UNDER THE PAYCHECK PROTECTION PROGRAM?

Answer:

There will be limits to the maximum amount of each loan, which is generally determined by (i) taking the average of monthly payroll costs for such business and multiplying it by a factor of 2.5 [1], and (ii) adding any SBA emergency loan provided after January 30, 2020, relating to the COVID-19 outbreak. To the extent this formula would arrive at an amount in excess of \$10 million, the Covered Loan is capped at \$10 million.

QUESTION:**WHAT CAN THE PAYCHECK PROTECTION PROGRAM COVERED LOANS BE USED FOR?****Answer:**

It is envisioned that the Covered Loans during the Covered Period are to be utilized by businesses to offset immediate and direct costs relating to COVID-19 closures and staffing depletions. The uses for SBA loan proceeds are payroll costs (when revenue is not sufficient to cover), rents (for leases entered into prior to February 15, 2020), interest on mortgages for office space (but not any payment of principal), utilities, employee salaries, and interest on any other debt obligations that were incurred prior to February 2020. The term "payroll costs" is specifically defined to exclude the compensation of any individual employee in excess of \$100,000 per year as prorated for the Covered Period. The proceeds may also be used to refinance SBA economic injury disaster loans made after January 31, 2020; however, there is not to be any duplication of loans relating the COVID-19 outbreak.

QUESTION:**ARE THERE ANY SPECIAL CERTIFICATION REQUIREMENTS IN ORDER TO BE A BORROWER UNDER THE PAYCHECK PROTECTION PROGRAM?****Answer:**

The current draft provides very specific requirements in order for potential borrowers to utilize the Paycheck Protection Program, including:

- The borrower must have been in operation on February 15, 2020, **and** either had (x) employees for whom the borrower paid salary and payroll taxes, or (y) paid independent contractors as reported on IRS Form 1099-MISC and "is substantially impacted by public health restrictions related to COVID-19."
- Borrowers must certify as to the use of covered loan proceeds, retention of employees, and they must also confirm that they do not have duplicative applications pending with the SBA.

QUESTION:**WHY ARE THE COVERED LOANS FUNDED BY THE SBA LENDERS INSTEAD OF THE SBA FUNDING THE BUSINESSES DIRECTLY?****Answer:**

SBA loans under Section 7(a) of the SBA Act are funded by the SBA Lenders, but they are supported by the SBA in the form of an SBA guarantee. In the event of a default, the notes of the borrower are assigned from the SBA Lenders to the SBA. This means that if the loans default, the SBA will repay the disbursing SBA Lender and take over the default and enforcement of the loans.

QUESTIONS:

WHY IS THE MEDIA DESCRIBING THE PROGRAM AS A GRANT? HOW DOES THE PAYCHECK PROTECTION PROGRAM DIFFER FROM A GRANT?

Answer:

It differs from a grant in that repayment of the Covered Loan is expected unless it is forgiven. The CARES Act allows for certain amounts of the Covered Loans to be forgiven (such amount, the "Forgiven Portion") under specified circumstances. When a Covered Loan is forgiven, the SBA remits to the SBA Lender the Forgiven Portion and interest accrued to date thereon.

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HOW IS THE FORGIVEN PORTION CALCULATED?

Answer:

The CARES Act contains several provisions in order to calculate the Forgiven Portion, and the SBA Lender makes a report and the determination of the Forgiven Portion. The Forgiven Portion is then treated, by the SBA, as if it were subject to an SBA guarantee.

- In order to be eligible for forgiveness, the borrower must evidence that the disbursed funds were used for one of the following purposes: (a) payroll costs; (b) costs related to maintenance of group health care benefits; (c) employee salaries, commissions, or similar compensation; (d) interest on mortgage payments (but not principal) incurred prior to February 15, 2020; (e) rent pursuant to a lease entered into prior to February 15, 2020; (f) utilities; or (g) interest on indebtedness incurred prior to February 15, 2020.
- The borrower must present specified documentation evidencing the use of funds.
- The Forgiven Portion cannot exceed the principal amount of the Covered Loan.
- The borrower must show that employees were retained and that wages of employees were not reduced by more than 25 percent [2]. If there have been significant layoffs and wage declines, the amount to be forgiven will be reduced. The CARES Act recognizes that certain actions may have been taken during the period from February 15, 2020, until 30 days following the passage of the CARES Act (the "Crisis Period"). If the reduction in employees and wages have been eliminated by June 30, 2020 (the "Recovery Period"), the layoffs and reductions made during the Crisis Period are disregarded when determining the Forgiven Portion. This is to incentivize borrowers to (i) rehire employees, and (ii) reinstate pre-Crisis Period wages during the Recovery Period.

QUESTION:

WHAT HAPPENS TO THE PORTION OF THE COVERED LOAN THAT IS NOT FORGIVEN?

Answer:

Remaining amounts will be reflected in a loan obligation, guaranteed by the SBA, which will have a maximum term of 10 years from the date on which the borrower applies for loan forgiveness as described above.

QUESTION:

ARE THE COVERED LOANS SECURED?

Answer:

There are no collateral requirements or personal guarantees. The CARES Act does provide for recourse to shareholders, members, and partners of an eligible recipient to the extent that the proceeds of the Covered Loans are used for an unauthorized purpose.

QUESTION:

WILL MY BUSINESS QUALIFY?

Answer:

Prior to the enactment of the bill, SBA 7(a) loan funding has generally been for small businesses with loan amounts up to \$1.5 million [3]. "Small business" is defined (depending on the industry) as a business with maximum of 250 to 1,500 employees.

The pending Paycheck Protection Program expands the eligibility requirements to include as an eligible recipient those business concerns with up to 500 employees during the Covered Period or, if greater, the number of employees established by the SBA "in which the business concern, nonprofit organization or veterans' organization operates." [4] Sole proprietors and self-employed individuals operating without a formal legal entity are expressly included so long as they submit payroll tax filings submitted to the IRS. Specifically excluded are not-for-profits eligible for Medicaid (other than those providing certain addiction services). Business concerns that are hospitality- and food service-related, as long as they employ not more than 500 employees per physical location, are included in the program, and affiliation rules (that would normally apply under the SBA) are waived until June 30, 2020, for business concerns in these industries. There are also waivers from the affiliation requirements for business concerns operating as a franchise and for business concerns that have received financial assistance from small business investment companies.

QUESTION:

HOW MUCH WILL A COVERED LOAN COST? WHAT FEES ARE PAYABLE TO THE SBA AND THE SBA LENDERS?

Answer:

The Covered Loans will bear a maximum interest rate of 4 percent. SBA Lenders will be paid an administration fee by the SBA of (a) 5 percent for loans up to \$350,000, (b) 3 percent for loans up to \$2 million, and (c) 1 percent for Covered Loans over \$2 million. Administrative fees usually payable to the SBA will be waived.

NOTES

[1] The formula is adjusted for "seasonal businesses" and businesses that do not have a full operating year of monthly payroll costs.

[2] For purposes of this provision, "employee" does not include any employee making \$100,000 or more a year.

[3] Conversely, SBA disaster loan funding is for "all businesses." The disaster loan program provides low-interest, long-term loans for physical and economic damage caused by a declared economic disaster. The SBA must declare disaster areas by state and territory. Your business must be in an SBA-declared disaster area to be eligible for SBA disaster assistance.

[4] Current industry size standards may be found in the attached link: <https://www.sba.gov/document/support--table-size-standards>.

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