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Practice Update

The CARES Act Expands Access to SBA Loan Programs

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On March 27, 2020, the President signed the Coronavirus Aid, Relief and Economic Security Act (the CARES Act) in response to the coronavirus (COVID-19) pandemic. Among other relief, most relevant to businesses, the CARES Act infuses $349 billion to the Section 7(a) loan program and $10 billion to the Economic Injury Disaster Loan (EIDL) program under the Small Business Act. The CARES Act expands the Section 7(a) loan program, through a new "Paycheck Protection Program" offering certain businesses affected by the coronavirus (COVID-19) outbreak access to immediate financial assistance in the form of forgivable loans administered through a Small Business Administration (SBA) approved lender and relaxes eligibility requirements by waiving certain aggregate affiliation requirements.[1]

Generally, Section 7(a) loans are available to most companies with not more than 500 employees (or such greater number of employees established by the SBA for each particular industry) subject to certain aggregate affiliation rules which previously would limit the use of the Section 7(a) loan program by portfolio companies of private equity funds.

The Paycheck Protection Program waives certain aggregate affiliation requirements. This permits private equity fund portfolio companies to be eligible

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to apply for loans under the Section 7(a) program if they satisfy one of the following criteria:

(i) operate in an accommodation or food services industry with a North American Industry Classification System (NAICS) code beginning with 72 with 500 or fewer employees;

(ii) operate as a franchise that is assigned a franchise identifier code by the SBA; or

(iii) receive financial assistance from a company licensed under Section 301 of the Small Business Investment Act of 1958.

The Paycheck Protection Program also permits accommodation and food service companies with a NAICS code beginning with 72 to apply the 500 employee test on a per physical location basis.

The affiliation rules are very fact-specific and other portfolio companies may also qualify for loans under the Paycheck Protection Program. The SBA is expected to give additional guidance on the application of affiliation rules.

I. Paycheck Protection Program (Section 1102 of the CARES Act)

The Paycheck Protection Program loans are intended to cover certain costs and expenses during the period beginning on February 15, 2020 and ending on June 30, 2020 (the covered period). Eligibility and certain loan terms and conditions are described below:

Eligibility. In general, (i) any business concern, nonprofit organization, veterans organization, or Tribal business concern that employs not more than the **greater** of (a) 500 employees (individuals employed on a full-time, part-time or other basis); or (b) if applicable, the size standard in number of employees established by the SBA for the industry in which such entity operates, and (ii) any business concern that is assigned a NAICS code beginning with 72 as of the date of the loan disbursement ("accommodation and food services") with more than 1 physical location that employs not more than 500 employees per physical location of the business concern.

Waiver of Affiliation Rules. The CARES Act waives the affiliation rules for:

- any business concern in the accommodation and food services industry with a NAICS code beginning with 72 and with not more than 500 employees;
- any business concern operating as a franchise that is assigned a franchise identifier code by the SBA; and
- any business concern that receives financial assistance from a company licensed under Section 301 of the Small Business Investment Company Act of 1958 (i.e., an SBIC).

Loan Amount. During the covered period, the maximum loan amount will be the **lesser** of:

- (i) $10 million or (ii) 2.5 times the applicant's average total monthly payments for payroll costs for the 12-month period preceding the date of the loan or, for seasonal employers, for the period from February 15, 2019 or March 1, 2019 to June 30, 2019 **plus**
- the amount of any EIDL loan made on or after January 31, 2020 described below that is being refinanced by the Paycheck Protection Program.

  If the applicant was not in business during the applicable period in clause (ii), then the average of total monthly payment for payroll costs in (ii) above will be calculated based on the period from January 1, 2020 to February 29, 2020.

Loan Forgiveness. A borrower will be eligible for loan forgiveness under Section 1106 of the CARES

Act (subject to reduction described below) in the total amount, up to the principal amount of a Paycheck Protection Program loan, of the sum of:

- the sum of payments of any (i) compensation with respect to employees (other than compensation of an individual employee in excess of an annual salary of $100,000, as prorated for the covered period) that is salary, wage, commission, tips, etc., vacation, leave, separation allowance, group health care benefits costs (including insurance premiums), retirement benefit or certain payroll taxes, and (ii) compensation of independent contractors that is a wage, commission, or similar compensation up to $100,000 in 1 year, as prorated for the covered period (collectively, the Payroll Costs);
- payments of interest on any mortgage on real and personal property that is a liability of the borrower and was incurred before February 15, 2020;
- payments of any rent obligation under a lease agreement in effect before February 15, 2020; and
- payments for electricity, gas, water, transportation, telephone or internet services that began before February 15, 2020.

Please note that forgiveness of a loan under Section 7(a) may not be available if a borrower elects to defer employer payroll social security tax permitted under Section 2302 of the CARES Act. We are awaiting additional guidance from the SBA or tax authorities.

If otherwise not forgiven, the loan will bear an interest rate not to exceed 4 percent and will mature not later than 10 years from the date the borrower applies for loan forgiveness. SBA authorized lenders are required to provide complete payment deferment (including principal, interest and fees) for a period not less than 6 months and not more than 1 year.

Reduction of Loan Forgiveness. The loan forgiveness is subject to reduction based on:

- the average number of full-time equivalent employees per month employed by the borrower during the covered period, as compared to the average number of full-time equivalent employees employed (at the borrower's option):
  - from February 15, 2019 to June 30, 2019; or
  - from January 1, 2020 to February 29, 2020; or
  - in the case of seasonal employers, from February 15, 2019 to June 30, 2019.
- any reduction in total salary or wages of any employee (who did not receive during 2019 an annual salary of more than $100,000) during the covered period that is in excess of 25 percent of the total salary or wages of such employee during the most recent full quarter during which such employee was employed before the covered period.

Any reductions in salary or terminations between February 15, 2020 and April 27, 2020 will not be counted for purposes of the calculations above if not later than June 30, 2020, the borrower has eliminated the reduction in number of full-time equivalent employees or in the salary or wages of such employees, as applicable.

Borrowers with employees that receive tips may also receive forgiveness for additional wages paid to those employees.

Treatment of Forgiven Loan. The loan amounts which have been forgiven will be considered cancelled indebtedness by the lender, but will be excluded from gross income for federal tax purposes.

Allowable Use of Proceeds. During the covered period, an eligible recipient of a loan under the

Paycheck Protection Program may use the proceeds for:

- Payroll Costs;
- costs related to continuation of group health care benefits during periods of paid sick, medical or family leave, and insurance premiums;
- payments of interest on any mortgage obligation;
- rent (including rent under a lease agreement);
- utilities; and
- interest on any other debt obligations that were incurred before the covered period.

Additional Requirements; No Duplication With Certain EIDL Loans. The borrower will have to make certifications that (i) the loan is necessary to support its ongoing operations, (ii) the proceeds will be used for the approved purposes above, and (iii) no EIDL loan (described below) has been applied for or is or will be obtained through December 31, 2020 for the same purpose as a Section 7(a) loan. However, a borrower can apply for a loan under the EIDL program for purposes other than the allowable use of proceeds under a Section 7(a) loan.

Other Favorable Features of the Paycheck Protection Program.

- SBA will not collect certain otherwise applicable fees.
- No personal guarantee or collateral is required and the SBA will not have recourse against any individual shareholder, member or partner of an eligible recipient unless the proceeds were used for an unauthorized purpose.
- SBA will waive the requirement that would otherwise apply that a small business concern is unable to obtain credit elsewhere.

SBA is required to provide guidance within 30 days after enactment of the CARES Act. In the meantime, as the application process will be initiated by a SBA approved lender, you should consider immediately contacting an SBA approved lender to begin the process.

II. Economic Injury Disaster Loan (Section 1110 of the CARES Act)

Section 1110 of the CARES Act expands the Economic Injury Disaster Loan program which permits loans up to $2 million. During the period beginning on January 31, 2020 and ending on December 31, 2020, the following entities will be eligible in addition to the entities eligible under Section 7(b) of the Small Business Act: a business with not more than 500 employees; any individual who operates under a sole proprietorship, with or without employees, or as an independent contractor; a cooperative with not more than 500 employees; an employee stock ownership plan (ESOP) with not more than 500 employees; or tribal small business concern with not more than 500 employees. The eligible applicants must have been in operation since January 31, 2020. Allowable uses of funds are the same as those under Section 7(b), including providing paid sick leave to employees unable to work due directly to COVID-19, maintaining payroll during business disruptions or slowdowns, meeting increased costs due to supply chain disruption, making rent or mortgage payments, or repaying obligations that cannot be met due to revenue losses.

In addition, similarly to the Paycheck Protection Program, through December 31, 2020, the SBA will waive personal guarantees on advances of not more than $200,000 for all applicants, or the provision that an applicant may be unable to obtain credit elsewhere.

During this period, an applicant may request an emergency advance of up to $10,000. An applicant will not be required to repay any amounts of an advance provided even if the EIDL is denied. If the applicant subsequently transfers to the Paycheck

Protection Program, the advance amount shall be reduced from the loan forgiveness amount under that program.

Two notable differences between the EIDL and Section 7(a) loans that may make the EIDL loans less attractive are that an EIDL (a) does not have the same exemptions as Section 7(a) from the affiliation rules, and (b) EIDLs are not forgivable.

III. Express Loans. The CARES Act has increased express loans under the Small Business Act from $350,000 to $1,000,000 through December 31, 2020.

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[1] The CARES Act also includes the Coronavirus Economic Stabilization Act of 2020 (the "CESA"), which makes available $500 billion and enacts other measures to provide liquidity to eligible businesses that are suffering as a result of COVID-19. The CARES Act authorizes the Treasury Secretary to issue requirements and application procedures for certain loans, loan guarantees and investments under CESA within 10 days of the enactment of the CARES Act. A notable difference between the CESA and the Paycheck Protection Program is that CESA prohibits forgiveness of the loans advanced under CESA and includes certain restrictions on stock buybacks, the payment of dividends and executive compensation.
