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SBA Loans Under the CARES Act

Chamberlain Corporate Update - SBA Loans Under the CARES Act

March 27, 2020

In response to the overwhelming economic impact of the COVID-19 pandemic on the U.S. economy, on Friday, March 27, 2020, after prior approval by the U.S. Senate and House of Representatives, the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act or the Act) was signed into law by President Trump.

This document focuses on the portion of the Act pertaining to SBA loans, particularly to the extent relevant to small and mid-sized businesses. In the event any applicable regulatory or other guidance is issued as this pandemic evolves, we will provide an update.

Expanding SBA Loan Qualifications for Businesses with 500 or Fewer Employees

The CARES Act provides a small business with a pathway to apply for one or more SBA loans up to \$10 million if the business decides to keep its staff employed and paid between February 15, 2020 through June 30, 2020 (the covered period).

Which Businesses Qualify for a Loan?

During the covered period, any business employing 500 or fewer employees (or the size standard in number of employees for the industry in which the entity operates as established by the SBA)[1] in the United States and which was operational as of February 15, 2020 will be eligible to receive a loan under Section 7(a) of the Small Business Act.[2] Certain self-employed individuals, independent contractors and sole proprietorships may also qualify for a Section 7(a) loan. The loan must be applied for, or the application must be pending, after the enactment of the Act.

Notably, however, the Act does not permit double-dipping under Section 7(a) and Section 7(b) of the Small Business Act. Rather, a borrower that receives assistance under Section 7(b)(2) of the Small Business Act (an economic injury disaster loan) for payroll support related to COVID-19 cannot also receive a loan under Section 7(a) for the same reason.

How much can be borrowed?

For Companies Operational Prior to February 15, 2019:

The maximum loan amount is equal to the lesser of (1) \$10 million or (2) the sum of (A) the outstanding amount of a loan under subsection 7(b)(2) of the Small Business

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Act that was made during the period beginning January 31, 2020 and ending on the date on which the covered loans are made available to be refinanced under the covered loan and (B) the product obtained by multiplying two and one-half (2.5) times the average total monthly payments of the company for payroll costs incurred during the one (1) year period before the date on which the loan is made.

Calculating the maximum loan amount for seasonal employers is the same as for all other companies, as stated above, except the average total monthly payments for payroll are equal to the average of payroll payments for the period beginning February 15, 2019 (or, at the Company's election, the period beginning March 1, 2019) and ending June 30, 2019.

For Companies Operational After February 15, 2019:

The calculation of the maximum loan amount is the same as for companies operational prior to February 15, 2019, as explained above, except that the average total monthly payments by the company for payroll costs shall be those payroll costs incurred during the period beginning January 1, 2020 and ending February 29, 2020.

Are there any Restrictions on Using the Loan Proceeds?

Section 7(a) loan proceeds can be used for any reason permitted under Section 7(a), which include the following: (a) payroll costs, (b) costs related to the continuation of group health care benefits, (c) employee salaries, commissions or similar compensation, (d) payments of interest on any mortgage obligation, (e) rent payments (including rent under a lease agreement), (f) utilities, and (g) interest on any other debt obligations incurred before February 15, 2020.

Payroll costs include not only payment of salary, wages, commission or similar compensation, but also include separation payments, payments required for the provision of group health care benefits, including insurance premiums, and payments of state and local compensation taxes, among other things. Payroll costs also include the compensation paid to any independent contractor as a wage, commission, income or similar compensation, in an amount not more than \$100,000 per year, as prorated for the covered period.

Notably, however, there are certain caps the company should be aware of with respect to covered payroll costs under the Act. Payroll costs do *not* include, among other things, compensation of any individual employee in excess of a \$100,000 annualized salary, as prorated for the covered period, or payments made for qualified sick leave wages for which the company is already receiving credit under the Families First Coronavirus Response Act.

An eligible company may also refinance any loan made under Section 7(b)(2) of the Small Business Act as part of a Section 7(a) loan.

Are There Collateral Requirements?

Unlike other loans under Section 7(a) of the Small Business Act, (i) there is no requirement for a personal guarantee, (ii) there is no collateral required for the loan, and (iii) there is no requirement that a company applying for the loan is unable to obtain credit elsewhere.

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In addition, there is no recourse against any individual shareholder, member or partner of an eligible recipient of a Section 7(a) loan for non-payment of the Section 7(a) loan, except to the extent such shareholder, member or partner used the loan proceeds for an unauthorized purpose.

Are there any Origination Fees and May Payments be Deferred?

During the covered period, the loan administrator may not collect a yearly administration fee or any guarantee fees. Also during the covered period, the lenders for each Section 7(a) loan must provide complete payment deferment relief for impacted borrowers for a period of not more than one (1) year. Each Section 7(a) loan shall further be guaranteed 100% by the SBA.

Lenders are required to provide complete payment deferment relief for borrowers with Section 7(a) loans for a period of not less than six (6) months and not more than one (1) year. The deferment shall be a complete deferment of any payment of principal, interest and fees.

The Act also waives any prepayment penalty on a Section 7(a) loan obtained under the Act.

Is Debt Forgiveness Permitted?

A recipient of a Section 7(a) loan may be eligible for forgiveness of some or all of the indebtedness on such loan.

The amount of forgiveness is capped at the principal amount of the loan, and shall be otherwise equal to the sum of the following costs incurred and payments made during the covered period: (a) payroll costs, (b) any payment of interest on a covered mortgage obligation, (c) any payment on a covered rent obligation, and (d) any covered utility payment.[3]

Any amounts forgiven will be considered as cancelled indebtedness by lenders and will be excluded from gross income for the purposes of the Internal Revenue Code of 1986, as amended.

Notably, however, debt forgiveness will be *reduced* in the event the company reduces its workforce or reduces its workforces compensation during the covered period.

The amount of loan forgiveness will be reduced by a percentage roughly equal to the percentage the company's workforce is reduced during the covered period. The amount of forgiveness will also be reduced if, during the covered period, the company reduces by more than 25% the compensation of employees who receive wages or salary at an annualized rate of \$100,000 or less.

How Will My Company Apply for Loan Forgiveness?

To apply for loan forgiveness, a company receiving a Section 7(a) loan will submit to the lender an application which must include documentation verifying the number of full-time equivalent employees on the company's payroll and such employees' pay rates for the required periods. The application must also include documentation of any alleged covered payroll, mortgage, lease or utility payment and any other documentation the administrator deems necessary.

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The application must also include a certification of the borrower that the documentation provided with the application is true and correct and which further provides the following:

- 1 That loan was necessitated by the uncertainty of current economic conditions and to support the ongoing operations of the company;
- 2 That the loan proceeds will be used to retain workers and maintain payroll or make mortgage payments, lease payments and utility payments;
- 3 That the company does not have an application pending for another Section 7(a) loan for the same purpose or that is duplicative of amounts applied for or received under the applied-for loan; and
- 4 During the period beginning on February 15, 2020 and ending on December 31, 2020, that the company has not received amounts under Section 7(a) of the Small Business Act for the same purpose and duplicative of amounts applied for or received under the applied-for loan.

The lender must issue a decision on an application for forgiveness no later than 60 days after the date it receives an application for loan forgiveness.

What About Portions of the Loan that are Not Forgiven?

If a Section 7(a) loan has a remaining balance after loan forgiveness, the loan will have a maximum maturity of ten (10) years and shall bear an interest rate of no more than four percent (4%).

Before applying for a Section 7(a) loan, you should review your current loan agreements and consult with your current lenders to ensure your application for or receipt of a Section 7(a) loan will not place you in default with respect to your current loan agreements.

If you or your company have any questions about obtaining a Section 7(a) loan under the Act, you should contact your legal counsel or one of the attorneys in our Corporate Group listed below.

[1] Employees include any individual employed on a full-time, part-time or other basis. Notably, the Act waives the Small Business Act affiliation rules aggregating affiliates for the purpose of meeting the size standards for eligibility for a Section 7(a) loan for (i) any business concern with not more than 500 employees and which is assigned a North American Industry Classification System Code beginning with 72 (accommodation and food service establishments), (ii) those businesses that receive financial assistance from Small Business Investment Companies (SBIC), and (iii) certain franchises. The current affiliation rules still apply to nonprofit and veteran organizations.

[2] Certain businesses with more than 500 employees employed in multiple physical locations, where there are no more than 500 employees per physical location, may qualify for Section 7(a) loans. For more information on coverages for larger businesses, please contact any member of our Corporate Group.

[3] For a detailed analysis of which of your company's payroll, mortgage, rent and utility payments are eligible for loan forgiveness, you should contact your company's attorney or any member of our Corporate Group.

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This update does not create an attorney-client relationship and does not constitute legal advice applicable to specific facts or circumstances.

