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CARES ACT EXPANSIONS: WHAT YOU NEED TO KNOW WHEN APPLYING FOR SBA LOANS DUE TO COVID-19

As the COVID-19 pandemic continues to wreak havoc on both the health of individuals and the health of our economy, there is one sector that is being hit particularly hard – small businesses. Fortunately, the third phase of Congress’s stimulus package to combat these economic effects, the Coronavirus Aid, Relief, and Economic Security Act (“CARES Act”), in part establishes a new loan program for small businesses to be administered by the Small Business Administration (“SBA”). The CARES Act drastically expands the amount of available monetary assistance and removes many of the barriers for obtaining a loan.

This summary provides an overview of the CARES Act small business loan provisions, existing small business loan options, and how businesses may seek these loans as we currently understand the legislation. We are constantly and diligently continuing to dive into the specifics of the legislation to better understand it, how the new law practically affects our clients, and what options are best for our clients. We will continue to keep you updated as the reality of this legislation unfolds.

The CARES Act

The CARES Act amends the Small Business Act to expand the existing Business Loan Program category for economic injury loans due to concerns over maintaining employment and payroll during the COVID-19 pandemic. The bill also makes similar expansive changes to the separate, SBA economic injury disaster loan program, including relaxing many of the loan eligibility and underwriting conditions, and

application requirements for small businesses. On March 27, 2020, after the House passed the bill by a voice vote, the President signed the bill into law.

Section 7(a) Loan Program under the CARES Act

Eligibility

The new “Paycheck Protection Program” (“PPP” or the “Program”) expands Section 7(a) of the Small Business Act by providing forgivable loans to businesses with 500 or fewer employees. This includes sole proprietors and other self-employed individuals. Businesses in the hospitality and restaurant industry are among businesses that are excused from the 500-employee limit. The CARES Act requires that the SBA Administrator issue guidance to lenders regarding loan eligibility, providing that they prioritize small business concerns, entities in underserved and rural markets, owners of socially and economically disadvantaged small business concerns, women, and businesses that have been in operation for less than 2 years. Eligible business entities are expanded to include sole proprietors, self-employed business owners and independent contractors.

Whether or not an applicant can repay the loan is not a determinative underwriting factor for whether an applicant is eligible. Rather, lenders will look to see if the applicant business was operational on February 15, 2020 and had paid employees or independent contractors on its payroll. The SBA can service the loans themselves or in cooperation with the lenders in the private sector. Private lenders already approved to make SBA loans can make loans under the Program immediately. The CARES Act removes the collateral or personal guarantee requirements for loans under the Program.

Loan Amount

The amount of each loan is capped at the lesser of either (A) 2.5 times the amount of the applicant’s average monthly payroll for the year before the loan originates, or (B) for businesses not operational in 2019, 2.5 times the average monthly payroll costs

for January and February 2020, or (C) a maximum amount of \$10 million. Loan amounts not forgiven will bear a maximum interest rate of 4%. There are no subsidy recoupment fees associated with the loans and no prepayment penalty for any payments made. The loans have a maximum maturity of 10 years, and an additional provision in the CARES Act provides for possible deferment of repayment of the loans for a period of at least six months, but not more than a year.

Qualification Requirements

The “covered period” for obtaining a loan is February 15, 2020 until June 30, 2020. There are few borrower requirements to qualify for a loan. Applicants must only make a good-faith certification of the following: (1) (NEED) that the loan is necessary to continue its operations due to the uncertainty of current the economic condition; (2) (USE) an acknowledgment that the loan funds will be used to retain workers and maintain payroll or make mortgage, lease, and utility payments; (3) (NO DUAL APPLICATIONS) the applicant has not filed an application for funds for the same purpose and duplicative of amounts applied for or received under a covered loan, and (4) (NO DUAL SOURCE) from February 15, 2020 until December 31, 2020, the applicant has not received funds for the same purpose and duplicative amounts applied for or received under a covered loan.

Allowable Uses

The CARES Act expands the allowable uses under Section 7(a) for SBA’s Business Loan program, adding the following to the existing allowable uses:

- Payroll costs – which broadly defines employee compensation to include salaries, wages, or commissions; paid leave, severance payments, group health insurance premiums, retirement benefits, state and local payroll tax payments; and, compensation to sole proprietors and independent contractors.
 - Notable exclusions include employees receiving annual compensation over \$100,000, or emergency sick and family leave wages for which

credit is allowed under the Families First Act, and non-USA resident workers.

- Group healthcare benefits paid during periods of paid sick, medical, or family leave, and paid group health insurance coverage premiums
- Interest on existing mortgages (but not the principal on a mortgage)
- Existing rent or lease payments
- Existing utility service payments
- Interest on any other debt obligations incurred before the covered period.

Loan Forgiveness Eligibility

One of the hallmarks and most popular provisions of the CARES Act legislation is the repayment forgiveness presumption. New loan proceeds are forgivable if they are used to fund specified expenses incurred by the borrowing business for a specified time period. Specifically, repayment forgiveness amounts are calculated based on the amounts subsequently spent by the borrowing business on (1) payroll costs (using the same definition as above), (2) existing mortgage interest payments, (3) existing rent payments, and (4) existing utilities during the 8-week period beginning on the origination date of the loan. It is important to note that group healthcare benefit payments and interest payments on other debt obligations are not forgivable amounts but are still allowable uses. A borrowing business' loan deferral or forgiveness amount is actually paid to the SBA lender by the Administrator. The debt forgiveness formula reduces this benefit when a borrowing business subsequently terminates employees or reduces wages during the covered period. In an effort to encourage businesses to rehire employees already laid off and reverse any pay cuts instituted between February 15, 2020, and 30 days after the enactment of the CARES Act (April 26, 2020), borrowing businesses who rehire those laid off workers and revert pay cuts by June 30, 2020 will not be penalized for having a reduced payroll at the beginning of the covered period. Additionally, businesses with tipped employees in the hospitality and dining sector may receive debt forgiveness for any voluntary, additional (non-tip) wages paid to those employees. Businesses must apply for loan forgiveness by

submitting documentation verifying payroll amounts, mortgage obligations, utility bills, and other documentation the Administrator may require.

Section 7(b)(2) Economic Injury Disaster Loan Program Expansion

On March 20, Tennessee received a declaration for Economic Injury Disaster Loan (“EIDL”) assistance from the SBA within two days, after Governor Lee submitted the State’s request. This Declaration allows Tennessee’s qualifying small businesses and non-profits affected by the COVID-19 pandemic to apply for up to \$2 million in loan assistance under the expanded provisions of Section 7(b)(2) of the Small Business Act. The CARES Act additionally declared that every state and its subdivisions have suffered sufficient economic damage to qualify all small businesses for EIDL funds.

Each EIDL loan amount is limited to the business’s economic injury, which is determined by the SBA, and other factors such as business interruption insurance and potential contributions available to the business. Importantly, if the business is a “major” source of employment, the SBA may waive the \$2 million limit.

The EIDL covered period is January 31, 2020 to December 31, 2020. During this time, the CARES Act allows the SBA and its authorized lenders to approve EIDL loans based solely on the applicant’s credit score or other appropriate methods. Additionally, it also waives several SBA loan underwriting rules and practices, such as personal guaranties of business owners for loans less than \$200,000, the one-year business history rule, and other presumption of creditworthiness practices. EIDL loans over \$25,000 require collateral, but loans cannot be denied if the applicant does not have any collateral to pledge. If this is the case, the applicant is required to pledge what is available, and the SBA will take real estate as collateral when practicable. The CARES Act expanded the definition of eligible borrowers to include small business concerns such as sole proprietors and independent contractors with or without payrolls, employer ESOPs and cooperatives and Tribal small businesses, in addition to existing eligible entities.

EIDL loans may be used to pay fixed ordinary and necessary financial obligations that businesses are unable to pay as a direct result of the disaster – such as pre-existing, fixed debts, payroll, and accounts payable. The loan's interest rate will depend on different factors set by law but will not exceed 3.75% and is set for the entire life of the loan. For non-profits, the interest rate will not exceed 2.75%. The loans are intended to be paid over a long period, up to 30 years, to ease the burden on businesses. Other terms are to be based on the borrowing business' ability to repay and financial condition.

EIDL loan proceeds cannot be used to refinance existing long-term debts, and businesses that have not complied with previous SBA loan requirements may not qualify to borrow under these expanded loan programs. However, the CARES Act allows businesses who received an SBA disaster EIDL loan after January 31, 2020 to refinance them through a loan under the new expanded 7(a) Program discussed above.

The CARES Act provides that EIDL loan applicants may request an emergency advance against loan funds of up to \$10,000. This amount is presumed eligible to be forgiven, and will be advanced, even if the application is later denied. This emergency amount is intended to be used for existing authorized purposes, as well as providing emergency paid sick leave to employees unable to work directly because of COVID-19, maintaining payroll, meeting increased supply chain costs, making rent and mortgage payments, and repaying debts unable to be paid due to lost revenues. If an applicant receives an emergency advance on an EIDL loan, and later refinances the EIDL loan into a loan under the new Program (for different uses), the emergency advance amount is subtracted from the amount forgiven.

To adequately fill out the required forms for an EIDL loan application, you will need to provide a detailed history of the business owners personal financial statements, past tax returns, and a current schedule of the business's current liabilities.

It is important to note that a business cannot receive funds for the same purposes/uses from both the new expanded 7(a) Program and the EIDL program under 7(b). However, as previously mentioned, if an applicant has received an EIDL, it can refinance that loan into a loan under the new Program.

SBA Express Loans

The SBA already has an Express Loan Program that provides loans within 36 hours. The CARES Act increases Express Loan amounts from \$350,000 to \$1,000,000 through the end of 2020.

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In an attempt to limit the spread of COVID-19, our professionals are serving clients remotely through telephone, email, and videoconferences. Rest assured that at Kramer Rayson LLP we remain ready and willing to assist our clients with The CARES Act, SBA Loans, and any other issue that may arise during these challenging times, just like we've done since 1948. Should you need to consult with one of our professionals, do not hesitate to contact us.