SF SHARTSIS FRIESE LLP

Client Alert: Small Business Loans under the CARES Act

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Security (CARES) Act was signed into law. The CARES Act provides approximately $350 billion in loans to be administered by the Small Business Administration (SBA), referred to as Paycheck Protection Program Loans (PPP Loans). These loans may be used to cover payroll costs, mortgage interest, rent and/or utilities expenses for up to eight weeks following the date of the loan. Some or all of the loan principal amount generally will be forgiven if the borrower uses the loan to pay qualifying expenses while maintaining its workforce. Additionally, the CARES Act expands the Economic Injury Disaster Loan Program (the EID Program) with $10 billion of additional funding.

On March 31, 2020, the U.S. Department of the Treasury issued additional guidance regarding the PPP Loans, including providing a copy of the PPP Loan application, which can be found on the Department's website: https://home.treasury.gov/policy-issues/top-priorities/cares-act/assistance-for-small-businesses.

Please note that the CARES Act was enacted less than a week ago in response to the Coronavirus pandemic and is subject to additional clarification and interpretation by Treasury, IRS, SBA and other federal regulatory agencies. If you need more information, or if you are considering relying on this relief, please contact one of the attorneys in the Corporate Group at Shartsis Friese LLP: P. Rupert Russell, Anthony J. Caldwell, Michael B. Dell, Jeffrey L. Braker, David Suozzi, Elizabeth Sparrowe Marcil, Sergio A. Broholm or Maribeth T. Charvet.

1. Paycheck Protection Program Loans

Eligibility

Generally, to qualify for a PPP Loan, a borrower must have been in operation on February 15, 2020 and must have no more than 500 employees (or no more than 500 employees per location for certain borrowers in the accommodation and food services industries). In addition, borrowers who have more than 500 employees may be eligible if they employ no more than the number of employees established by the SBA for the industry in which such borrower operates. Full-time and part-time employees are included; however, it is unclear whether service providers based outside the U.S. are included. All businesses – including nonprofits, veterans organizations, Tribal business concerns, sole proprietorships, self-employed individuals, and independent contractors – are eligible for a PPP Loan so long as they comply with the above requirements.

While a borrower's affiliates are normally considered by a lender when determining whether a borrower is eligible for an SBA loan, the CARES Act waives these affiliation rules for borrowers in the accommodation and food services industries, as well as certain franchises and other companies. However, it does not address the affiliation rules for other industries.

As part of the application for a PPP Loan, a borrower also must certify in good faith, among other things, that the uncertainty of current economic conditions makes the loan necessary to support the borrower's ongoing operations, and the funds will be used to retain workers and maintain payroll or to make mortgage, lease, and utility payments.

Use of Loan Proceeds

Proceeds may be used to fund any of the following:

- Payroll Costs (as defined below)
- Costs related to the continuation of group health benefits and any retirement benefits
- Payments of interest on any mortgage obligation (but not payment or prepayment of principal on such obligations)
- Rent
- Utilities
- Payments of interest on any debt incurred before February 15, 2020

"Payroll Costs" means all compensation with respect to employees that is salary, wages, commissions or similar compensation, cash tips, PTO, health insurance, severance pay, retirement benefits and state and local employment taxes assessed on the compensation of U.S. employees. In calculating Payroll Costs, compensation to an individual employee in excess of an annual salary of $100,000 per year must be excluded. In addition, Payroll Costs exclude compensation paid to employees residing outside the U.S., federal payroll taxes and qualified sick leave and family leave wages that are creditable under the Families First Coronavirus Response Act.

Loan Size

The maximum size for each PPP Loan is capped at $10 million and is calculated as follows:

- If the borrower was in business between February 15, 2019 and June 30, 2019, the maximum loan size is equal to 250% of the borrower's average monthly Payroll Costs during the one-year period leading up to the date of the loan. Borrowers that employ seasonal workers can instead choose March 1, 2019 - June 30, 2019 as their measurement period.
- If the borrower was NOT in business between February 15, 2019 – June 30, 2019, the maximum loan is equal to 250% of the borrower's average monthly Payroll Costs between January 1, 2020 and February 29, 2020.
- If the borrower took out an EID Loan between February 15, 2020 and June 30, 2020 and wants to refinance that loan into a PPP Loan, the outstanding EID Loan amount is added to the payroll sum for purposes of calculating the maximum loan amount.

Loan Terms

Under the CARES Act, PPP Loans may have up to a 10-year term and an interest rate not to exceed 4%. According to the additional guidance issued by the U.S. Department of the Treasury on March 31, 2020, each PPP Loan will have a 2-year term and a 0.50% fixed interest rate.

The SBA will not collect any fees on loans issued under this program. All loan payments (principal, interest and fees) are deferred for at least six months, and up to one year. PPP Loans will not have any prepayment penalties and are nonrecourse, unless the loan proceeds are used for an unauthorized purpose. A borrower does not need to provide any collateral or a personal guarantee.

Loan Forgiveness

A borrower will be eligible for forgiveness of a PPP Loan in an amount equal to the sum of the following costs incurred and payments made during eight weeks following the origination of the loan; provided that the amount forgiven may not exceed the total principal amount of the PPP Loan:

- Payroll Costs
- Payments of interest on any covered mortgage obligation (but not payment or prepayment of principal on such obligations)
- Covered rent
- Covered utilities

In order to be considered "covered", mortgages and leases must have been incurred or entered into before February 15, 2020, and service on a utility must have commenced before February 15, 2020. The U.S. Department of the Treasury issued guidance on March 31, 2020 saying that they anticipate that no more than 25% of the forgiven amount of a PPP Loan may be for non-payroll costs (i.e., rent). The amount of any PPP Loan that is forgiven will not be taxed as income to the borrower.

The amount of the PPP Loan eligible for forgiveness may be proportionally reduced if the borrower does not retain full time employees during the 8-week period following origination of the PPP Loan. For purposes of measuring employee retention, the borrower must compare the average number of full time employees employed by the borrower per month during the covered period to the average number of employees employed by the borrower per month during the previous year or time period.

In addition, the amount of the PPP Loan that is eligible for forgiveness will be reduced on a dollar-for-dollar basis by the amount of any reduction in the total salary or wages paid to an employee during the 8-week period following the origination of the PPP Loan that is more than 25% of the total salary and wages of that employee during the most recent full quarter during which the employee was employed. Only employees who were not paid at an annual rate of at least $100,000 during any pay period in 2019 are included for purposes of determining if there has been a 25% reduction in wages.

In certain circumstances, a borrower that reduced workforce or salary/wages paid to an employee between February 15, 2020 and April 26, 2020 may be able to disregard those reductions to its PPP Loan forgiveness amount if the borrower eliminates those workforce or salary/wages reductions by June 30, 2020.

The Borrower must apply through its lender for loan forgiveness. The application must include all of the following:

- Documentation verifying the number of employees on payroll and pay rates, including IRS payroll tax filings and State income, payroll and unemployment insurance filings
- Documentation verifying payments on covered mortgage obligations, lease obligations, and utilities
- Certification from a representative of the borrower that is authorized to certify that the documentation provided is true and that the amount that is being forgiven was used in accordance with the program's guidelines for use.

Application Process

The Paycheck Protection Program is currently being administered out of the existing network of approved SBA lenders. Lenders' eligibility determinations are to be based only on whether a borrower meets the eligibility criteria above and not anything else. Lenders are expected to begin accepting applications on Friday, April 3, 2020. Borrowers will need to complete the Paycheck Protection Program loan application and submit the application with the required documentation to an approved lender by June 30, 2020. The U.S. Department of the Treasury is encouraging applicants to apply as soon as possible due to the time required to process loans and the cap on funds available for loans.

Additional information and a copy of the PPP Loan application is available at the U.S. Department of the Treasury's website: https://home.treasury.gov/policy-issues/top-priorities/cares-act/assistance-for-small-businesses.

Cross Functionality with Employee Retention Payroll Tax Credit

A borrower may not receive both an Employee Retention Payroll Tax Credit and a Paycheck Protection Loan. The forgiveness of a Paycheck Protection Loan will prevent the use of the CARES Act Payroll Tax Deferral provision for payroll taxes corresponding to the period following the enactment of the CARES Act and ending December 31, 2020.

2. Economic Injury Disaster Loans

In addition to Paycheck Protection Program, the CARES Act expands the SBA's existing EID Loan Program, which provides long-term loans with favorable borrowing terms. Borrowers may be eligible for loans under both programs; however, they are unable to seek recovery under the EID Loan Program for the same costs that are covered by a PPP Loan.

Eligibility

During the period between January 31, 2020 and December 31, 2020, any of the following entities can qualify for an EID Loan:

- Businesses with not more than 500 employees
- Individuals operating under a sole proprietorship or as an independent contractor
- Cooperatives, ESOPs or tribal small business concerns with not more than 500 employees

Small business concerns and small agricultural cooperatives that meet the applicable size standard for SBA are also eligible, as well as most private non-profits of any size. Consistent with other EID Loan programs, to qualify, a borrower must have suffered "substantial economic injury" from COVID-19. The CARES Act waives the requirement that an EID borrower needs to be in operation for at least one year before the disaster but still requires that it be in operation on January 31, 2020.

Use of Loan Proceeds

EID Loans may be used to pay for expenses that could have been met had the disaster not occurred, including payroll and other operating expenses.

Loan Size

EID Loans under the CARES Act are based on the borrower's actual economic injury determined by the SBA up to $2 million.

Loan Terms

The interest rate on EID Loans is 3.75% for small businesses and 2.75% for nonprofits. EID Loans may have up to a 30-year term. EID Loans under the CARES Act do not require personal guarantees for loans up to $200,000; however, EID Loans exceeding $25,000 are required to be secured by some form of collateral to the extent collateral is available.

The CARES Act permits borrowers to request an advance of up to $10,000 to pay allowable working capital needs. This advance functions as a grant because it is not required to be repaid, even if the EID Loan application is denied. However, the amount of the advance must be deducted from any loan forgiveness amounts under a PPP Loan, described above.

Application Process

Unlike PPP Loans, applications for EID Loans should be submitted directly to the SBA at DisasterLoan.sba.gov. To expedite the approval of EID Loans during the covered period, the CARES Act allows the SBA to approve a loan based solely on the borrower's credit score or other means of determining the borrower's ability to repay the loan, without requiring the submission of tax returns. The CARES Act waives the requirement that the borrower demonstrate that it is unable to obtain credit elsewhere.