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CARES Act provides relief for small businesses through SBA loans and programs

The CARES Act has given funding and authority to the Small Business Administration (SBA) to help small business through three new programs: Paycheck Protection Loans, Economic Injury Disaster Loans, and additional loans through the Small Business Debt Relief program. Each of these is discussed in summary below.

Paycheck Protection Loan (under Section 7(a) of the Small Business Act)

Any business, nonprofit organization, veterans organization or tribal concern of not more than 500 employees and self-employed individuals, sole proprietors and independent contractors in operation as of February 15, 2020, are eligible for a ***partially (and in some cases, fully) forgivable*** "paycheck protection" loan under Section 7(a) of the Small Business Act, which loan is deployed and originated by ***private lenders***. Businesses with more than 500 employees are eligible in certain industries based on NAICS Codes. Businesses with NAICS Codes beginning with 72 (restaurants and hotels) are not subject to affiliation rules and are eligible as long as they don't have more than 500 employees per location.

The size of applicant combined with its affiliates must not exceed the size standard designated for the applicant's primary industry alone or primary industry of applicant and its affiliates, whichever is higher. SBA considers distribution of receipts, employees, cost of doing business among different industries and classification of assets when determining the applicant's primary industry. Entities are affiliates of each other when (i) one entity controls or has the power to control the other or a third party or parties controls or has power to control both, (ii) an affiliate of the entity owns or has power to control more than 50% of voting equity of the entity being examined (officers or managing members who control the management of the concern or individuals or entities who have the ability to prevent a quorum by the board are usually considered to be "in control" of the concern), (iii) the officers who control the management of the concern at issue also control the management of one or more other entities, (iv) two or more individuals or firms with identical or substantially identical business or economic interests (such as close relatives or firms with common investments) may be treated as one party; (v) the concern is close relatives with another individual or entity with identical or substantially identical business or economic interests (same industry in same area) or (vi) the same individuals or entities together own a substantial portion of multiple concerns in the same or related industry, and such concerns conduct business with each other, or share resources, equipment, locations, or employees with one another. **Note: The SBA has indicated that further guidance related to the applicability of affiliation rules will be forthcoming.**

- Borrowers obtain the loan from any SBA-certified lender. The Department of Treasury has expanded the authority to also include any federally insured depositary institution or credit union, any Farm Credit System institution and any other finance provider that meets certain criteria.

- Borrowers must make a good faith certification that the current economic environment (as a result of Covid-19) makes the loan necessary to support ongoing operations and that the funds will be used to retain workers or make mortgage interest, lease or utility payments.

- The maximum loan amount is the lesser of $10 million or 2.5 times the average monthly payroll costs of borrower (which exclude compensation amounts in excess of $100,000 for any individual employee, federal payroll and income taxes, compensation of non-U.S. residents and any qualified sick and family leave for which a credit is allowed under the Families First Coronavirus Response Act) during the 1-year period preceding the loan. A business can use an alternate period if work is seasonal or the business is less than a year old. There are no loan fees and no prepayment penalties. The loans will have a two-year maturity and an interest rate of 1.0%.

- The SBA has clarified that independent contractors are not to be included in payroll costs for an employer and independent contractors can apply for their own loans under this program.
- Loan proceeds are to be used solely for payroll support, salaries, mortgage interest payments, rent and utilities. The SBA has indicated that no more than 25% of the loan proceeds are to be used for non-payroll costs.
- No collateral or guaranty is required.
- No SBA fees are to be charged upon origination of the loan.
- Payments on Paycheck Protection Loans can be deferred for 6 months.

Amounts that are forgiven are calculated as follows:

- The maximum forgiveness available under a Paycheck Protection Loan is equal to the total payroll costs incurred by the employer-borrower plus mortgage interest payments, rent and utilities (the “forgiveness costs”) incurred during the eight-week period following origination of the loan (the “covered period”). The SBA has indicated that no more than 25% of the forgiveness may be dedicated to non-payroll costs.
- The allowable forgiveness costs are then calculated by multiplying the forgiveness costs by a quotient equal to the average number of full-time equivalent employees (“FTEs”) per month employed by borrower during the covered period divided by either (i) the average number of FTEs per month from February 15, 2019 to June 30, 2019 or (ii) the average number of FTEs per month from January 1, 2020 to February 29, 2020. The employer-borrower can choose either (i) or (ii).
- Forgiveness costs are further reduced for any employee (earning $100,000 or less) that has a wage reduction greater than 25% (compared to such employee’s most recent full quarter).
- If by June 30, 2020, the employer/borrower eliminates any reductions in employees or compensation that occurred from February 15, 2020 and ending 30 days after enactment of the CARES Act, such reductions shall not count against the amount forgiven.
- Forgiveness under this program is not treated as taxable gross income for income tax purposes.

For more information on the tax provisions of the CARES Act, please see our Tax Practice Group’s coverage.

Economic Injury Disaster Loans

Until December 31, 2020, eligibility for an Economic Injury Disaster Loan (EIDL) is the same as for a loan under the Paycheck Protection Program.

- Borrowers will need to certify that the current economic environment (as a result of Covid-19) makes the emergency loan necessary.
- The loan amount may be up to $2 million.
- Principal and interest can be deferred at the SBA’s discretion.
- Loan proceeds are to be used to pay for expenses that could have been met but for the economic disaster, including sick leave and family leave payments under the Families First Coronavirus Response Act.
- Borrowers can obtain an EIDL and a Paycheck Protection Loan but they cannot be used to cover the same costs.
- Collateral is required under EIDL and guaranties are required for loans over $200,000.

Small businesses who have applied for an EIDL may request an emergency advance/grant of $10,000 from SBA, which advance does not need to be repaid.

Small business debt relief

Any business concern, nonprofit organization of not more than 500 employees in operation as of February 15, 2020, and who otherwise meets the definition of “small business concern”, is eligible for a “small business debt relief” loan to provide relief to small businesses by using loans under the 7(a), 504 or Microloan programs.

Standard 7(a) loans under Small Business Debt Relief (SBDR) program of up to $5 million may be used for short or long-term working capital needs. This loan can be obtained in conjunction with a Paycheck Protection Loan, but use of proceeds cannot be duplicated (if Paycheck Protection Loan proceeds are used for payroll, SBDR 7(a) loan proceeds cannot be used for payroll for the same employees for the same period of time).

504 loans under Small Business Debt Relief program are coordinated by community development corporations (CDCs) and are capped at $5 million in most cases. 504 loan proceeds are to be used for long-term fixed assets for expansion or modernization (real estate or large equipment). Borrowers are expected to make 10% down payment (CDCs contributes 40% and traditional lender contributes final 50%). The term of the loan can be 10, 20 or 25 years with below-market interest rates.

Microloans are low-principal loans (usually between $10,000 to $50,000) that are designed to assist with initial start-up costs and expansion and are usually coordinated by SBA-certified mission-based lenders who also can provide business counseling.

"Small business concern" qualification

The small business debt relief loans described above are only available for companies and non-profits who meet the SBA standards for "small business concerns" and who also have less than 500 employees. The SBA sets either revenue or number of employee limits, or both. To find the standards for a particular type of business, the NAICS codes are used. For example, size standards for "Lessors of Residential Buildings and Dwellings" (code 531110) and "Residential Property Managers" (code 531311) are based on annual net receipts, not number of employees for purposes of the CARES Act.

Lessors of Residential Buildings and Dwellings have a $30 million annual net revenue limit, while Residential Property Managers: $8 million annual net revenue limit.

More updates are expected on this issue. Please check back to our COVID-19 resource page regularly for updates.

Hap Burke, Jennifer Price, and Sarah Landgraf are attorneys in Thompson Coburn's Real Estate practice group.

Vicky Gilbert is an attorney in Thompson Coburn's Banking practice group and can be contacted regarding SBA loans and programs under the CARES Act.

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authorsTest

halpin
Halpin J. Burke

jennifer
Jennifer R. Price

victoria a.
Victoria A. Gilbert

sarah
Sarah E. Landgraf