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BANKING & FINANCE LAW ALERT

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Financial relief for small businesses under the CARES Act

The third phase of COVID-19 legislation was signed into law on Friday, March 27, 2020, and has been named the Coronavirus Aid, Relief and Economic Security Act (CARES Act). For small businesses, this legislation means that $349 billion in stimulus dollars is heading out to eligible small businesses, sole proprietors, ESOPs, non-profits, veterans organizations, and other tribal business concerns, to provide assistance maintaining payroll and employee benefits, along with overhead costs.

Eligible businesses should carefully review the Small Business Administration's (SBA) eligibility requirements for each program, which our colleague Jack Meadows laid out in this Law Alert. In addition, businesses should review other tax incentives contained within the CARES Act, to ensure that the business does not render itself ineligible by taking advantage of too many, or the wrong combination of, programs. If you'd like to review your qualifications with an attorney before seeking out an SBA-approved lender, the Porter Wright team can help you identify your needs and goals and help shepherd you through the approval process.

Economic Injury Disaster Loans

An Economic Injury Disaster Loan (EIDL) is the SBA's foundational program under Section 7(b)(2) of the Small Business Act, that provides financial assistance to small businesses who have suffered injury as a result of a physical or economic disaster. A business cannot qualify under the EIDL program without the SBA having issued a Disaster Declaration for the county and state in which the business is physically located. Important to the COVID-19 disaster, the entire state of Ohio has been declared a disaster area by the SBA.

After the passage of the CARES Act, the EIDL program was meaningfully modified with relation to applications made during the COVID-19 disaster period. These modifications include expanding the types of eligible businesses to include:

- small business
- private non-profit organizations
- agricultural cooperative
- ESOP
- sole proprietor or independent contractor (with or without employees)
- tribal small business concern

Additionally, with respect to the COVID-19 disaster, the CARES Act waives the requirement that the applicant provide a personal guarantee for loans $200,000 or less, and likewise will waive the requirement that the applicant need be in business for one year period prior to the disaster, except that no waiver may be made for businesses not in operation on January 31, 2020. Finally, and likely the most significant change, is that the administrator has been directed to waive the "credit elsewhere" requirement for all applications submitted between January 31, 2020 and December 31, 2020.

Loans made under the program are intended to capture the actual or temporary loss of revenue suffered by impacted businesses. Accordingly, loans are capped at $2 million, and can only be used to pay qualified expenses, such as fixed debts, payroll, accounts payable, and other bills that cannot be paid because of the disaster's impact. These funds are allocated based on the actual losses of the business and cannot be increased absent documentation evidencing the losses.

Repayment terms for the EIDL program are very accommodating of the struggling business. For the COVID-19 disaster declaration, the interest rate is 3.75% for small businesses, and 2.75% for non-profits, and loans can be repaid over a thirty (30) year term. There are no prepayment penalties for loans made under the EIDL program.

EIDL Emergency Grant Program

In addition to expanding and infusing the EIDL program with stimulus funds, the CARES Act established an EIDL Grant program. EIDL Grants are available to any eligible business that applies for a loan under Section 7(b)(2) in response to COVID-19, and may be made immediately available (upon request) to the applicant within three (3) days after the administrator receives the application. The applicant must certify that it is an eligible entity by providing the administrator with a self-certification form, sworn under penalty of perjury.

Grants made under this section shall be not more than $10,000. But businesses should note that not every business will receive that amount; the SBA must issue guidance within fifteen days of the passage of the

CARES Act to provide guidelines as to how much each business will receive in grant funds.

An applicant will not be required to repay grant funds in the event an EIDL application is denied, although exceptions remain for fraudulent certifications. In the event the applicant refinances an EIDL loan into a Paycheck Protection Program (PPP) loan, the applicant's potential forgiveness amount will be reduced by the grant amount paid to the applicant.

Paycheck Protection Program

As enacted by the CARES Act, the Paycheck Protection Program (PPP) is a new division of the SBA Section 7(a) loan program, specifically developed to address the COVID-19 disaster. In differing from the EIDL program, PPP loans have greatly relaxed and expanded eligibility requirements. Businesses must continue to meet the SBA's size standards (500 employees or less), the types of businesses that may be eligible can touch "any business concern," ranging from private, non-profit organizations to sole proprietors, ESOPs, veterans organizations and other tribal business concerns.

Another expansion of typical SBA rules has included the waiver of affiliation rules. Under traditional SBA programs, a business is affiliated (by ownership or control) with another when one entity controls or has the power to control the other, or a third party controls both. Affiliates, particularly investors, could potentially disqualify an applicant business under normal circumstances. PPP applicants should be aware that not all affiliation rules have been waived, but only specific types of affiliations:

- Any business with 500 or fewer employees per physical location that is assigned a NAICS code beginning with 72, such as hotels, restaurants, or food service businesses
- Businesses operating a franchise that are assigned a franchise identifier code by the SBA
- Businesses that receive assistance from a small business investment company (SBIC)

Similar to the EIDL program, PPP loans are intentionally designed to support the business's costs of payroll and employee benefits, rent, mortgage, utilities and other overhead costs. Loans are made based on a formula calculating 2.5 times the average total monthly payments for these costs, or $10 million, whichever is less. In their application, businesses will be required to certify that:

1. The uncertainty of current economic conditions makes the loan necessary,

2. The funds will be used to retain workers, maintain payroll, make mortgage/lease payments, and/or utility payments, and not be used for other, unauthorized purposes, and

3. The applicant does not have an application pending for a loan which covers the same costs.

PPP Loans offer some added benefits to businesses: waiving SBA loan fees, waiving collateral and personal guarantees, and also waiving the "credit elsewhere" requirements. Payments on PPP loans can be deferred from six months to a year following closing on the loan, and interest rates on loans cannot exceed 4 percent. And, there are no prepayment penalties for PPP loans.

Loan forgiveness

For now, only businesses with a PPP loan are eligible for potential loan forgiveness. Loan forgiveness is established by the amount equal to covered payroll costs, payment of interest on mortgage obligations, payment on covered rent obligations, covered utility payments and payments made during the eight-week period following the origination of the loan.

Forgiveness is contingent upon the payment of payroll costs and expenses for applicable employees, specifically excluded, employees who did not receive annualized wages and salary for any pay period during 2019 in excess of $100,000.

The amount of forgiveness may be proportionally reduced by a reduction in employment. The reduction formula used is at the election of the employer, by using either the average full-time equivalent employees from the same period in the prior year, or the number of employees in the first two months of 2020. To encourage businesses to hire back employees, partial forgiveness can still be achieved if the employer rehires employees no later than June 30, 2020.

The amount of forgiveness may also be reduced for a reduction in pay/wages of any employee during the eight-week period following the origination of the loan if the reduction was greater than 25% of the employee's compensation during the most recent quarter. When aligned with the encouragement that businesses rehire employees, it is not clear whether businesses will need to rehire and compensate employees at their full wages in order to preserve the entire forgivable amount of the loan.

Be aware, the amount of the loan forgiveness is capped at the principal amount of loan, and unpaid fees and interest will still need to be paid by the business. If a business is granted forgiveness, and portions of the PPP loan is not forgiven, the amount not forgiven is payable over a maximum of 10 years at an interest rate not to exceed 4%.

Importantly, the loan forgiveness amount will not be includable in the borrower's gross income.

Considering applying for a loan?

The application method for EIDL and PPP loans differ greatly.

If your business's best option is to apply for an EIDL loan, you can start your COVID-19 Economic Injury Disaster Loan application here. After registering for an SBA account, the step-by-step application process will require information about your business that it will use to determine your eligibility for the loan requirements. If you are not careful to submit all the information requested, your loan will not be processed and may be denied.

If you are considering a PPP loan, these loans are made through SBA-approved lenders, who will provide you with applications and requests for supporting documentation. We expect that banks will be inundated with applications in the very near future, so it is in your business's best interest to begin gathering information about your business to help facilitate the application process. Items we expect to be requested may include:

- SBA 7(a) Borrower Information Forms
- SBA Request for Transcript of Tax Return
- Articles of Incorporation/Organization
- Bylaws/operating agreement(s)
- Evidence of payroll and verification documents, reports, bank statements, summary of payroll benefits
- Twelve month profit and loss statements
- Mortgage statements / Lease Agreement(s)
- Utility bills

For more information contact Cassandra Rice, Jack Beeler, Jack Meadows or any member of Porter Wright's Banking & Finance practice group.