feinberg | hanson

Feinberg Hanson LLP
855 Boylston Street
Boston, Massachusetts 02116
O. 617 603 3304 F. 617 603 3305
feinberghanson.com

This Memorandum is subject to further review and update as circumstances develop and should not be relied on for any legal advice without consultation with an attorney.

MEMORANDUM

DATE: March 27, 2020

RE: COVID-19 Loan Options for Small Businesses

On March 27, 2020, the "Coronavirus Aid, Relief, and Economic Security Act" or "CARES Act" (H.R. 748) was signed into law by President Trump. The CARES Act includes provisions specifically designed to help small businesses who have been harmed by the COVID-19 pandemic. This memo summarizes the two types of loans available to such businesses through Small Business Administration (SBA) programs:

1. Paycheck Protection Loans available under Section 7(a) of the Small Business Act
2. Economic Injury Disaster Loans (EIDL)

In addition to the above loans, the CARES Act provides for the SBA to pay principal, interest and associated fees for a 6-month period on certain pre-existing loans guaranteed by the SBA.

Most small businesses will prefer Paycheck Protection Loans over EIDLs due to the potential for loan forgiveness. However, as further regulations governing Paycheck Protection Loans are expected to be released late next week at the earliest, businesses with an immediate need for relief may need to apply for a currently available EIDL and later refinance such EIDL into a Paycheck Protection Loan. In that case, any emergency advance received under the EIDL will be reduced from the loan forgiveness amount applicable to the Paycheck Protection Loan. Conversely, a business that receives a Paycheck Protection Loan would not be able to then receive an EIDL for the same purpose.

Paycheck Protection Loans under the SBA's existing 7(a) Loan Program

- Program Details:
    - For the period from February 15, 2020 to June 30, 2020, the SBA will be able to provide 100% federally-backed loans up to a maximum amount to eligible businesses to help pay operational costs like payroll, rent, health benefits, insurance premiums, utilities, etc.

- Loans will be eligible for partial forgiveness in an amount equal to the sum of payroll costs, rent and utilities expenses and interest payments on mortgages, in each case, paid during the eight-week period commencing on the date of the loan (see "Loan Forgiveness" below).
- The interest rate on loans under the program is not to exceed 4% and interest payments are deferred for one year.
- Maximum loan term is 10 years.
- No collateral or personal guarantee is permitted to be required for a loan.
- There will be no prepayment penalty.

- Eligibility:
  - To be eligible, a business must not employ more than 500 employees or, if applicable, the size standard in number of employees established by the SBA for the industry in which the entity operates. (Size Standards can be referenced here.)
    - Note that the affiliate rules applicable to determining "small business concern" eligibility are also applicable to determining a company's employee count. This is particularly relevant for companies with venture capital or private equity investment. Please contact us for assistance with affiliate calculations.
  - Businesses must make a good-faith certification that:
    - The loan is needed to continue operations during the COVID-19 emergency.
    - Funds will be used to retain workers and maintain payroll or make mortgage, lease, and utility payments.
    - The applicant does not have any other application pending under this program for the same purpose.
    - From February 15, 2020 until December 31, 2020, the applicant has not received duplicative amounts under this program.

- Maximum Loan Amount:
  - The maximum loan amount is the lesser of:
    - (A)
      - 2.5 times average total monthly payroll costs incurred in the one-year period before the loan is made;
      - PLUS the outstanding amount of a loan made under the SBA's Disaster Loan Program between January 31, 2020 and the date on which such loan may be refinanced as part of this new program.

      OR

    - (B) Upon request, for businesses that were not in existence during the period from February 15, 2019 to June 30, 2019 –

        - 2.5 times the average total monthly payroll payments from January 1, 2020 to February 29, 2020;
        - PLUS the outstanding amount of a loan made under the SBA's Disaster Loan Program between January 31, 2020 and the date on which such loan may be refinanced as part of this new program.

      OR

      - (C) $10 million.

- <u>Permissible Uses</u>:
  - Payroll costs:
    - Includes: compensation to employees, such as salary, wage, commissions, cash, etc.; paid leave; severance payments; payment for group health benefits, including insurance premiums; retirement benefits; state and local payroll taxes; and compensation to sole proprietors or independent contractors (including commission-based compensation) up to $100,000 in 1 year, prorated for the covered period
    - Excludes: individual employee compensation above $100,000 per year, prorated for the covered period; certain federal taxes; compensation to employees whose principal place of residence is outside of the US; and sick and family leave wages for which credit is allowed under the Families First Act
  - Group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums
  - Salaries, commissions, or similar compensations
  - Payments of interest on mortgage obligations
  - Rent/lease agreement payments
  - Utilities
  - Interest on any other debt obligations incurred before the covered period

- <u>Loan Forgiveness</u>:
  - Following an application and approval by the applicable lender, indebtedness will be forgiven (and excluded from gross income) in an amount (not to exceed the principal amount of the loan) equal to the following costs incurred and payments made during the 8 week period beginning on the date of the origination of the loan:
    - Payroll costs
    - Interest payments on mortgages incurred prior to February 15, 2020
    - Rent on any lease in force before February 15, 2020
    - Utility payments for which service began before February 15, 2020

- Forgiveness amounts will be reduced for any employee cuts or reductions in wages.
    - The reduction formula for employee cuts is:

      The maximum available forgiveness under the rules described above multiplied by:

      Average number of full-time equivalent employees (FTEEs) per month – calculated by the average number of FTEEs for each pay period falling within a month – during the covered period divided by:
      Either (at election of the borrower) –

      > Average number of FTEEs per month employed from February 15, 2019 to June 30, 2019; or
      >
      > Average number of FTEEs per month employed from January 1, 2020 until February 29, 2020.

      Note that this formula will be used to reduce forgiveness amounts but cannot be used to increase them.

    - For reductions in wages, the forgiveness reduction is a straight reduction by the amount of any reduction in total salary or wages of any employee during the covered period that is in excess of 25% of the employee's salary/wages during the employee's most recent full quarter of employment before the covered period. "Employee" is limited, for purposes of this subparagraph only, to any employee who did not receive during any single pay period during 2019 a salary or wages at an annualized rate of pay over $100,000.

    - There is relief from these forgiveness reduction penalties for employers who rehire employees or make up for wage reductions by June 30, 2020. Specifically, in the following circumstances, the forgiveness reduction rules above will not apply to an employer between February 15, 2020 and 30 days following enactment of the CARES Act –

        - The employer reduces the number of FTEEs in this period and, not later than June 30, 2020, the employer has eliminated the reduction in FTEEs; or
        - There is a salary reduction, as compared to February 15, 2020, during this period for one or more employees and that reduction is eliminated by June 30, 2020 (it is unclear whether this is also

intended to be limited to employees who made under $100,000 in 2019).

- Borrowers seeking forgiveness of amounts will be required to submit to their lender
  - Documentation verifying FTEE on payroll and their pay rates
  - Documentation on covered costs/payments (e.g., documents verifying mortgage, rent, and utility payments)
  - Certification from a business representative that the documentation is true and correct and that forgiveness amounts requested were used to retain employees and make other forgiveness-eligible payments
  - Any other documentation the SBA may require

- Additional information on and regulations regarding the loan forgiveness provisions will be released by the SBA within 30 days of the enactment of the CARES Act.
- As the CARES Act is currently drafted, there is ambiguity regarding whether forgiveness is at the discretion of the lender. Prior to entering into any loan agreement, be sure to confirm the lender's forgiveness policy.

- How to Apply:
  - Loans will be available through SBA and Treasury approved banks, credit unions, and some nonbank lenders. If you need a referral, please contact us.
  - Businesses may also use the SBA's Lender Match to find a lender.

SBA's Economic Injury Disaster Loan (EIDL) Program

- EIDL Details:
  - Provides small businesses financially impacted by COVID-19 loans of up to $2 million. The actual amount of each loan is limited to the economic injury determined by the SBA.
  - Interest rate is 3.75% per annum.
  - Repayment term will be determined by business's ability to repay the loan, with a maximum loan term of 30 years.
  - Loans are to be used for working capital. Funds may be used to pay fixed debts, payroll, accounts payable and other bills that can't be paid because of the disaster's impact.
  - Funds cannot be used for (a) expansion/replacement of lost sales/profits, (b) refinancing debt, or (c) equity buybacks/dividends.
  - Emergency advances are available:

        - Entities applying for loans under the Disaster Loan Program may request an emergency advance from the SBA of up to $10,000, which does not have to be repaid, even if the loan application is later denied.
        - Advances are to be awarded within 3 days of an application.
        - If an applicant receives an advance and then transfers into, or is approved for the 7(a) Loan Program, the advance amount will be reduced from the loan forgiveness amount for a loan for payroll costs made under 7(a).
- Eligibility:
    - Businesses with 500 or fewer employees
    - Business must have been in operation as of January 31, 2020
    - Credit Requirements:
        - Credit History – Applicants must have a credit history acceptable to the SBA.
        - Repayment – Applicants must show the ability to repay the loan.
        - Collateral – Collateral is required for all EIDL loans over $25,000. The SBA takes real estate as collateral when it is available. The SBA will not decline a loan for lack of collateral, but SBA will require the borrower to pledge collateral that is available.
        - There is no requirement that an applicant is unable to find credit elsewhere.
    - Insurance Requirement:
        - The SBA may require businesses to obtain and maintain appropriate insurance.
- How to Apply:
    - Online at https://disasterloan.sba.gov/ela/
    - The following items must be submitted:
        - Business Loan Application (Form 5)
        - Tax Information Authorization (IRS Form 4506T), completed and signed by each applicant, each principal owning 20 percent or more of the applicant business, each general partner or managing member and for any owner who has greater than 50 percent ownership in an affiliate business. Affiliates include, but are not limited to, business parents, subsidiaries, and/or other businesses with common ownership or management.
        - Complete copies, including all schedules, of the most recent federal income tax returns for the applicant business or an explanation if not available.
        - Personal Financial Statement (SBA Form 413) completed, signed, and dated by the applicant, each principal owning 20 percent or more of the applicant business, and each general partner or managing member
        - Schedule of Liabilities listing all fixed debts (SBA Form 2202 may be used)
        - Additional information may be requested following the initial application.

    - Applicants are not charged application fees nor are they required to accept an EIDL.