Client Alert

April 2020

SBA Announces Terms of Paycheck Protection Program

On March 27, 2020, the President signed into law an amended version of H.R. 748, the Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act” or “Bill”), a “Phase III” coronavirus economic stimulus package. On March 31, 2020 the Department of Treasury (the “UST”) published further guidance on the CARES Act.

The small business lending provisions contained in the Bill are summarized below. The CARES Act also provides for tax, healthcare, cash payments and other relief designed to help businesses and their employees.

Small Business Administration Provision Highlights

- Creates a new $350 billion “Paycheck Protection Program” with streamlined procedures for loans to small businesses;
- Reduces the certification requirements for lending institutions to become SBA certified;
- Reduces the requirements to qualify as a borrower for a 7(a) loan;
- Increases funding for traditional 7(a) loans by $17 billion;
- Increases the maximum loan amount of 7(a) loans to $10 million and reduces the applicable interest rates;
- Streamlined and reduced diligence requirements for lenders and borrowers;
- Provides subsidies and six months deferment for existing 7(a) loans; and
- Provides 100% loan guarantees through December 31, 2020

<u>CARES Act and the Paycheck Protection Program:</u>

The $2 trillion stimulus package allocates roughly $350 billion to guarantee loans for small businesses through the Small Business Administration (“SBA”) 7(a) loan program. The SBA currently guarantees approximately $25 billion in 7(a) program loans.

The CARES Act creates a new Paycheck Protection Program (the “Paycheck Program”) for the covered period of February 15, 2020 until June 30, 2020. Congress has the authority to increase the covered period until the end of 2020 if the need should arise due to the pandemic. The UST and SBA anticipates that the funding cap will be reached, and encourages applicants to apply as soon as possible.

<u>Characteristics of the Paycheck Program:</u>

While the Paycheck Program is still considered a 7(a) loan, loans made during this covered period will have different requirements and features than that of a traditional 7(a) loan. Loans under the Paycheck

Program are unsecured, with no collateral or personal guarantees in contrast with a traditional 7(a) loan. The maximum loan amount to each business is equal to the lesser of $10 million, or the average monthly payroll costs from the last year of the borrower multiplied by 2.5. New businesses may calculate the monthly payroll average as of January 1, 2020 through February 29, 2020 and highly seasonal businesses may calculate the average based using the 12 weeks beginning on February 15, 2019, or from March 1, 2019 to June 30, 2019. The interest rate will be a .50% fixed rate and there are no prepayment penalties or fees.

Small businesses and sole proprietorships can apply for and receive loans under the Paycheck Program starting on April 3, 2020 through existing SBA lenders. Independent contractors and self-employed individuals can apply starting on April 10, 2020 through existing SBA lenders. The UST has not stated when new lenders will be authorized to provide Paycheck Program loans. Each applicant can only file for one loan under the Paycheck Program.

Lenders will be compensated by the SBA based on the balance of the financing outstanding at the time of the final disbursement:

- Loans $350,000 and under: 5.00%
- Loans greater than $350,000 to $2 million: 3.00%
- Loans greater than $2 million: 1.00%

Lenders may also use agents to help facilitate the making of the loans. The agent’s fees will be paid out of the lenders fees as stated below:

- Loans $350,000 and under: 1.00%
- Loans greater than $350,000 to $2 million: .50%
- Loans greater than $2 million: .25%

Applicable Uses for Paycheck Program Funds:

The borrower will be able to use the proceeds of the funds for the following:

- Payroll costs, including benefits;
- Interest on mortgage obligations, incurred before February 15, 2020;
- Rent, under lease agreements in force before February 15, 2020; and
- Utilities, for which service began before February 15, 2020.

Payroll costs include:

- Salary, wages, commissions, or tips (capped at $100,000 on an annualized basis for each employee);
- Employee benefits including costs for vacation, parental, family, medical, or sick leave; allowance for separation or dismissal; payments required for the provisions of group health care benefits including insurance premiums; and payment of any retirement benefit;
- State and local taxes assessed on compensation; and
- For a sole proprietor or independent contractor: wages, commissions, income, or net earnings from self-employment, capped at $100,000 on an annualized basis for each employee.

Paycheck Program Loan Forgiveness:

The Paycheck Program also includes loan forgiveness for a portion of the loan based on certain expenses of the borrower paid during the eight weeks after the loan origination. The forgiveness is based on the sum of (i) payroll costs plus (ii) payment of interest on a mortgage plus (iii) rent and plus (iv) utility payments. The mortgage must have been in place on February 15, 2020. The available forgiveness is reduced if the number of employees and the amount of employee compensation declines during the course of the loan. The applicant has until June 30, 2020 to restore its full-time employment and salary levels for any changes made between February 15, 2020 and April 26, 2020 in order to avoid a reduction of the forgiveness amount. Furthermore, the UST has stated that it is anticipated that not more than 25% of the forgiven amount may be used to cover non-payroll costs due to high subscription. The goal of this 25% cap is to incentivize each borrower to properly allocate the forgiveness portion of the funds for use in employee retention, as opposed to other overhead costs. The purpose of the loan forgiveness is to incentivize businesses to retain employees and to encourage business to hire back previously fired employees. There is a limit if the borrower is also receiving an economic injury disaster loan (“EIDL”)[1] (discussed below).

The applicant will request the forgiveness amount from the lender servicing the loan. The forgiveness request must include documents that verify the number of full-time equivalent employees and pay rates, as well as the payments on eligible mortgage, lease, and utility obligations. The applicant must certify in good-faith that the documents are true and that the funds were used for the proper purposes. The lender must make a forgiveness decision within sixty (60) days of the request from the applicant.

A lender cannot sell a Paycheck Program loan on the secondary market until the loan forgiveness portion has been calculated. The SBA is looking to automate the calculation on the forgiveness amount in order for the SBA to quickly pay the lender the forgiveness portion and to allow them to sell the remainder of the loan on the secondary market. The SBA will not collect any fee for any guarantee sold into the secondary market.

Which Lenders are qualified to lend under the Paycheck Program:

Lenders already authorized to make loans under the existing SBA program are automatically authorized to provide loans under the Paycheck Program subject to accepting the terms and conditions established by the UST. Any federally insured depository institution, federally insured credit union, and Farm Credit System institution may also participate in the Paycheck Program.

Lenders not so authorized can still apply to the UST to participate in this new program. The SBA has stated that these terms and conditions will be published shortly after the Act is signed into law. The lenders will submit their applications to DelegatedAuthority@sba.gov once these applications are published.

Who Qualifies as a Borrower for the Paycheck Program?:

The Paycheck Program applies to businesses, not-for-profits and veterans organizations that were in operation on February 15, 2020 and had employees or independent contractors. The Paycheck Program covers business with 500 or fewer employees, subject to various exceptions. Sole proprietors and the self-employed are also eligible. The applicant, along with each 20% or greater owner, must certify in good faith that the business meets all requirements for the loan and will use the proceeds for their applicable purposes.

[1] If the economic injury addressed by the EIDL is unrelated to Covid-19, the borrower can also apply for a Paycheck Protection Program loan.

An applicant's employee count includes the employees of their affiliates as well. The SBA affiliation rules remain mostly unchanged by the CARES Act. However, the Paycheck Program waives the application of the affiliation rules for three types of applicants:

1. Any business concern with no more than 500 employees and that is assigned a NAICS code beginning with 72;
2. Any business concern operating as a franchise that is assigned a franchise identified code by the SBA; and
3. Any business concern that receives financial assistance from a company licensed under section 301 of the Small Business Investment Act of 1958.

The size standards aggregate all entities that share 50% common control under traditional SBA 7(a) affiliation rules. Hospitality and restaurant businesses, franchises, and recipients of Small Business Investment Company (SBIC) investment have statutory exceptions. Franchises and hospitality businesses with multiple locations are tested by a 500 employee per location standard. Any business that receives SBIC financial assistance satisfies the size restriction.

The Paycheck Program does not require the standard "Credit Elsewhere" test that traditional 7(a) loans require. This means the borrower does not have to prove that they are unable to receive credit from another institution in order to qualify for the Paycheck Program. The borrower must certify, in good faith, that their business requires the loans to continue operation during the pandemic, that the funds will be used for the stated purpose of payroll preservation and maintaining operation, and that the borrower does not have any other application pending under the Paycheck Program.

Streamlined Loan Diligence Procedures:

The SBA has announced that it will relax certain procedures in the loan origination diligence period to get money to borrowers faster. The SBA is currently working on new loan diligence forms for both the lender and the borrower. These forms will require less information in order for the loan to be originated and the lender to receive an SBA loan number. The SBA will continue to use their existing forms (form 1919 and 1920) for loan diligence for the time being, but will abbreviate the amount of information required through posted guidance.

The applicant will need to complete the Paycheck Program loan application and submit the application with the required documentation to the lender. This application must be processed by the lender by June 30, 2020. The applicant must also provide payroll documentation to the lender to verify the application.

Subsidy and Deferment for Existing 7(a) Loans:

The SBA is currently expanding the deferment procedures for both existing 7(a) loans and new loans under the Paycheck Program. The SBA will pay the principal, interest and any fees on certain existing 7(a) loans for a six-month period starting on the next payment due date. Loans currently in deferment will include an additional six months of payment by the SBA beginning with the next payment.

All payments under the Paycheck Program are deferred for six (6) months. However, interest will accrue during this deferment period.

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