## Paycheck Protection Program | Section 7(a) SBA Loans authorized by the CARES Act

The H.R. 748, the Coronavirus Aid, Relief and Economic Security Act (the "***CARES Act***") is now law, after the President signed on March 27, 2020. Among other stimulus relief, the CARES Act authorizes $349b in forgivable Section 7(a) SBA loans under the "***Paycheck Protection Program***", which loans would be issued by qualified SBA lenders. The Small Business Administration ("***SBA***") will be issuing guidance and rules in the coming days or weeks that will permit small businesses to obtain these loans to fund their payroll and other expenses.

This Paycheck Protection Program is separate from and in addition to the SBA's Economic Injury Disaster Loan Program ("***EIDL***") passed in connection with the Families First Coronavirus Response Act, as described in our client alert. Businesses will be eligible to borrow under both the EIDL program and to refinance their EIDL loans through Paycheck Protection Program Section 7(a) Loans. This is a huge loan program and a massive subsidy to small businesses. For context, SBA loans of any type totaled $29b in FY2019.

### Executive Summary of the Paycheck Protection Program

- $349b in authorized Section 7(a) SBA loans, to be issued directly by banks and 100% guaranteed by the SBA.
- Businesses with fewer than 500 full or part time employees will be eligible, with higher employee limits for hotels, restaurants and other industries approved by SBA.
- No personal guaranties or collateral.
- Loan amounts will be 2.5 times avg. monthly payroll costs, up to a $10m cap.
- Interest is capped at 4% and payments of principal and interest deferred for 6 months.
- Loans will be forgiven in an amount equal to 8 weeks of payroll, mortgage, rent, and utility expenses, with the amount of forgiveness reduced if employee headcount or compensation is decreased.

### Program Overview

The Paycheck Protection Program operates as a form of subsidy equal to 2.5 months of payroll costs for small business. Early indications are that demand for these loans will be very high because of the financial need in this current economic climate and the favorable terms of the loans. The Section 7(a) SBA loan program has been used as a framework for issuing loans in the Paycheck Protection Program, but many of the traditional limitations of a Section 7(a) loan have been done away with – for example, lenders will not be required to obtain SBA approval of a credit determination, borrowers will include many companies that would not be "small business concerns" typically eligible for a 7(a) loan, and there are no personal guaranty or collateral requirements. Lenders will be incentivized to issue loans; the SBA will reimburse processing costs at a rate between 2% and 5% of the principal amount of the loan, with the rate dependent on the size of the principal.

Eligible Borrowers. Borrowers eligible for Paycheck Protection Program loans include all "business concerns" with fewer than 500 employees. All borrowers will need to have been actively conducting a trade or business on February 15, 2020, and must be able to demonstrate that the borrower had incurred payroll costs or 1099 payment obligations at that time.

Other types of eligible borrowers are as follows:

- Businesses with more than 500 employees operating primarily in NAICS Codes starting in 72 (i.e. restaurants, hotels and casinos) are also eligible so long as not more than 500 employees work at any single location.
- Other industries may be subject to employee caps greater than 500, as determined by the SBA.
- Independent contractors, self-employed persons or sole proprietorships.
- 501(c) nonprofits.
- Veterans' organizations or Tribal business concerns.
- Any other "small business concern" which otherwise would be eligible for a Section 7(a) loan.

The attribution rules of 13 CFR 121.103 may in some circumstances limit eligibility for these loans to the extent that "affiliates" of a borrower may be aggregated for purposes of determining the number of the business concern's employees. Affiliates generally include businesses under common control with a borrower, and control may result from the power to direct management of the borrower, or in the negative, such as an investor who has the right to prevent a borrower from taking action under the terms of borrower's charter, bylaws, or other agreements among the owners of the borrower. The attribution rules will not apply to those businesses with NAICS codes starting with 72 (hotels, restaurants, or casinos), or those with existing financing from a Small Business Investment Company ("***SBIC***").

Loan Certification. Borrowers will not need to make any special showing of economic necessity to obtain a loan, and the "no credit elsewhere" rules have been waived for these loans. Borrowers will need to supply a written certification in good faith including the following items:

- The uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient;
- Acknowledging that funds will be used to retain workers and maintain payroll or make mortgage, payments, lease payments and utility payments; and
- Eligible recipient does not have an outstanding loan or pending application for a loan under this subsection for the same purpose and duplicative amounts.

Eligible Loan Amount. The maximum loan amount under the Payroll Protection Program is equal to 2.5 times the borrower's average monthly payroll costs, up to a $10m cap. The average payroll costs will be calculated from the 1 year period preceding loan origination, except that seasonal employers may elect a different testing period. Payroll costs include salary, wages, commission, paid leave, allowance for dismissals, benefits, and state or local taxes plus any 1099 payments to independent contractors not in excess of $100k annually. Payroll costs exclude compensation to any single employee or independent contractor in excess of $100k annually and any payments to persons that are not US residents. An eligible borrower may also increase the amount borrowed under a Paycheck Protection Program loan to pay off an outstanding EIDL (made under Section 7(b)(2) of the Small Business Act) that the borrower wishes to refinance.

Uses of Borrowed Funds. While loan eligibility is based solely on payroll costs, funds may be used to pay employee or contractor compensation (even in excess of $100k), plus mortgage, rent, utility expenses and payments on indebtedness incurred prior to date of issuance.

Interest and other Payment Terms. Interest is capped at 4%. Borrowers may defer payments on these loans for the six (6) month period commencing on the origination date. SBA loan fees have also been waived. Borrowers may elect to refinance any EIDL loan by obtaining a Paycheck Protection Program loan.

Forgiveness. The loans would be forgiven in an amount equal to payroll, rent, mortgage interest and utility expenses for the 8 week period commencing at loan origination, up to the entire principal amount of the loan. The amount of the loan forgiven would be reduced under two circumstances:

- Forgiveness will be reduced at the ratio that (x) the borrower's average full-time employee headcount during the 8 week period following loan disbursement bears to (y) the average number of full-time employees during the period between Feb 15, 2019 – Jun 30, 2019 or, if elected by the borrower, Jan 1, 2020 – Feb 29, 2020. The average will be based on the number of employees included in each pay period.
- Forgiveness will be reduced on a dollar for dollar basis by reductions to compensation in excess of 25% for any employee earning less than $100k annually.

Borrowers who have already reduced employee headcount or compensation after February 15, 2020 will be able to eliminate the effects of any reduction to loan forgiveness eligibility if the number of employees or compensation reductions are returned to February 15 levels on or before June 30, 2020.

To obtain forgiveness, a borrower will need to provide the following documentation:

- Payroll tax filings
- State income, payroll and unemployment insurance filings
- Documentation verifying mortgage, rent, or utility payments, such as cancelled checks payment receipts, transcripts of accounts or other documents

The borrower will also certify that the documentation provided is true and correct and that the proceeds of the loan were used to pay payroll costs, rent, mortgage payments or utilities.