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CARES Act:
Small Business Administration (SBA) Provisions

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Government Contracts

The Coronavirus Aid, Relief, and Economic Security (CARES) Act opens up new Small Business Administration (SBA) loan opportunities to support many companies and nonprofit organizations with 500 or fewer employees. In response to the COVID-19 outbreak, the Act significantly expands the reach of traditional SBA 7(a) loans by providing $349 billion to guarantee private Paycheck Protection Loans (PPLs) that cover an average of 2.5 months of payroll costs for businesses in response to COVID 19 up to $10 million. The Act also expands the Economic Injury Disaster Loan (EIDL) program to similarly increase eligibility and provide the opportunity to obtain a $10,000 advance when applying for these loans to provide immediate support for businesses in need.

The details of these programs will still need to be clarified in a number of ways by guidance that is expected from the SBA in the coming days and weeks. Particular industries, such as the accommodations and food services industries, have new eligibility provisions that provide additional opportunities to apply for loans. However, in some cases, it is potentially unclear how Congress intended for affiliates to be considered when evaluating loan eligibility. Nonetheless, companies and nonprofit organizations that may be eligible for these loans can take steps now to ensure they receive much needed support for operating costs and ultimately benefit from forgiveness and other provisions associated with these loans.

Companies may seek both PPLs and EIDLs at the same time, as they are intended to be used for different purposes. However, receiving an EIDL can reduce the amount available under a PPL. Specific information is provided on each loan program below, and updates will be forthcoming as new guidelines become available in the coming weeks.

Payment Protection Loans (PPLs)

Eligibility

PPLs are generally intended to support payroll costs for businesses and non-profit organizations, with 500 or fewer employees (including full-time, part-time, or other status and with a higher threshold applicable in some industries), traditionally defined small businesses, self-employed individuals, and independent contractors that were in operation as of February 15, 2020. However, PPLs can also be used for mortgage interest, rent, and utility payments; interest payments on any other debt obligations that were incurred before February 15, 2020; and, in part if authorized by loan documentation, traditional 7(a) expansion activities. Payroll
costs include salaries, wages, and tips; paid sick or medical leave; dismissal and separation allowances; health benefits and insurance premiums; retirement benefits; and state and local payroll taxes (based on the text of the Act, likely excluding federal income tax withholding and FICA, and all pro-rated from February 15, 2020 to June 30, 2020 for individuals making over $100,000 per year, and separately excluding employees living outside the United States).

Although some details remain outstanding, in addition to traditionally defined small businesses, other entities have been provided with access to PPLs:

- **“Any Business Concern”**: The Act makes “any business concern” with 500 or fewer employees eligible for a PPL, and a higher threshold can apply depending on a concern’s industry. The Act differentiates between these types of concerns and traditionally defined small businesses, which suggests that a company can qualify based on having 500 or fewer employees alone without having to count the employees of affiliates. However, the Act separately indicates that affiliation rules do not apply for companies in the accommodations and food services industries—and that these rules continue to apply to nonprofit organizations—which could raise questions about whether the rules apply to a generic “business concern” compared to a traditionally defined small business.

- **Members of the Accommodations or Food Services Industries with NAICS Code Sector 72 Classification**: Business concerns in the accommodations or food services industries, such as hotels and restaurants, with a NAICS Sector 72 classification are also eligible for PPLs when they have multiple physical locations and 500 or fewer employees at each location. The text of the Act expressly waives affiliation rules for these types of businesses when they have 500 or fewer employees—without reference to location—which may significantly undermine the intent of the specialized per-location eligibility standard as many businesses in the accommodations and food services industries have affiliates that could have their employees counted when evaluating the eligibility of businesses with 500 or fewer employees at each location, but more than 500 employees across all locations. Businesses that separately incorporate at each location may be less impacted by this potential oversight, although there could still be questions about whether any PPLs extended to their affiliates should be considered when determining the value of their own PPL. Additional questions also continue to exist with respect to how to handle temporary employees; employees that are technically employed by an operating company, affiliate, or professional employer organization; and employees paid for by passive leasing organizations.

- **Eligibility for Franchises and SBIC**: The Act waives affiliation requirements for business concerns operating as franchises registered with the SBA and business concerns that receive financial assistance from Small Business Investment Companies or “SBICs.” As a result, these organizations clearly do not need to count the employees of their affiliates when evaluating their eligibility.

- **Nonprofits**: 501(c)(3) and (c)(19) nonprofit organizations are eligible for PPLs. The Act expressly states that affiliation rules apply to these entities for eligibility purposes as they were traditionally defined small businesses.
Loan Terms
The maximum loan amount is calculated based on the average of 2.5 months of payroll costs with a $10 million cap and special rules for seasonal employers and recently formed companies. The maximum interest rate is 4.00%, and the maximum term is approximately 10 years. Lenders must defer payments on any principal or interest for at least 6 months and up to one year. There is no upfront obligation to obtain a loan, such as collateral or fees, and there is no personal recourse against the borrower unless the loan proceeds are used for unapproved purposes. There is no prepayment penalty.

Loan Forgiveness
- **General Terms:** With appropriate documentation, loan proceeds can be forgiven to the extent that they are used for payroll (including certain benefits), mortgage interest, rent, and utilities. The forgiven amount cannot exceed the principal and is limited to payroll costs incurred and mortgage interest, rent, and utility payments made during the 8 weeks following loan approval. A portion of payments made to employees that receive annual salary over $100,000 cannot be forgiven.

- **Adjustment for Reduction in Employees or Salaries:** The forgiven amount will be reduced proportionately if a recipient’s average full-time equivalent employees from February 15 through June 30, 2020 is lower than the corresponding period in 2019, or the first 2 months in 2020, with non-seasonal employers being able to choose between the two latter periods for comparison. A similar reduction applies when an employee earning an annual rate of pay of $100,000 or less in 2019 has his or her compensation reduced by more than 25 percent as compared to the most recent full quarter of his or her employment before February 15, 2020. The full forgiveness amount from February 15 through April 26, 2020 will be available if there is a reduction in a recipient’s average full-time equivalent employees during this period, but the recipient’s employee count later returns to the same employment figures by June 30, 2020. Similarly, the full forgiveness amount will be available if a recipient corrects a reduction in the compensation of one or more employees in the same periods. This correction would not impact any reductions from April 27 through June 30, 2020.

Economic Injury Disaster Loans
Emergency loans of up to $2 million under the SBA’s Economic Injury Disaster Loan (EIDL) Program are also available with new terms. Eligible entities may apply for both a PPL and EIDL; however, loan proceeds may not be used for duplicative purposes. If a borrower receives a $10,000 EIDL advance as well as a PPL, the advance reduces the amount of the PPL that is ultimately forgiven.

Eligibility and Application Requirements
In addition to traditionally defined small businesses, and already eligible private nonprofit organizations, EIDLs are available to businesses, cooperatives, employee stock ownership plans, and tribal small business concerns with 500 or fewer employees, as well as some individuals who operate under a sole proprietorship, act as independent contractors, or are self-employed. Similar to business concerns that are eligible for PPLs, there are outstanding questions as to whether affiliation rules apply to newly eligible entities that are distinguished in the Act from traditionally defined small business concerns.
**Application Requirements:** Applicants must submit an application from January 31 to December 31, 2020 and be in business as of January 31, 2020.

Small business owners in all U.S. states and territories are currently eligible to apply for an EIDL due to COVID-19 and are not required to show they are unable to obtain credit elsewhere.

For loans of up to $200,000, applicants will not be required to provide a personal guarantee.

**Loan Terms & $10,000 Advance**

- **Loan Terms:** The current maximum loan amount for EIDLs is $2,000,000, and the interest rate cannot exceed 4.00%. EIDLs over $25,000 generally are expected to be secured by personal or business assets but cannot be denied solely on the failure to provide collateral. An applicant’s creditworthiness will be determined based solely on one’s credit score without reviewing prior tax returns.

- **$10,000 Advance:** Applicants may request and receive an advance of up to $10,000 prior to the determination of whether the applicant is eligible for the full EIDL, which may be used to provide paid sick leave to employees who are unable to work due to COVID-19, to maintain payroll to retain employees during business disruptions or substantial slowdowns, or certain other purposes. The advance does not need to be repaid even if the EIDL application is subsequently denied. The request for an advance is expected to be processed within three days. Any amount that is obtained through an advance will reduce the amount that could otherwise be forgiven under a PPL.

- **Loan Forgiveness:** There is no forgiveness associated with EIDLs.

**Allowable Uses of EIDLs**

Applicants may use EIDLs for ordinary and necessary operating expenses based on their actual economic injury and financial needs.

However, EIDLs cannot be used to:

- refinance indebtedness incurred prior to the disaster event;
- make payments on loans owned by a federal agency or a Small Business Investment Company;
- pay any civil or criminal fine or penalty;
- repair physical damage;
- pay dividends or other disbursements to owners, partners, officers or stockholders, except for reasonable amounts directly related to their performance of services for the business; or,
- expand facilities or acquire of fixed assets.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our firm:

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