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CARES Act Expands SBA Loan Programs to Offer Relief for Small Businesses During the COVID-19 Pandemic



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Small businesses looking for an economic lifeline as a result of losses due to the COVID-19 pandemic have several loan programs they may be able to tap for help, thanks to the stimulus package signed into law last Friday, March 27, 2020. The \$2 trillion bill offers \$349 billion in specific relief for small businesses – including loan forgiveness. This historic bill adds to the already-existing Small Business Administration (SBA) disaster loan program available at low interest rates.

In most cases, small businesses are defined as having 500 or fewer employees. Companies in a wide variety of industries – real estate, retail, restaurants, hospitality, manufacturing and professional services, to name a few – will be able to take advantage of these programs and receive much-needed capital relatively quickly.

Navigating the various eligibility requirements, let alone deciding what might be most beneficial to your business, may be tricky. For example, while businesses may be able to take advantage of more than one loan program, doing so may affect the amount of loan forgiveness available. Additionally, businesses must prepare to provide a myriad of information to lenders. This overview can help you evaluate your options and form a strategy.

If you have any questions or want to discuss these matters further, please don't hesitate to contact the Gould & Ratner attorney with whom you work regularly, or any of the lawyers in our [Coronavirus/COVID19 Resources Team](#).

CARES Act Relief

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) has several potential benefits for your small business, wrapped into \$349 billion of relief.

Highlights of the small business relief options in the CARES Act include:

- A "Paycheck Protection" program that features loan amounts up to \$10 million that cover previously off-limits expenses, including salaries and rent
- Loan forgiveness for business expenses in the first eight weeks of loans to certain borrowers
- Subsidies for some existing SBA loans
- Expanded and/or relaxed terms for certain new SBA loans

It is worth noting that while Treasury Secretary Steven Mnuchin has stated that loan applications should be able to be processed and approved within 1-2 days of submission, many experts have cautioned it may take 1-2 weeks now that the CARES Act is enacted before the loans are available to small businesses.

“Paycheck Protection” Loans

The CARES Act temporarily modifies the SBA’s primary loan program, called “Section 7(a) Loans,” into a “Paycheck Protection” program. Under the CARES Act guidelines, small businesses would apply for loans from SBA-approved private lenders like banks, with the loans guaranteed 100% by the SBA. Loan forgiveness for up to eight weeks between Feb. 15 and June 30, 2020, for specific operational expenses is the hallmark of the program and further detailed below.

Loan Terms

These loans will be negotiated through your private lender, but with the following restrictions as set forth in the CARES Act:

- A maximum loan amount of \$10 million, but limited to 2.5 months of average regular payroll expenses over the past year (or a lesser amount of time for new and seasonal businesses), subject to a cap of a \$100,000 of annual salary per employee
- Ability for small business to cover expenses normally not allowed by the SBA, including salaries, leave costs, rent/mortgage payments, utilities, insurance premiums and other debt obligations
- No personal or collateral guarantee will be required
- Interest rate cannot exceed 4%
- All payments (principal and interest) can be deferred at least six months and up to a year
- Term of the loan can be up to 10 years, with no prepayment penalty
- Borrower and lender fees are waived, as is the lack of “credit elsewhere” test

Eligibility – Size of Business

For most small businesses, the CARES Act Paycheck Protection program covers businesses with 500 or fewer employees that were in operation as of Feb. 15, 2020, and had employees or independent contractors. For some industries, however, the number of workers allowed for qualification may be higher or lower, depending on the SBA’s size standards. For example, affiliates of larger companies in the restaurant or hotel industry may qualify for loans not available to affiliates of businesses in other industries due to a provision that they qualify so long as physical locations do not have more than 500 employees each. Businesses are advised to review specific size qualifications with the SBA, a qualified lender or an attorney before proceeding with an application.

Eligibility – Affiliation Rules Apply

The CARES Act only exempts certain industries from the SBA’s “affiliation rules.” Generally, companies must include certain affiliates in determining whether they qualify as a small business. The SBA states: “Affiliation with another business is based on the power to control, whether exercised or not. The power to control exists when an external party has 50 percent or more ownership. It may also exist with considerably less than 50 percent ownership by contractual arrangement or when one or more parties own a large share compared to other parties.” A business that is wholly owned or substantially owned by investment companies or development companies that are licensed or qualified under the Small Business Investment Act of 1958 (SBIA), are not considered affiliates of those investment companies or development companies.

For example, if you own 10 hotels or 20 restaurant franchises – two specific industry sectors exempted from affiliation rules under the CARES Act – and your combined revenue exceeds \$10 million, you would not have to aggregate affiliate ownership and could apply for loans on a location-by-location basis as if their owners were not the same.

The SBA’s traditional affiliation rules threaten to leave out private-equity owned companies and startups where venture capital firms control 50% of the voting stock, among others. Absent future guidance providing leniency for these scenarios, these companies may be ineligible for CARES Act relief (and other SBA loans). We will continue to monitor for additional clarification.

Loan Forgiveness for Initial Eight Weeks

In general, the loan principal under the Paycheck Protection program can be forgiven for the amount spent on a borrower's payroll costs, including wages, tips, paid and sick leave, allowance for dismissal or separation, healthcare premiums, retirement benefits, rent or mortgage interest, utilities and some other covered expenses during an 8-week period after the loan's origination (the covered period). As an added bonus, the amount of money forgiven will not be taxed as income.

Not surprisingly, the program has several requirements and restrictions. For example, if an employer lays off workers or reduces total wages and salaries by more than 25% during the covered period, the amount of the loan forgiven is reduced by that percentage. In the case of employee count, the SBA will look at an employer's average of full-time employees historically and compare to the covered period. The CARES Act permits the employer to choose between comparing covered employees with the average number of full-time employees between Feb. 15 – June 30, 2019, or the number of full-time employees between Jan. 1 – Feb. 29, 2020. If the employer's full-time employees are fewer than during the comparison period, loan forgiveness will reduce by that ratio. However, this penalty can be avoided by employers rehiring laid off workers during this time. In addition, the amount of payroll costs for any individual employee's salary that is greater than \$100,000 will not be forgiven.

Another caveat for the Paycheck Protection loan forgiveness program involves timing and which SBA loan program is used to pay eligible expenses. In short, expenses paid with funds from other SBA loans do not appear eligible for loan forgiveness under the CARES Act. For example, if you already have an existing Section 7(a) loan or an SBA disaster loan, and you use its proceeds to cover April 2020 rent and utilities prior to your Paycheck Protection loan origination on April 15, those previously paid monthly April expenses would not be eligible for loan forgiveness, even though they partially apply to a portion of the covered period. However, if you have applied but are waiting for approval for an SBA disaster loan, you are free to reject it in full, or decrease the amount, once you are approved.

The loan forgiveness program has additional restrictions on what is covered, and we expect further guidance from the SBA and/or Treasury Department in the coming days. Close attention to accurate recordkeeping, as well as detailed accounting, will be required to take advantage of the program. Of course, quick access to your payroll records to determine your full-time employee count (as well as your expenses) is critical.

How to Apply

A covered employer must apply through a private lender, not the government. At a minimum, applications will require documentation verifying full-time employees on your payroll and their wages, including taxes and unemployment filings. Employers should also prepare records verifying other debts, including mortgage and rent.

Given the high volume of applications expected, we recommend working initially with an SBA-approved lender that knows you, values your client relationship and may already have access to some of your financial records needed for the loan. This may help streamline the application process, which likely will take longer than expected given the program's new terms and benefits.

The CARES Act requires that the SBA issue regulations within 15 days of its enactment. As lenders need regulations to ensure the loans are actually backed by the government, we anticipate loans will not be available before mid-April, a sentiment echoed last week by Secretary Mnuchin.

Current Section 7(a) Loans

If you have an existing Section 7(a) loan in good standing, the CARES Act provides funds to help the SBA pay your principal, interest and fees for six months, starting on your next payment due date. If your loan is currently deferred, you would be eligible for a six-month payment subsidy beginning when your loan's deferment ends.

SBA Economic Injury Disaster Loan Program (EIDL)

The other primary SBA loan program available for small businesses during the COVID-19 pandemic is its Economic Injury Disaster Loan Program (EIDL), which offers capital loans up to \$2 million for qualifying businesses for ongoing costs associated with operations, payroll, and debt. The CARES Act added an additional \$562 million for SBA disaster loans in response to COVID-19,

including but not limited to EIDLs, and it expanded the EIDL Program.

The disaster loan has no cost to apply, and no obligation to accept if approved. While these loans may provide some immediate relief to businesses affected by the COVID-19 pandemic, it is important to understand the terms and implications of these to see if it the best option for your business.

EIDL Emergency Grants

Applicants for EIDLs are now also eligible for emergency grants under the CARES Act – you may receive an advance of up to \$10,000 within 3 days of receipt of your applications. This grant may be used for any purpose that an EIDL could be used, including

- providing paid sick leave to employees unable to work due to the direct effect of the COVID–19
- maintaining payroll to retain employees during business disruptions or substantial slowdowns
- meeting increased costs to obtain materials unavailable from the applicant's original source due to interrupted supply chains; making rent or mortgage payments
- repaying obligations that cannot be met due to revenue losses

You will be required to certify under penalty of perjury that you are an eligible entity (discussed below).

These emergency grants are not subject to repayment, even if your loan request is denied. If you receive this grant and either transfer into or get approved for a Paycheck Protection loan, the advanced amount will be reduced from the loan forgiveness amount of your Paycheck Protection loan.

Eligibility

The CARES Act has made EIDLs available nationwide by providing that a nationally declared emergency is a trigger for the EIDL Program. In addition, it expanded the meaning of “eligible entity” during the covered period (Jan. 31, 2020, through Dec. 31, 2020) to include:

- a business concern having not more than 500 employees;
- a sole proprietorship or an independent contractor;
- a cooperative with not more than 500 employees;
- an ESOP with not more than 500 employees; or
- a tribal business concern with not more than 500 employees.

In addition, small businesses may qualify for the program under the eligibility standards in effect before the CARES Act's expansion of this standard. This determination is generally done by considering your revenues and number of employees, with regard to your business's industry. The SBA's [Table of Size Standards](#) can assist you in determining if you qualify as a small business. There is also an “alternative size standard” based on the owner. Namely, if the owner's tangible net worth is less than \$15 million and the annual revenues of the business are not in excess of \$5 million, this can be an alternate standard to classify the business as a small business.

The EIDL Program requires that you show (i) that the COVID-19 pandemic has resulted in your economic injury or hardship, and (ii) how you expect it to continue to impact your business for the next 6 months.

Lastly, note that if you had a previous disaster loan and currently have a loan of \$5 million on a more conventional SBA loan, you may nonetheless qualify for this disaster loan. However, if your business receives more than one-third of its revenues from gambling, you are not eligible. Likewise, agricultural enterprises, religious organizations, charitable organizations, and businesses whose primary business purpose is gambling (e.g., casinos and racetracks) are not eligible. Small agricultural cooperatives, small business engaged in aquaculture, or private non-profit organizations may be eligible, assuming they meet the other criteria detailed above.

Uses of EIDL

These loans are meant to “offer an affordable way for individuals and businesses to recover from a declared disaster.” Accordingly, the loans can be used for ongoing payroll and other business expenses, such as accounts payable and supply chain disruption expenses. The loans should not be used for business expansions or as a substitute for lost profits or sales.

Terms of Loans

Small businesses can seek to borrow up to \$2 million, with the goal of keeping their business solvent. The loans can be disbursed gradually or in a lump sum. The loans are offered at a 3.75% interest rate, with terms up to 30 years (though the default term is 15 years). Payments on the loans can be (and are generally automatically being) deferred for 12 months from the date of the loan close. There are, however, no prepayment penalties. In addition, borrowers can return to their applications and amend to increase or decrease the amount requested before funding. Borrowers are encouraged to be specific about the amount they seek, with projections showing why such amounts are necessary to keep the business afloat.

Under the EIDL Program, loans up to \$25,000 are unsecured, and loans exceeding this amount require collateral, including a personal guaranty or a mortgage on a personal home or investment property. However, lack of collateral is not a reason for declining the loan application. Thus, you should nonetheless consider applying even if you don't have sufficient collateral to secure amounts sought. Further, if the business is owned by another business or entity, the SBA will require a personal financial statement (and corresponding pledge of personal assets) from the individual(s) who ultimately own the business.

For loans made before Dec. 31, 2020, due to COVID-19, the CARES Act is waiving personal guarantees on loans below \$200,000. The CARES Act also waived the requirement that an applicant must not be able to obtain credit elsewhere, as well as the requirement that an applicant have been in business for the 1-year period prior to the disaster.

How to Apply

Potential borrowers are encouraged to apply online at <https://disasterloan.sba.gov/ela>, though applications can be completed by mail as well. Be patient – given the volume of applications, the SBA website is experiencing some technical issues.

The CARES Act permits the SBA to approve EIDLs based solely on an applicant's credit score or “use alternative appropriate methods to determine an applicant's ability to repay.” As a result, you should nonetheless be prepared to provide the following to the SBA with your application:

- Federal tax returns from business, principals, managing members and affiliates. Any owner(s) who owns 20% or more may be required to provide their most recent federal income tax return;
- Complete copies of most recent business income tax return, with all schedules and attachments. If you have completed your 2019 business income tax returns, you should use that. If you have not completed it, be prepared to provide profit and loss statements and balance sheets for both 2019 and 2020;
- Complete schedule of liabilities;
- Complete personal financial information; and
- Most recent sales information.

Additional information may be required by the underwriter. Should you require assistance, you can call district offices at 1-800-659-2955 or email them at disastercustomerservice@sba.gov.

Once your application is completed, the SBA's goal is to reach a decision within 2-3 weeks, with disbursement of funds one week thereafter.

Other Options

Speak to your bank to see what, if any, other options you may have. Many banks may be willing to consider deferment of interest payments or offer short-term bridge-loans to existing clients.

The SBA also offers an **Express Disaster Bridge Loan**, which permits small businesses that currently have a business relationship with an SBA Express Lender to access up to \$25,000 with less paperwork. These bridge loans are meant to address the urgent need for cash while waiting for a decision and disbursement of your EIDL, and will be paid in full or part by proceeds from your EIDL loan.

Separate from the CARES Act, the Federal Reserve on March 23, 2020, announced that it expects to establish a **Main Street Business Lending Program** soon "to support lending to eligible small-and-medium sized businesses, complementing efforts by the SBA." The CARES Act supports the establishment of such a program.

If you are small business in Chicago, you may also be eligible for assistance through the [Chicago Small Business Resiliency Fund](#), which was established to provide neighborhood businesses impacted by the COVID-19 health crisis with emergency cash flow via low-interest loans with up to a 5-year maturity. To qualify, your business must have:

- experienced more than a 25% revenue decrease due to the impact of COVID-19;
- fewer than 50 employees; and
- gross revenues less than \$3 million.

The City of Chicago will begin to accept applications starting on March 31, 2020.

In Illinois, the Department of Commerce & Economic Opportunity has announced the **Hospitality Emergency Grant Program**, the **Illinois Small Business Emergency Loan Fund**, and the **Downstate Small Business Stabilization Program**. Information on these programs can be found [here](#).

If you are outside Illinois, many cities and states are offering their own emergency relief programs for local small businesses. Make sure to consider those in addition to the SBA loan, and check with your trade organization for any loans specific to your industry.

If you have any questions or want to discuss these matters further, please don't hesitate to contact the Gould & Ratner attorney with whom you work regularly, or any of the lawyers in our [Coronavirus/COVID19 Resources Team](#).

Additional Resources

- [U.S. Senate Committee on Small Business & Entrepreneurship, The Small Business Owner's Guide to the CARES Act](#)
- [SBA Coronavirus \(COVID-19\): Small Business Guidance & Loan Resources](#)
- [SBA, The Three Step Process: Disaster Loans](#)
- [SBA Small Business Training Presentation Slides, Economic Injury Disaster Loans For Coronavirus Related Economic Disruptions](#)
- [SBA Express Bridge Loans](#)
- [SBA Handout, Small Business Compliance Guide: Size and Affiliation](#)
- [U.S. Chamber of Commerce Coronavirus Emergency Loans – Small Business Guide and Checklist](#)
- [Women's Business Development Center, WBDC Checklist for U.S. Small Business Administration Economic Injury Disaster Loan Program](#)
- [Women's Business Development Center, WBDC Application Guide for SBA Economic Injury Disaster Loans](#)