

Insights

WHAT BUSINESSES AND LENDERS NEED TO KNOW ABOUT THE CARES ACT AND THE PAYCHECK PROTECTION PROGRAM

Apr 22, 2020

SUMMARY

The Coronavirus Aid, Relief, and Economic Security, or “CARES Act”—the third emergency bill that Congress has prepared in response to the Coronavirus (COVID-19) pandemic—was signed into law Friday, March 27, 2020. BCLP lawyers have analyzed the law, including its provision for a Paycheck Protection Program (PPP), and have been advising clients on what impact it may have on their businesses and whether those businesses may be eligible for assistance.

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The [U.S. Legislative Response to COVID-19](#) contained significant relief for small businesses, including \$349 billion in Small Business Administration (SBA) loan guaranties and subsidies and additional funding for SBA programs. Funding lapsed on April 16 when the original \$349 billion in appropriations was spoken for and the SBA put a halt to authorizing new loan applications. Congress is currently negotiating another coronavirus response bill in which more than \$300 billion will be added to the Paycheck Protection Program, and it is expected that small businesses will be able to submit applications again soon.

Highlights include:

- **Expansion of SBA’s 7(a) Loan Program to Support New “Paycheck Protection Program” Loans.**
The SBA’s existing 7(a) program will see:
 - Increase in maximum loan amount to \$10 million.

- Allowable uses expanded to include:
 - Payroll support (including salaries, benefits, and paid sick or medical leave);
 - Mortgage, rent and utility payments; and
 - Other debt obligations.

- **Loan Forgiveness.** Certain borrowers would be eligible for loan forgiveness equal to the amount incurred and spent during an eight-week period after the origination date of the loan on:
 - Payroll costs;
 - Interest payment on any mortgage in force before Feb. 15, 2020;
 - Rent on any lease in force before Feb. 15, 2020; and
 - Utilities for which service began before Feb. 15, 2020.

Borrowers must spend at least 75% of the loan on payroll costs. The amount forgiven would be reduced in proportion to any reduction in employees retained and to the reduction in pay of any employee beyond 25% of prior year compensation.

- **Subsidies for Certain Existing SBA 7(a) Loans.**

- **Special Terms.**
 - No personal or collateral guarantee will be required.
 - The eligible recipient does not have to certify that it is unable to obtain credit elsewhere.
 - Eligible borrowers must make a good faith certification that the loan is necessary due to the uncertainty of current economic conditions caused by COVID-19; that funds will be used for a permitted purpose; and that they are not receiving fund from another SBA program for the same uses.
 - Maximum term of loan is 2 years.
 - Interest rate cannot exceed 1%, but interest payments are deferred for six months.
 - No prepayment penalty.

Who Qualifies?

The CARES Act program covers business with 500 or fewer employees, unless the covered industry's SBA size standard allows more than 500 employees, which were operational on Feb. 15, 2020. The size standards are tested on an affiliate basis—combined with all businesses under common control (50% ownership or contractual control)—counting on an aggregate basis towards the size test, except for hospitality and restaurant businesses, franchises, and recipients of Small Business Investment Company (SBIC) investment. The program is available for employees whose principal place of residence is in the United States.

This means that the 500-employee threshold is measured for the certain excepted businesses in the hospitality and restaurant business, franchises, and recipients of SBIC loans on a location-by-location basis. For instance, a hotelier with more than 500 employees nationwide may seek loans for individual properties. Consultation with an attorney to determine how a loan request can be structured to ensure eligibility may be key.

Loan Forgiveness

Following a detailed application, the loan will be eligible for forgiveness in an amount (not to exceed the principal amount of the loan) equal to the sum of payroll costs, rent and utilities expenses, and interest payments on mortgages so long as any such lease, mortgage, or utility was in service **prior to** February 15, 2020 and, in each case, paid during the eight-week period commencing on the date of disbursement of the loan. Rental payment under a lease in effect as of January 1, 2020, would be eligible for forgiveness while rental payment under a lease effective as of March 15, 2020, would not.

Payroll costs include salary, commissions, wages, and “similar compensation,” as well as health and retirement benefits and state and local taxes. Payroll costs do not include FICA or federal withholding from the period of Feb. 15 through June 30, and they do not include compensation for salary above \$100,000 (exact calculation of what amounts above \$100,000 will be allowed will be more clear once the SBA promulgates regulations, which are expected about a week after the law's passage).

Loans will be made by lenders who are participants in the SBA's Section 7(a) program and those lenders will also decide whether to accept a borrower's application for forgiveness. Such decision must be made within 60 days of receipt of the application for forgiveness. Not later than 90 days after the loan forgiveness amount has been agreed by the lender, the SBA is authorized to reimburse the lender directly for the principal amount of any forgiven debt, plus interest accrued through the date of repayment.

The amount of any loan forgiveness will be reduced by any meaningful reductions in employee wages (in excess of 25% for any employee) or layoffs of employees during the covered period in accordance with the terms of the program. Borrowers that rehire workers previously laid off will not

be penalized for having reduced payroll at the beginning of the period. The forgiven loan will not be considered taxable income.

Any loan amount not forgiven is carried forward as an ongoing loan with a maximum term of 2 years and a maximum interest rate of 1%.

Detailed accounting and complete and accurate recordkeeping will be vital to taking advantage of these provisions.

Maximum Amount of Loan

The maximum loan amount is the **lesser of** \$10 million or the product obtained by multiplying average total monthly payments for payroll costs during the 1-year period before the loan application by 2.5. (Regulations have clarified that lenders can accept calculations based on the 2019 calendar year.) If average monthly payroll costs for the 12-month period were \$1.5 million (annual payroll costs of \$18 million), the maximum loan amount would be \$3,750,000. The loan can also include the outstanding amount of a loan made under the SBA's Economic Injury Disaster Loan Program between January 31, 2020, and the date on which such loan may be refinanced as part of this new program.

Allowance for New Lenders

The CARES Act allows the Department of Treasury to establish a process by which lending institutions that are not currently authorized to offer SBA loans will be able to participate during the declared national emergency.

Subsidy/Deferment for Existing Loans

The SBA will pay the principal, interest and any associated fees that are owed on certain existing 7(a) loans for a six-month period starting on the next payment due date. Loans already currently in deferment would include an additional six months of payment by the SBA beginning with the next payment. Loans made during this period until six months after the enactment of the legislation would also qualify for six months of deferral payment by the SBA. This does not apply for new "Paycheck Protection Program" loans made under the CARES Act.

Existing SBA Disaster Loan Program

In a [previous alert](#), we highlighted the SBA's disaster assistance loans that were made a part of Congress's second emergency bill, the Coronavirus Preparedness and Response Supplemental Appropriations Act signed into law on March 6, 2020. Under that law, the SBA expanded the ways in which businesses could apply for an Economic Injury Disaster Loan (EIDL).

Importantly, under the CARES Act, a borrower that receives a 7(a) loan for employee salaries, payroll support, mortgage payments and/or other debt obligations would not be able to receive an EIDL for

the same purpose, or co-mingle funds from another loan for the same purpose.

The EIDL program does have the benefit of establishing an emergency grant to allow an eligible entity to request an advance on the EIDL of up to \$10,000. An applicant would not be required to repay such an advance payment, even if it is subsequently denied an EIDL.

The programs discussed above, and other assistance programs being established throughout this pandemic, will have varying benefits and eligibility requirements. A business should carefully assess which of the new federal programs is most advantageous before applying and how best to plan for, apply to, and manage any loans received for the maximum benefit.

Other CARES Act Provisions Specific to Lenders

Bryan Cave Leighton Paisner's legislative affairs team has provided an overview of the CARES Act and other congressional emergency measures [here](#). A more in-depth look at CARES Act provisions relevant to lenders in general is available [here](#). The firm's continuing analysis of COVID-related legal issues is housed [here](#).

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