COVID-19 Relief: Understanding SBA Loan Opportunities Under the CARES Act

The CARES Act provides $350 billion for small business Paycheck Protection Loans and an additional $10 billion for the existing Economic Injury Disaster Loan program.

By Alexander B. Ginsberg, David B. Dixon, Jenny Y. Liu

TAKEAWAYS

口 Under the CARES Act, Congress has appropriated $350 billion for Small Business Administration (SBA) Paycheck Protection Loans of up to $10 million to small businesses impacted by COVID-19.

口 The Act also appropriates $10 billion for SBA Economic Injury Disaster Loans of up to $2 million to small businesses impacted by natural disasters—now including the COVID-19 pandemic—and modifies this program.

口 The Act allows a company that already has an Economic Injury Disaster Loan to apply for a Paycheck Protection Loan if it will not duplicate the applicant’s use of the Economic Injury Disaster Loan. Applicants should approach this issue with caution.

03.27.20

On March 11, 2020, President Trump announced in a national address that the SBA would be making $50 billion in low-interest loans available to small businesses impacted by the COVID-19 pandemic. The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) greatly exceeds the President’s initial pledge by appropriating $350 billion for “Paycheck Protection Loans” for small businesses—including up to $10 million per company for companies with fewer than 500 employees. The Act also makes $10 billion available to the SBA’s existing Economic Injury Disaster Loans for companies impacted by COVID-19, and modifies the rules for those loans is several ways. At the time of this publication, the CARES Act (H.R. 748)
has been passed by both chambers of Congress and is expected to be signed by President Trump on March 27, 2020. We summarize below the Act’s major provisions related to these two types of SBA loan opportunities.

**Section 7(a) Paycheck Protection Loan**

- Section 1102 of the Act, dubbed the “Paycheck Protection Program,” amends Section 7(a) of the Small Business Act to make loans **up to $10 million** (based on a formula) available **until June 30, 2020**, to existing “small businesses,” a term defined under the Act as companies of **up to 500 employees** (including their “affiliates”—i.e., firms under common ownership or control) unless an applicable size standard for an industry (i.e., NAICS code) allows for a greater number of employees.

- In addition, the Act **waives** SBA “affiliation” rules for industry “Sector 72,” which applies to Accommodation and Food Services, such that businesses within this sector qualify for new loans as long as they do not have more than 500 employees at any given location. In other words, hotel and restaurant chains may qualify for these loans. The SBA’s affiliation rules also are waived for franchises that are approved on the SBA’s Franchise Directory, and small businesses that receive financing through the Small Business Investment Company program.

- These loans may be used to cover business costs, including payroll costs (pro-rated based on a maximum employee annual salary of $100,000), employee benefits and leave, mortgage interest payments, debt refinancing, rent and utilities.

- The Act **waives** the personal guaranty requirement typically associated with Section 7(a) loans, as well as the requirement for applicants to demonstrate that they are unable to obtain credit from other sources. The Act further provides that the SBA “shall have no recourse” against any individual shareholder, member or partner of a loan recipient unless the loan is used for an unauthorized purpose.

- It also requires that eligible borrowers make good faith certifications that they have been impacted by COVID-19 and will use the loan funds to retain workers and maintain payroll and other debt obligations.

- The Act also states that interest for the Paycheck Protection Loans will be no more than four percent and that payment of the loans shall be deferred for no less than six months and no more than one year.

- Importantly, Section 1106 of the Act, titled “Loan Forgiveness,” provides that the Government will **forgive** the amount of a loan under the Act that a recipient can document was used to pay: (1) payroll costs; (2) mortgage interest; (3) rent and (4) utilities—in each case for up to eight weeks following the issuance of the loan.

- The Act also increases the maximum SBA Express loan—a loan whose application SBA will process in 36 hours—from $350,000 to $1 million through December 31, 2020.

- Section 1114 of the Act directs the SBA to pass emergency regulations to implement the Act within **15 days** after its enactment.
The Act allows a company that already has or is applying for a Section 7(b) Economic Injury Disaster Loan (discussed in the next section) to also apply for a Paycheck Protection Loan if it will not duplicate the applicant’s use of the Disaster Loan. A provision of the Act titled “Duplication” states as follows: “Nothing in this paragraph shall prohibit a recipient of an economic injury disaster loan made under [the Disaster Loan program] during the period beginning on January 31, 2020, and ending on the date on which covered loans are made available that is for a purpose other than paying payroll costs and other obligations described [above] from receiving assistance under this paragraph.” The purposes for which the new Section 7(a) Paycheck Protection Loans may be used are similar to those for which Section 7(b) Disaster Loans may be used. Disaster Loans, however, also may be used for “meeting increased costs to obtain materials unavailable from the applicant’s original source due to interrupted supply chains.” We will closely monitor SBA’s interpretation of this provision.

Section 7(b) Economic Injury Disaster Loans

The CARES Act also contains provisions related to SBA’s existing Economic Injury Disaster Loan program. The program operates pursuant to Section 7(b) of the Small Business Act and provides low-interest (3.75 percent for small businesses and 2.75 percent of nonprofits) long-term loans to small businesses located in areas that SBA has declared to be geographic disaster zones. Small businesses can apply for up to $2 million in 7(b) Disaster Loans if they are located within the geographic disaster zones identified on the SBA website.

Key changes to this program based on the CARES Act include:

- Section 1110 of the CARES Act provides that SBA Disaster Loans, as modified by the CARES Act, will be available until December 31, 2020. (Note that the “covered period” for the Section 7(a) loans described above runs only until June 30, 2020.)
- The Act similarly changes the definition of “small business,” for the purposes of a Disaster Loan, to include a company with no more than 500 employees, but does not waive the affiliation rules for Sector 72.
- The Act also waives the personal guaranty requirement and the requirement for applicants to demonstrate that they are unable to obtain credit from other sources.
- The Act provides for a $10,000 emergency advance (within three days of submitting an application) while an applicant’s loan application is pending, which SBA will not require to be repaid. Notably, the Act contemplates that an applicant may receive this advance while still applying for a Section 7(a) loan described above and that, if the applicant later receives a 7(a) loan, the amount of the advance will “be reduced from the loan forgiveness amount for a loan for payroll costs.”

As background on the Economic Injury Disaster Loan program, Section 7(b) Disaster Loans may be used to pay fixed debts, payroll, accounts payable and other costs, but are not intended to replace lost sales or profits and cannot be used for certain purposes, including to refinance debt, make payments on loans owed by another federal agency, to pay tax penalty obligations, repair physical damages, or to pay dividends to stockholders. These Disaster Loans also offer long-term repayments in order to keep payments affordable, up to a maximum of 30 years. Terms are determined on a case-by-case basis, based upon each borrower’s ability to repay.
To be eligible, the applicant also must have an acceptable credit history, have the ability to repay the loan, be physically located in a declared disaster area, and have suffered working capital losses due to the declared disaster, not due to a downturn in the economy or other reasons.

Applicants may apply for a Disaster Loan online and should expect to provide at least the following paperwork:

- Completed SBA loan application (SBA Form 5)
- Tax Information Authorization (IRS Form 4506T) for the applicant, principals and affiliates
- Complete copies of the most recent Federal Income Tax Return
- Schedule of Liabilities (SBA Form 2202)
- Personal Financial Statement (SBA Form 413).

Pillsbury attorneys can help clients interpret the foregoing requirements and determine whether to apply for an SBA loan.

*Pillsbury’s experienced crisis management professionals are closely monitoring the global threat of COVID-19, drawing on the firm’s capabilities in supply chain management, insurance law, cybersecurity, employment law, corporate law and other areas to provide critical guidance to clients in an urgent and quickly evolving situation. For more thought leadership on this rapidly developing topic, please visit our COVID-19 (Coronavirus) Resource Center*

These and any accompanying materials are not legal advice, are not a complete summary of the subject matter, and are subject to the terms of use found at: https://www.pillsburylaw.com/en/terms-of-use.html. We recommend that you obtain separate legal advice.

**LINKS & DOWNLOADS**

English-Chinese version