TONKON TORP

FAQ for SBA Loans for Businesses under the CARES Act

This afternoon, the CARES Act, a $3 trillion stimulus package aimed at aiding individuals and businesses in the U.S. that have been impacted by the COVID-19 pandemic, was signed into law. The CARES Act includes a $349 billion allocation of funding for the issuance of fee-free loans to U.S. businesses pursuant to Section 7(a) of the Small Business Act (15 U.S.C. 636(a)).

This FAQ answers many of the questions that businesses may have that are seeking to take advantage of the new 7(a) loan program administered by the U.S. Small Business Administration ("SBA") under the CARES Act.

Q: Who is eligible to apply?

Any U.S. business with 500 or fewer employees is eligible, unless the applicant's SBA industry size standard allows a potential loan applicant to have more than 500 employees (*e.g.*, hospitality, restaurant, and franchise businesses). For example, a hotel owner that operates multiple properties and has over 500 employees may seek loans for individual properties.

An individual who operated as a sole proprietorship or as an independent contractor from February 15, 2020 through June 30, 2020 (the "covered period" for loan eligibility purposes) are also eligible to apply.

Q: What lenders will make the loans?

Hundreds of lenders across the country work with the SBA to provide 7(a) loans. However, lenders that handle a higher volume of 7(a) loans have more experience with the process and may be able to process your application more quickly. This list published by the SBA shows the 100 most active lenders that issue 7(a) loans.

Q: How do I apply?

Contact your lender as soon as possible to determine how you can apply for a 7(a) loan. In determining whether a borrower is eligible for a 7(a) loan, a lender can only consider (i) whether the borrower was in operation on February 15, 2020, and (ii) whether the borrower had employees for whom the borrower paid salaries and payroll taxes.

Given the simplicity of the eligibility determination, we expect that most lenders will make available a new, more streamlined 7(a) loan application (e.g., required provision of payroll, rent, utility, mortgage, and debt information). It remains to be seen how quickly lenders and the SBA will be able to roll out an expedited loan origination process.

Q: How long will it take for my loan to be approved?

The timing for lender approval will depend on the systems and staffing of the lender, the relationship between the lender and the SBA, and how quickly the application is submitted after applications are made available.

It seems certain that there will be a tremendous surge in SBA loan applications following the enactment of the CARES Act, and there could be funding delays for those that do not submit their loan applications quickly. An applicant should work actively with its current lender to apply for a 7(a) loan, or look to work with a lender that is experienced in dealing with the SBA and in issuing 7(a) loans if it does not have a current relationship with an SBA lender.

Q: How long will it take for funding to occur?

Again, the time to funding will depend on the lender's systems, staffing, experience in working with the SBA, and how quickly an application is submitted. The goal of the CARES Act is to provide economic relief to business owners as quickly as possible, and the loan origination process should be streamlined to achieve this goal. One SBA lender has stated that it expects the turnaround time from application to funding to be only a matter of days. An SBA representative has suggested that the process may take longer.

Q: How much can I borrow?

A borrower eligible for a 7(a) loan can receive an amount equal to 2.5 times the borrower's average total monthly payroll costs for the one-year period prior to the date on which the loan is made, up to $10,000,000.

"Payroll costs" are defined to include (i) all salary, wage, commission, or similar compensation, (ii) payment of cash tips or equivalent, (iii) payment for vacation, parental, family, medical, or sick leave, (iv) allowance for dismissal or separation, (v) payment required for the provision of group health care benefits, including insurance premiums, (vi) payment of any retirement benefits, and (vii) payment of State or local tax assessed on the compensation of employees.

The definition of "payroll costs" specifically excludes: (i) compensation for an individual employee in excess of an annual salary of $100,000, as prorated for the covered period, (ii) federal taxes imposed or withheld under chapters 21, 22, or 24 of the Internal Revenue Code for the applicable period, (iii) any compensation of an employee whose principal residence is outside the United States, and (iv) qualified sick leave and family leave wages for which a credit is allowed under the Families First Coronavirus Response Act.

Q: What operating costs can I pay with the proceeds of the loan?

7(a) loan proceeds may be used for payroll costs, mortgage interest, rent, utilities, and interest on other outstanding debt obligations incurred prior to February 15, 2020.

Q: What is the loan interest rate?

The interest rate is negotiated between the lender and the applicant, but the CARES Act provides that the interest rate on 7(a) loans issued pursuant to the CARES Act cannot exceed 4%. Lenders will likely charge a lower rate if you have excellent credit history and strong financials.

Q: What are the repayment terms?

The repayment terms typically depend on the borrower's ability to repay. Under the current 7(a) loan program, terms for working capital loans fall within the 5 to 10-year range, while loans for real estate typically carry a 25-year term. The CARES Act provides that a 7(a) loan must have a maximum maturity date of 10 years from the date on which the borrower applies for forgiveness of the loan.

Q: May I defer repayment of the loan for a period of time?

Yes. The CARES Act requires lenders to provide complete payment deferment relief for a minimum of six months and up to one year.

Q: What portion of the loan will be guaranteed by the federal government?

100% of the 7(a) loans that are issued under the CARES Act are guaranteed by the federal government.

Q: Will the loan require collateral or a personal guarantee?

No. 7(a) loans issued pursuant to the CARES Act do not require any collateral or a personal guarantee.

Q: What portion of the loan may be forgiven?

Loan forgiveness is available for the amount of the loan used for payroll costs, mortgage interest, rent obligations, and utility payments during the 8-week period beginning on the date of origination of the 7(a) loan (the "covered period" for purposes of the CARES Act loan forgiveness provisions), except that the total amount of loan forgiveness cannot exceed the principal amount of the loan.

However, any amounts that are otherwise eligible for forgiveness will be reduced if (i) the borrower's average number of full-time equivalent employees per month during the covered period has decreased compared to its average number of full-time equivalent employees per month during either (i) the period from February 15, 2019 through June 30, 2019, or (ii) January 1, 2020 through February 29, 2020 (with the applicable period being chosen by the borrower). The loan forgiveness amount will also be reduced if the borrower cuts employee salaries by more than 25%.

That said, a reduction in the number of employees or the implementation of pay cuts will not impact the amount of loan forgiveness if the employer restores the number of employees and/or restores pay to prior levels by June 30, 2020. Therefore, if an employer furloughs employees and such employees start work again at their normal pay scale prior to June 30, 2020, then the amount of loan forgiveness will not be reduced.

Q: What are the loan forgiveness requirements?

To obtain loan forgiveness, an applicant must submit a detailed application that includes documentation verifying the number of full-time equivalent employees on payroll and pay rates for the covered period and any other applicable periods used in calculating the amount of loan forgiveness.

The applicant must also submit payroll tax filings filed with the IRS and applicable state authorities, and provide a certification that the amount of forgiveness requested was used to retain employees, or make payments for mortgage interest, rent, and/or utility payments.

Q: Is the portion of the loan that is forgiven taxable to me?

No. Any loan amounts that are forgiven are excluded from gross income.

Q: Who can I contact to learn more?

Contact your primary Tonkon attorney to discuss your potential application for a 7(a) loan.

Tonkon Torp corporate finance attorneys Jeff Cronn (503.802.2048, jeff.cronn@tonkon.com) and Ferdie Ruplin (503.802.2029, ferdie.ruplin@tonkon.com) are also available to answer your questions on these loans.