

Outside Counsel

What To Know About Financial Lifelines For Small and Mid-Sized Businesses

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The speed and severity of the sweeping economic disruptions caused by the COVID-19 pandemic have created an unprecedented demand for financial assistance by small to medium-sized businesses. Businesses with fewer than 500 employees account for 48% of jobs in America and 43.5% of GDP. Most of these businesses do not have enough available cash to withstand the financial strain of ongoing expenses with reduced or no revenue for a prolonged period. The Coronavirus Aid, Relief and Economic Security Act (the CARES Act) provides financial assistance for these businesses that are experiencing economic hardships caused by the COVID-19 pandemic. Targeting these businesses, the CARES Act established



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the Paycheck Protection Program (PPP) and expanded the Economic Injury Disaster Loan (EIDL). The CARES Act also provided the Treasury with \$454 billion to make loans, loan guarantees and other investments in Federal Reserve programs and facilities that will give support to eligible businesses, States and municipalities. To that end, the Federal Reserve started the Main Street Loan Programs.

The PPP allows for government guarantees of loans to small businesses by lenders approved by the Small Business Administration (SBA). The CARES Act originally allotted \$349 billion to fund the PPP program with an additional \$310 billion added about a month

later. The loans are intended to cover eight weeks of payroll, along with some utility and rent costs, up to a maximum of \$10 million. These loans will be forgiven if businesses keep employees on payroll, maintain certain employee salaries and use at least 75% of the proceeds for payroll costs, and the other 25% for certain specified expenses. While the PPP loans have been compared to free money, it is more accurate to describe them as conditional grants.

Businesses that have less than 500 employees, or that are “small business concerns” as defined in §3 of the Small Business Act, 15 U.S.C. 632 (generally deemed to be an enterprise which is independently owned and operated and which is not dominant in its field of operation) can apply for these loans. A business can also qualify as a “small business concern” if it meets both tests in the SBA’s “alternative size standard” as of March 27, 2020. The tests are

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(1) maximum tangible net worth of the business is not more than \$15 million; and (2) the average net income after Federal income taxes (excluding any carry-over losses) of the business for the two full fiscal years before the date of the application is not more than \$5 million. If any portion of the loan amount is not forgiven, that portion of the loan must be repaid within two years at an annual interest rate of 1%. Independent contractors and sole proprietors are eligible to apply for their own PPP loans.

The maximum loan amount is intended to be two months of average monthly payroll costs plus an additional 25% of that amount. "Average monthly payroll" can be calculated based upon two alternative measurement dates which borrowers can choose from: either the trailing 12-month period prior to the loan application, or calendar year 2019. For purposes of the calculation, employee salaries are capped at \$100,000, not including benefits paid on behalf of employees such as health insurance or 401(k) matching. In order to qualify for loan forgiveness for the full amount of the loan, businesses must maintain their number of full time employees, and may not decrease salaries and wages of employees making less than \$100,000 by more than 25%. Businesses will be able to request loan forgiveness from the



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lender servicing the loan, and will be required to provide documents verifying the number of full-time employees, pay rates, as well as payments made for eligible obligations, along with a certification that the forgiveness amount was used to retain employees and make eligible payments. The lender will be required to make a decision on the forgiveness within 60 days. The 25% of loan proceeds that does not need to be used for payroll expenses can be used to pay interest on mortgage obligations incurred prior to Feb. 15, 2020, rent pursuant to leases in force prior to Feb. 15, 2020, and utilities for which service began before Feb. 15, 2020.

Banks and the SBA have been severely criticized for how the PPP has been handled. Before banks starting taking applications,

there was a great deal of anxiety that the initial \$349 billion authorized would not be enough to satisfy the demand. Business owners knew that the loans were being issued on a "first-come, first served" basis and that submitting an application early would increase the chances of having the loan funded. Some banks received thousands of applications an hour when the program came online and could not handle the volume. Also, the rush to get the applications in caused some of the borrowers to submit applications that were mispackaged, causing delays and ultimate rejection.

The loan approval process used by the SBA and the SBA approved lenders has been slow due to the use of an antiquated software program called E-Tran. Disgruntled business owners have also

accused banks of giving preference to their depository customer base. Bank of America was sued for prioritizing its existing clients.

EIDL loans are intended to cover six months of operational expenses for small businesses up to \$2 million. The loans carry low interest rates (3.75% for small businesses and 2.75% for non-profits) and loan terms of up to 30 years. Loans of \$25,000 or more require collateral, and loans for more than \$200,000 require a personal guarantee. Within three days of applying for the EIDL loan, applicants can request emergency advances of up to \$10,000 depending on the number of employees the applicant has which do not need to be repaid and can be used in a variety of ways. The EIDL loans are not forgivable in the same way that the PPP loans are.

Businesses employing no more than 500 employees, including sole proprietorships, independent contractors, gig-economy workers and self-employed individuals are all eligible to apply for an EIDL loan. The loan amount is based on an applicant's actual economic injury rather than any set percentage of historical figures. Loan proceeds cannot be used to refinance pre-existing debt or pay dividends.

Small businesses are permitted to obtain both a PPP and an EIDL loan, but the key is to use the money to cover different

expenses. The PPP loans require the borrower to certify that "the eligible recipient has not received amounts under this subsection for the same purpose and duplicative amounts." If a small business obtains an EIDL to cover payroll costs, a borrower is prohibited from getting a PPP loan to cover the same payroll costs. A small business would have to use the EIDL for different operating expenses or payroll for a different period. EIDL loans could be refinanced into PPP loans. Any

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grant under the EIDL will reduce the amount forgiven under the PPP.

The Federal Reserve has also established the Main Street Lending Program (MSLP) in accordance with the CARES Act to help facilitate loans to small and mid-size businesses. There are two components with a combined size of \$600 billion: the Main Street New Loan Facility for new loans and the Main Street Expanded Loan Facility to increase the size of existing loans.

In order to apply for these Federal Reserve loan programs, the businesses must have less than 10,000 employees or up to \$2.5 billion in 2019 annual revenues. They must be created or organized in the United States or under the laws of the United States and have a significant portion of their operations in, and a majority of their employees based in the United States.

The maximum maturity is four years with an interest rate equal to the adjustable Secured Overnight Financing Rate plus 250 to 400 basis points. Principal and interest payments are deferred for one year and there is no prepayment penalty. These loans may not be forgiven. Businesses must apply through eligible lenders and make certain attestations about their eligibility and use of proceeds. Businesses that participate in the PPP loans may also take out a MSLP.