BakerHostetler

Baker&Hostetler LLP

SunTrust Center, Suite 2300
200 South Orange Avenue
Orlando, FL 32801-3432

T 407.649.4000
F 407.841.0168
www.bakerlaw.com

Keith C. Durkin.
direct dial: 407.649-4005
kdurkin@bakerlaw.com

TO: Client and Contacts

FROM: Keith C. Durkin

DATE: March 26, 2020

SUBJECT: **Federally Guaranteed Forgivable Business Loans**

Last night, the Senate approved legislation known as the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), which is designed to provide much needed economic relief to individuals and businesses devasted by COVID-19. This bulletin summarizes the economic stimulus package providing government-backed forgivable loans to affected eligible businesses through the newly formed Payroll Protection Program.

Eligibility. Federally guaranteed SBA loans are available to businesses with 500 or fewer employees, including corporations, partnerships, sole proprietorships, independent contractors, certain nonprofit organizations, veterans organizations, and Tribal businesses. Restaurant and hotel entities are eligible to apply the 500 or fewer employee test on the basis of each physical location. Special rules apply to hotel and restaurant businesses operating as franchises, and certain generally applicable affiliation rules are waived for hotel and restaurant franchises. The application process will end on June 30, 2020 (the "Covered Period").[1] The Payroll Protection Program simplifies the rigid SBA requirements for loans in favor of a 500-employee size limit, provided the borrower (a) was operating on Feb. 15, 2020; and (b) paid salaries and payroll taxes to and on behalf of employees, or paid independent contractors through Forms 1099. The SBA has the authority to increase the 500-employee limitation on an industry-by-industry basis. Employers receiving the employee retention tax credit under the CARES Act are not eligible for these loans. Specific language in the Payroll Protection Program states the SBA should issue guidance to lenders prioritizing loans to small businesses, rural markets, minority owned businesses, veteran owned businesses, and business in operation for less than 2 years.

[1] The Covered Period is Feb. 15, 2020, through June 30, 2020.

Loan Terms and Amounts. The amount of each loan is limited to the lesser of (a) $10 million or (b) the borrower's average total monthly "payroll costs" for the 1-year period ending on the date the loan is made multiplied by 2.5, plus any refinanced SBA economic injury disaster loan obtained after January 31, 2020. There is a special rule to compute the average monthly payroll costs for seasonal businesses. During the Covered Period, Borrowers are not required to provide collateral security for the loans or cause owners or affiliates to guarantee the loans. Payroll costs include the cumulative amount of salaries, wages, tips, retirement benefits, certain employer provided benefits, severance payments, state and local taxes paid on employee compensation, and other compensation paid to employees and independent contractors, excluding, however, any compensation paid to an employee or independent contractor in excess of an annualized amount of $100,000. Payroll costs do not include amounts paid to persons who reside outside the U.S., certain taxes imposed or withheld during the Covered Period, and certain payroll costs for which tax credits were allowed pursuant to the Families First Act. The Payroll Protection Program expands the permitted use of these SBA loan proceeds to include payroll costs, employee benefits, commissions, interest payments on mortgages, rent, utilities, and interest on debt obligation incurred before the Covered Period.

Deferral. Lenders are required to provide "complete payment deferment relief" for a period between six months and one year on all principal and interest. Loans may have a maximum maturity date, which is 10 years after the borrower applies for the debt forgiveness described below. During the Covered Period, interest rates are capped at 4%. After expiration of the Covered Period, loans will bear interest at comparable SBA rates. While no interest payments are required during the deferment period, interest will accrue on the loan from the day the loan is made.

Lenders. Loans will be made by banks and other commercial lenders with existing authority to make SBA loans and other lenders the SBA determines are qualified to originate and administer the loans. While repayment of the loans will be guaranteed by the federal government, potential borrowers will work directly with their originating lenders to close and administer the loans. The SBA will reimburse lenders the following processing fees: (a) 5% of the principal balance for loans $350,000 and below; (b) 3% of the principal balance for loans between $350,000 and $2,000,000; and (c) 1%of the principal balance for loans over $2,000,000.

Loan Forgiveness. A borrower may apply for forgiveness of a portion of the loan. The maximum eligible forgiven amount is equal to the cumulative amount of payroll costs, rent, utility payments, and interest paid on mortgages on real or personal property paid during the eight-week period following origination of the loan. The foregoing amounts include arrearages. The forgiven amount is not included in the borrower's federal taxable income. Amounts eligible for forgiveness may be less than the principal amount of the loans depending on the borrower's utilization of the proceeds. The SBA will reimburse the forgiven amount together with additional accrued interest to the lender within 90 days after the forgiven amount is finally determined. The forgiven amount is subject to several reductions and limitations. Payroll costs that were not taken into account to compute the maximum loan amount are not taken into account to compute the loan forgiveness amount. The amount forgiven cannot exceed the principal balance of the loan. The forgiven amount is reduced by multiplying the amount forgiven by a fraction; the numerator is the average number of full-time employees per month during the eight-week period following origination of the loan, and the denominator is, at the election of the borrower, one of the two following values: (a) the average number of full-time employees per month between Feb. 15, 2019, and June 30, 2019; or (b) the average number of full-time employees per month between January 1, 2020 and ending on February 29, 2020. Employees terminated between February 15, 2020 and 30 days after passage of the CARES Act, but rehired by June 30, 2020, qualify in the numerator so long as they're fully paid as if they weren't terminated. A borrower will need to calculate their average number of full-time employees in both 2019 and between January 1, 2020 and ending on February 29, 2020 to determine the most favorable result. Accordingly, if a borrower's workforce is 60% of the workforce during the applicable comparison period, then only 60% of the maximum expected forgiveness amount qualifies for forgiveness. If the borrower maintains 100% of the workforce, then 100% of the forgiveness amount qualifies for forgiveness. The forgiveness amount is also subject to reduction based on salary reductions. Generally, the borrower's forgivable amount is reduced by salary reductions greater than 25%. Lastly, if any portion of a borrower's loan is forgiven, then the borrower cannot defer their 2020 payroll tax obligations.

Impact on Existing Loans. Prior to applying for a forgivable SBA loan all prospective borrowers should review all existing loan agreements, notes and bond or trust indentures to determine if the incurring additional debt will cause a default or otherwise violate the terms of those agreements. Companies may also be guarantors of their parent entity's existing debt, and may, therefore, be subject to the same restrictions. Financial covenants, permitted debt definitions, permitted investments, and other terms of loan documents may need modifications to allow borrowers to access this government relief without technical defaults. Businesses with existing debt should consult with their legal counsel and lenders now about any necessary amendments or waivers to allow these loans. Existing lenders will likely support and encourage borrowers to obtain these loans.

Borrowers of SBA Economic Injury Disaster Loans. The SBA also separately provides emergency loans of up to $2 million to assist companies suffering from COVID-19 financial distress. The Payroll Protection Program allows these loans to be refinanced as a federally guaranteed loan under the Payroll Protection Program. The refinanced loan proceeds become subject to all the conditions and limitations of the Payroll Protection Program explained above.

The Paycheck Protection Program is a powerful tool in the CARES Act stimulus package because it will provide much needed cash-flow to businesses struggling to fund operations. Applications should be prepared immediately because the estimated time intervals between application submission, approval and funding are unknown.