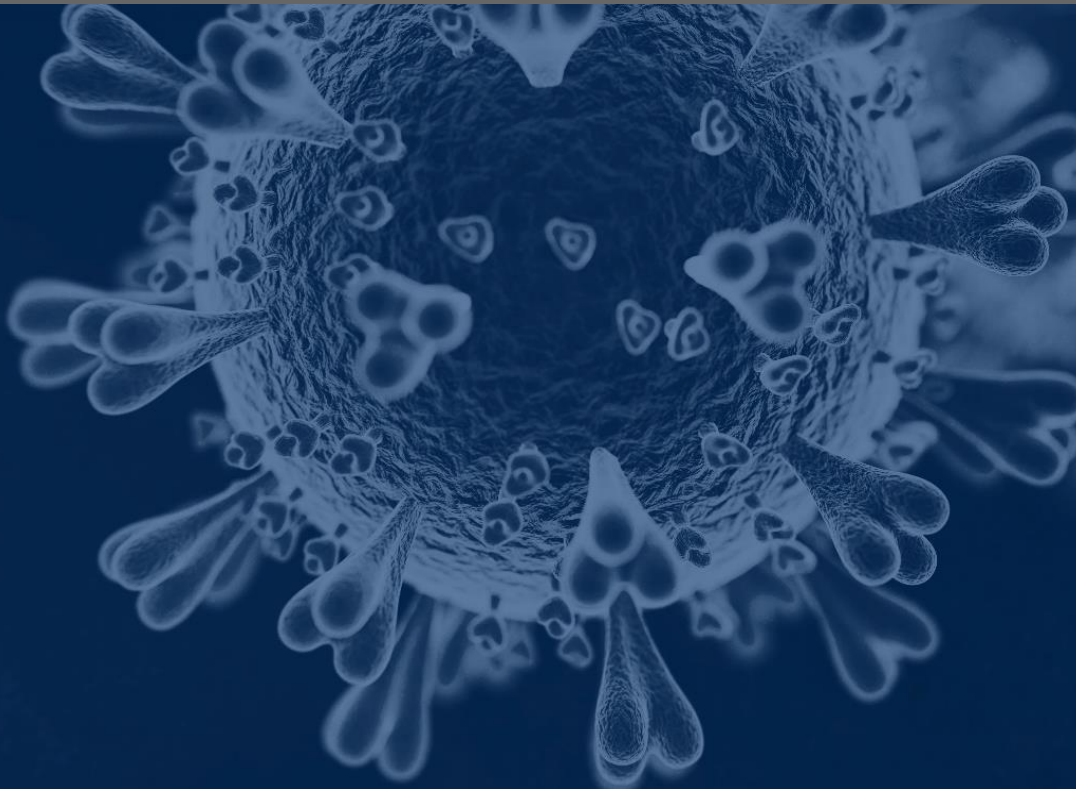
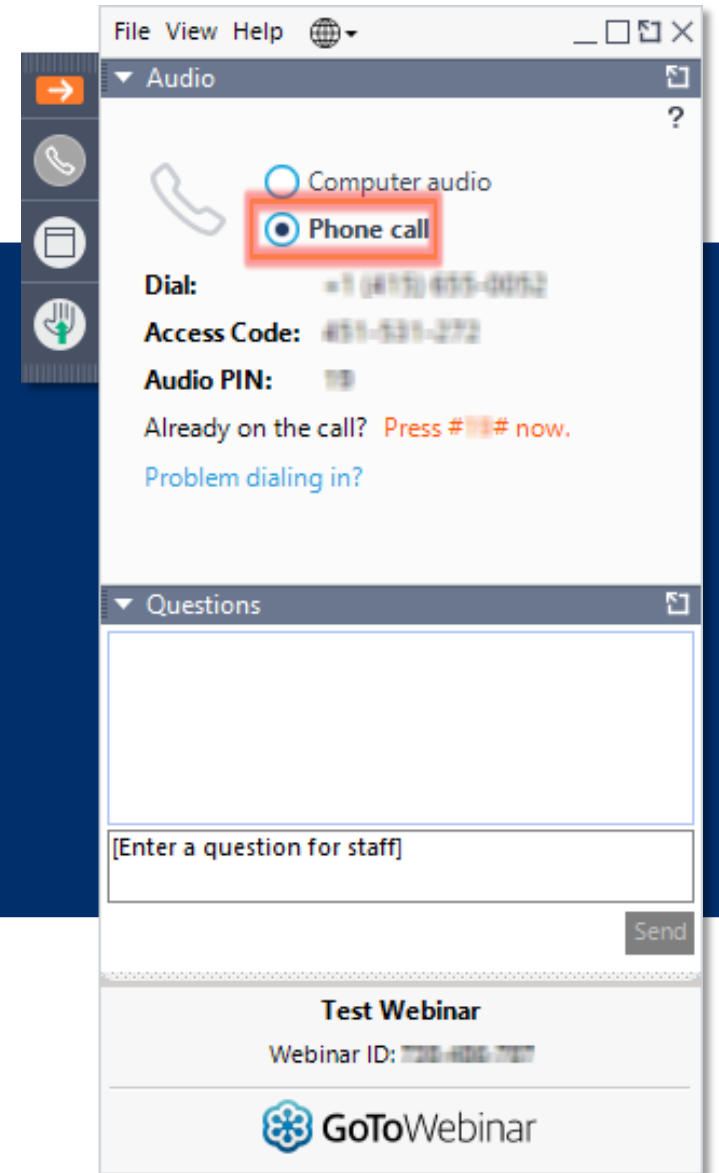


# Understanding COVID-19 SBA Disaster and Small Business Loans

March 27, 2020



- Select "Computer audio" to join via VOIP
- Select "Phone call" to dial in



## Audio Instructions

- Grab Tab
- Handouts
- Questions

The screenshot shows the GoToWebinar attendee control panel. On the left is a vertical toolbar with icons for navigation, phone, document, and a hand cursor. The main area has two sections: 'Audio' and 'Questions'. The 'Audio' section includes radio buttons for 'Computer audio' and 'Phone call', with 'Phone call' selected. Below this are fields for 'Dial:', 'Access Code:', and 'Audio PIN:', followed by a prompt 'Already on the call? Press # [redacted] # now.' and a link 'Problem dialing in?'. The 'Questions' section features a large text input area with a placeholder '[Enter a question for staff]' and a 'Send' button. At the bottom, it displays 'Test Webinar', 'Webinar ID: [redacted]', and the GoToWebinar logo.

## Attendee Control Panel

# OBJECTIVES

- Discuss the impact of the Paycheck Protection Program included in the “Coronavirus Aid, Relief, and Economic Security Act” or the “CARES Act” passed on March 25
- Review Paycheck Protection Program Loans
  - Who is eligible
  - Loan terms
  - Loan forgiveness
- Review SBA Economic Injury Disaster Loans
  - Who is eligible
  - Loan terms
  - How to apply



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## Meet the Speakers

# BACKGROUND

- March 6, 2020: U.S. Small Business Administration (“SBA”) authorized to make disaster loans in response to the COVID-19 pandemic
- March 19/21, 2020: Ohio, Indiana and Kentucky’s applications approved for Economic Injury Disaster Loan Program
- March 25, 2020: Senate unanimously passed the Coronavirus Aid, Relief, and Economic Security Act or the “CARES Act” which includes a Paycheck Protection Program
- SBA’s Disaster Loan program is a pre-existing program in which the SBA makes direct loans to homeowners and businesses to help them recover from declared disasters
- Paycheck Protection Program is a modification of the SBA’s 7(a) loan program, in which banks make loans to businesses that are guaranteed by the SBA

# PAYCHECK PROTECTION PROGRAM LOANS

- Authorizes \$349 billion of federally guaranteed loans to qualifying small and medium sized businesses
- Still requires approval from the House and President
- Modifies the 7(a) loan program in four important ways:
  - Expands the businesses that are eligible for loans
  - Modifies the loan terms
  - Allows for forgiveness of loan if the borrower maintains its payroll
  - Modifies provisions to incentivize banks to lend, and make the process faster and more efficient

# WHO IS ELIGIBLE FOR PAYCHECK PROTECTION LOANS?

- Generally: businesses, 501(c)(3) non-profits or veteran's organizations with:
  - 500 or fewer employees or
  - The applicable size standard for the industry as provided by SBA, if higher
- Includes certain sole-proprietors, independent contractors, and other self-employed individuals as eligible for loans
- 500 employee limit waived for accommodation and food service businesses so long as business employs no more than 500 employees at any physical location
- Must meet the SBA's definition of "business concern"

# AFFILIATION

- Employee limit includes employees of affiliates, except:
  - Hospitality and restaurant businesses
  - Franchises on the SBA's Franchise Directory
  - Businesses who receive financing through the Small Business Investment Company (SBIC) program
- Affiliation based on control -- one party has the power to control the other, or a third party or parties controls or has the power to control both
- It does not matter whether control is exercised, so long as the power to control exists

# AFFILIATION

- SBA defines affiliation broadly, and includes affiliation by:
  - Ownership
  - Management
  - Close Relatives
  - Identity of Interest
  - Economic Dependence
  - Common Investments
  - Newly Organized Business
  - Totality of the Circumstances
  - Franchise Agreements (waived for certain franchises for Paycheck Protection Loans)

# INELIGIBLE BUSINESSES

- Did not modify the types of businesses that are generally ineligible for SBA business loans, which includes (among others):
  - Financial businesses
  - Passive businesses
  - Foreign businesses
  - Gambling businesses
  - Private clubs
  - Life insurance
  - Religious businesses
- Hobbies
- Applicant's Character (including owners)

# CREDIT AVAILABLE ELSEWHERE

- CARES Act waives the “credit available elsewhere” test normally applicable to SBA loans
- This means that owners of business are not required to seek other sources of capital, including equity or debt investments from owners prior to obtaining a Paycheck Protection Loan
- Very important distinction with traditional SBA loans

# PAYCHECK PROTECTION LOAN TERMS

- Loan Amount: 2.5x monthly payroll costs, max of \$10 million
- Interest Rate: Up to 4%
- Permitted Uses:
  - Payroll costs (defined term), group health costs, insurance premiums, and interest on a preexisting mortgage / other debt, rent, and utility payments
  - Employee compensation above \$100,000 excluded
  - NOT to be used to prepay or refinance debt
- Collateral: None
- Guarantee: None
- Maturity: Up to 10 years and payment terms consistent with SBA 7(a) loans
- Deferment: Automatic deferments for at least six months and up to one year
- Prepayment Penalty: None
- SBA Disaster Loans: Cannot have both (with some exceptions)

# PAYCHECK PROTECTION LOAN FORGIVENESS

- Eligible for loan forgiveness equal to the amount spent by the borrower during an 8-week period after loan closing on:
  - Payroll costs (same exclusions)
  - Interest on any mortgage incurred prior to Feb. 15, 2020
  - Rent on any lease in force prior to Feb. 15, 2020
  - Utility payments for which service began before Feb. 15, 2020
- Maximum forgiveness is principal amount of the loan
- Loan forgiveness will not be taxable income

# LOAN AMOUNT ELIGIBLE FOR FORGIVENESS

- Amount eligible for forgiveness reduced proportionally by:
  - Reduction in employees retained compared to the prior year and
  - Reduction in pay of any employee in excess of 25%
- Borrowers re-hiring workers previously laid off will not be penalized and payments to such workers eligible for forgiveness
- Businesses should ensure they can rehire workers
- Borrowers must document payroll and payments
- Borrower certifications required regarding use of loan
- Borrowers and lenders are looking for guidance and safe harbors here

# INCENTIVES FOR BANKS

- Like SBA 7(a) loans, banks who lend will take risk that SBA won't guaranty loan
- Act increased SBA guaranty of such loans to 100% for the remainder of 2020
- Modified the procedures and requirements of lending banks
- Banks will likely be seeking additional guidance from Treasury / SBA on these aspects prior to making loans
- Act contains funding to make payments on existing SBA 7(a) or 504 loans (and such payments will not be deemed to be deferral payments)

# ECONOMIC INJURY DISASTER LOANS

- Economic Injury Disaster Loans are working capital loans of up to \$2 million with long-term repayment structures (up to a maximum of 30 years)
- Most successfully used as part of Deepwater Horizon / BP Oil Spill
- Loans may be used to:
  - Pay fixed debts
  - Payroll
  - Accounts payable
  - Other approved expenses (detailed in a later slide) that cannot be paid because of COVID-19's impact
- Interest rate:
  - 3.75% for small businesses
  - 2.75% for non-profit organizations

# LOAN DETAILS

- SBA uses credit scores of business owners in their decisions for approval
- SBA must be reasonably assured an applicant can repay its loan
- Borrowers will be required to retain receipts and evidence of how loan proceeds are used for 3 years
  - Such receipts are subject to SBA audit
  - Borrowers who misapply loan proceeds may be liable to SBA for 1.5x of the total loan proceeds disbursed when SBA learns of the misapplication

# OWNER GUARANTEE

- 20% or more owners are generally required to personally guaranty the loan
  - May be secured or unsecured – but most loans require collateral from owners
  - May be limited
  - Changing ownership prior to submitting application to lower an individual's ownership to avoid a personal guaranty could jeopardize eligibility

# WHO CLASSIFIES AS A “SMALL BUSINESS”?

- SBA “small businesses”, has two elements:
  - SBA’s size standards for small business
  - Small business concern
- Size standards are determined on an industry-specific (using NAICS codes) sliding scale based on the annual receipts or revenues of the business or in some cases, the number of employees
- Businesses should review the sliding scale to see if they could potentially qualify
- Annual receipts maximums vary widely by industry

# EXAMPLES OF SMALL BUSINESSES

- Examples of the SBA's annual receipts maximum for certain businesses likely affected by COVID-19 pandemic:

Restaurants, Bars, and Caterers	\$8 Million
Hotels	\$35 Million
Child Day Care Services	\$8 Million
General Freight Trucking, Local	\$30 Million
Lessors of Nonresidential Buildings	\$30 Million
Fitness and Rec Sports Centers	\$8 Million
Retail Stores	\$41.5 Million

# AFFILIATES

Affiliates of borrower are included in size standards calculations

- Size of the applicant alone (without affiliates) must not exceed the size standard designated for the industry in which the applicant is primarily engaged; and
- Size of the applicant combined with its affiliates must not exceed the size standard designated for either the primary industry of the applicant alone or the primary industry of the applicant and its affiliates, whichever is higher

# FRANCHISES

- Applicant franchisee must have the right to profit from its efforts and bear the risk of loss commensurate with ownership
  - This limitation applies generally
- Franchisee must be free from significant control by franchisor
- SBA considers only the franchise agreements of the applicant
- SBA maintains a centralized list of franchise agreements that are eligible for SBA financial assistance
- SBA may require additional documentation necessary to resolve issues in the franchise agreement

# SMALL BUSINESS CONCERN

- “A small business concern” is a business that:
  - Organized for profit (non-profits eligible separately)
  - place of business in the U.S.
  - Operates primarily within the U.S. or makes a significant contribution to the U.S. economy through payment of taxes or use of American products, materials or labor
  - Is independently owned and operated
  - Is not dominant in its field on a national basis
- The business may be a sole proprietorship, partnership, corporation, or any other legal form

# OTHER REQUIREMENTS

- Private non-profit organizations also eligible (rules are a bit different)
- Businesses must be unable to (i) meet its obligations as they mature or (ii) pay its ordinary and necessary operating expenses
- Businesses including their affiliates and 20% owners must have “used all reasonably available funds” in the business and be “unable to obtain credit elsewhere”

# OBTAINING CREDIT ELSEWHERE

- With cash flow and disposable assets, can business could obtain financing from non-federal sources on reasonable terms?
- Includes assets of 20% owners
- Two tests – Cash Flow Test and Asset Test – and if applicant meets both tests, the business is presumed to have credit available elsewhere

# ELIGIBLE USE OF FUNDS

- Working capital necessary to carry on the business until resumption of normal operations and for expenditures necessary to alleviate the specific economic injury, but not in excess of pre-injury expenses, including:
  - Payroll
  - Accounts Payable
  - Pay fixed debts
  - Pay monthly mortgage (may NOT payoff a mortgage)
  - Short term notes may be paid, along with lines of credit
- Can make payments on IRS deferments but would rather IRS give more of a deferment

# INELIGIBLE USE OF FUNDS

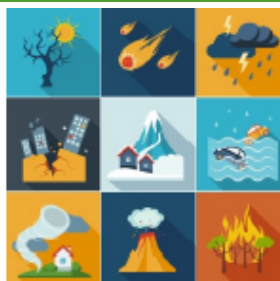
- Loan proceeds may not be used to:
  - Refinance indebtedness incurred prior to the disaster event
  - Make payments on loans owned by another federal agency (including SBA) or a Small Business Investment Company
  - Pay tax penalties or fines
  - Repair physical damage or buy fixed assets
  - Pay dividends or other disbursements to owners, partners, officers or stockholders, except for reasonable remuneration directly related to their performance of services for the business
- Cannot replace sales or profit of business

# COLLATERAL REQUIREMENTS

- Collateral is required for all loans over \$25,000, which may be:
  - Mortgage or real estate lien
  - Security interest in personal/business property
  - Both of the above
- SBA will look to 20% owners for collateral
- SBA will not decline a loan if an applicant and owners lack sufficient collateral so long as the SBA is reasonably sure the borrower can repay its loan
- SBA requires borrowers and owners to pledge what is available and may decline/cancel loans if a borrower refuses to pledge available collateral

# INFORMATION/DOCUMENTS REQUIRED BY SBA

1. Business Loan Application (SBA Form 5)
2. Tax Information Authorization (IRS Form 4506T)
3. Copies of most recent Federal income tax returns for the business
4. Personal Financial Statement (SBA Form 413) for each 20 percent or more owner, and each general partner or managing member
5. Schedule of Liabilities listing all fixed debts (SBA Form 2202 may be used)
6. 2019 federal tax return or if not filed, a 2019 year end profit and loss statement and balance sheet
7. A current year-to-date profit and loss statement
8. SBA Form 1368 providing monthly sales figures



## The Three Step Process: Disaster Loans

### About Disaster Loans

The U. S. Small Business Administration (SBA) provides low-interest, long-term disaster loans to businesses of all sizes, private non-profit organizations, homeowners, and renters to repair or replace uninsured/underinsured disaster damaged property. SBA disaster loans offer an affordable way for individuals and businesses to recover from declared disasters.

#### STEP 1: Apply for Loan

- Apply: 1) online; 2) in-person at a disaster center; or 3) by mail.
- Apply online at the SBA's secure website [disasterloan.sba.gov/ela](https://disasterloan.sba.gov/ela).
- As a business of any size, you may borrow up to \$2 million for physical damage.
- As a small business, small agricultural cooperative, small business engaged in aquaculture, or private non-profit organization you may borrow up to \$2 million for Economic Injury.
- As a small business, you may apply for a maximum business loan (physical and EIDL) of \$2 million.
- As a homeowner you may borrow up to \$200,000 to repair/replace your disaster damaged primary residence.
- As a homeowner or renter, you may borrow up to \$40,000 to repair/replace damaged personal property.

#### STEP 2: Property Verified and Loan Processing Decision Made

- SBA reviews your credit before conducting an inspection to verify your losses.
- An SBA verifier will estimate the total physical loss to your disaster damaged property.
- A loan officer will determine your eligibility during processing, after reviewing any insurance or other recoveries. SBA can make a loan while your insurance recovery is pending.
- A loan officer works with you to provide all the necessary information needed to reach a loan determination. Our goal is to arrive at a decision on your application within 2 - 3 weeks.
- A loan officer will contact you to discuss the loan recommendation and your next steps. You will also be advised in writing of all loan decisions.

#### STEP 3: Loan Closed and Funds Disbursed

- SBA will prepare and send your Loan Closing Documents to you for your signature.
- Once we receive your signed Loan Closing Documents, an initial disbursement will be made to you within 5 days:
  - Physical damage:
    - \$25,000
  - Economic injury (working capital):
    - \$25,000 (In addition to the Physical damage disbursement)
- A case manager will be assigned to work with you to help you meet all loan conditions. They will also schedule subsequent disbursements until you receive the full loan amount.
- Your loan may be adjusted after closing due to your changing circumstances, such as increasing the loan for unexpected repair costs or reducing the loan due to additional insurance proceeds.

# PROCESS AND TIMING; LOAN AMOUNT

- Three Step Process
  - Step 1: Apply for Loan (online preferred)
  - Step 2: SBA reviews applicant's credit then verifies losses and determines eligibility. Goal is to do this in 2-3 weeks. SBA loan officer works with applicants to provide necessary information
  - Step 3: Loan Closing Documents and Initial Disbursement (generally \$25,000)
- Loan amount available is based on evaluation of economic loss
  - Phase I loans provide immediate working capital loans generally equal to a few months of gross profit prior to disaster up to a cap
  - Phase II loans require greater detail on actual economic losses and evaluation of past business operations

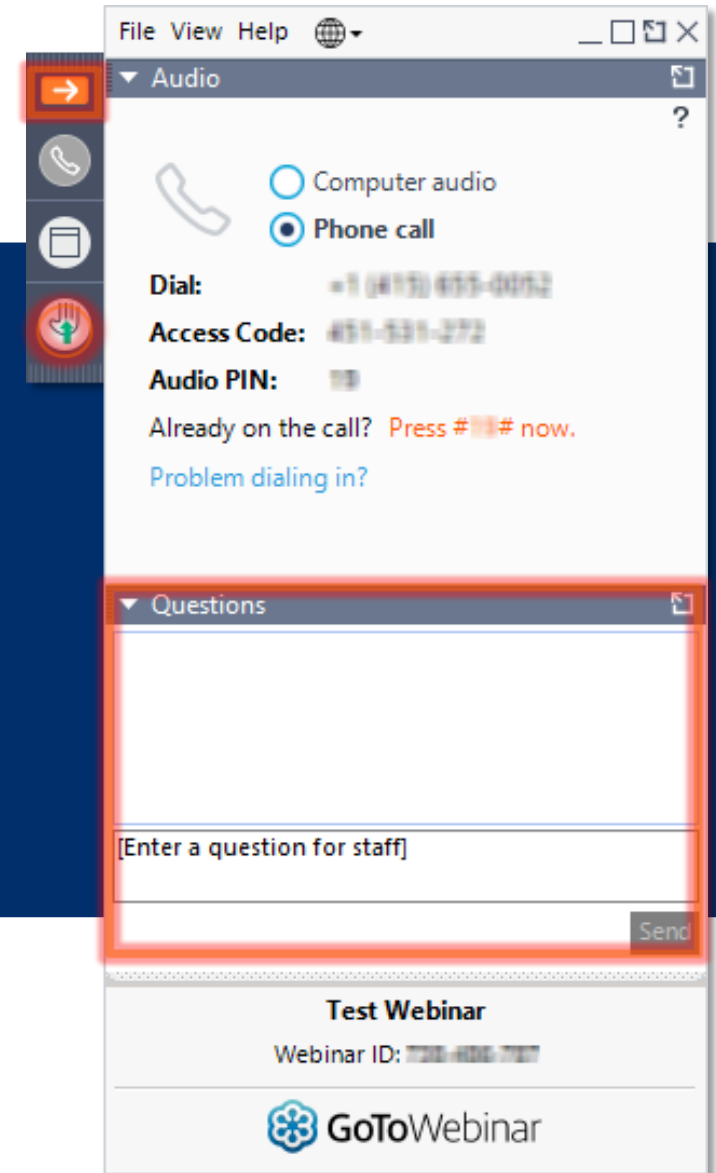
# CONCLUSION

There has been and will continue to be unprecedented interest in both these programs, which will inevitably strain the SBA's and lending banks' resources. As banks and borrowers dig into details, there will be questions that require SBA guidance.

It will be crucial for borrowers to understand which loan is better for them, and get a bank and advisors involved early. Incomplete or incorrect documents and applications will cause delay.

The KMK Law and First Financial Bank teams look forward to assisting Ohio, Kentucky and Indiana small businesses and non-profits in this process.

Please type your message/question in the window pane of the attendee control panel.



## Questions?



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Contact Us

# Understanding COVID-19 SBA Disaster and Small Business Loans

THANK YOU

