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Coronavirus Aid, Relief, and Economic Security (“CARES”) Act: Highlights of Federal Lending Programs

Spring 2020

Background

The Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”), signed into law on March 27, 2020, is a \$2 trillion federal emergency assistance program for individuals, families and businesses impacted by the COVID-19 pandemic.

Under the CARES Act, capital is available to support businesses, including:



Federally-backed loans, guarantees and investments



Emergency grants



Tax relief and tax credits

CARES Act Federal Lending Programs: Options

Small Business

Paycheck Protection Program (“PPP”)

- ✓ Available Amount: Up to \$10mm
- ✓ Features: Loans which are subject to **forgiveness** and **deferred payments**; available until 6/30/20
- ✓ Problem: affiliation for PE/VC coo's (but some limited relief available)
- ✓ Tax Considerations: **Incompatible** with the (i) Employee Retention Credit and (ii) Payroll Tax Deferral (if debt is forgiven)

7(a) Loans (including Express Loans)

- ✓ Available Amount: Up to \$5mm for standard 7(a) loans and up to \$1mm for Express Loans (vs. \$350K under existing program)
- ✓ Features: Approval within 5-10 b. days (7(a) loans) and 36 hours (Express Loans), max. 85% SBA guarantee, personal guarantee required, collateral required for loans >\$25K, deferred payments
- ✓ Problem: affiliation for PE/VC co.'s

Economic Injury Disaster Loan (“EIDL”) Program + Emergency EIDL Grants

- ✓ Available Loan Amount: Up to \$2mm
- ✓ Features: 3.75% interest rate, \$10K grant available upon request
- ✓ Considerations: New EIDL Loans cannot be obtained for same purpose as PPP loans and application must be submitted before PPP application; \$10K advance to be reduced from PPP forgiveness amount

Medium-Sized Businesses

Treasury Lending Program

- ✓ Elements: loans, loan guarantees, and other investments
- ✓ Eligibility: Includes businesses with between 500 and 10,000 employees

Possible “Main Street” Lending Program

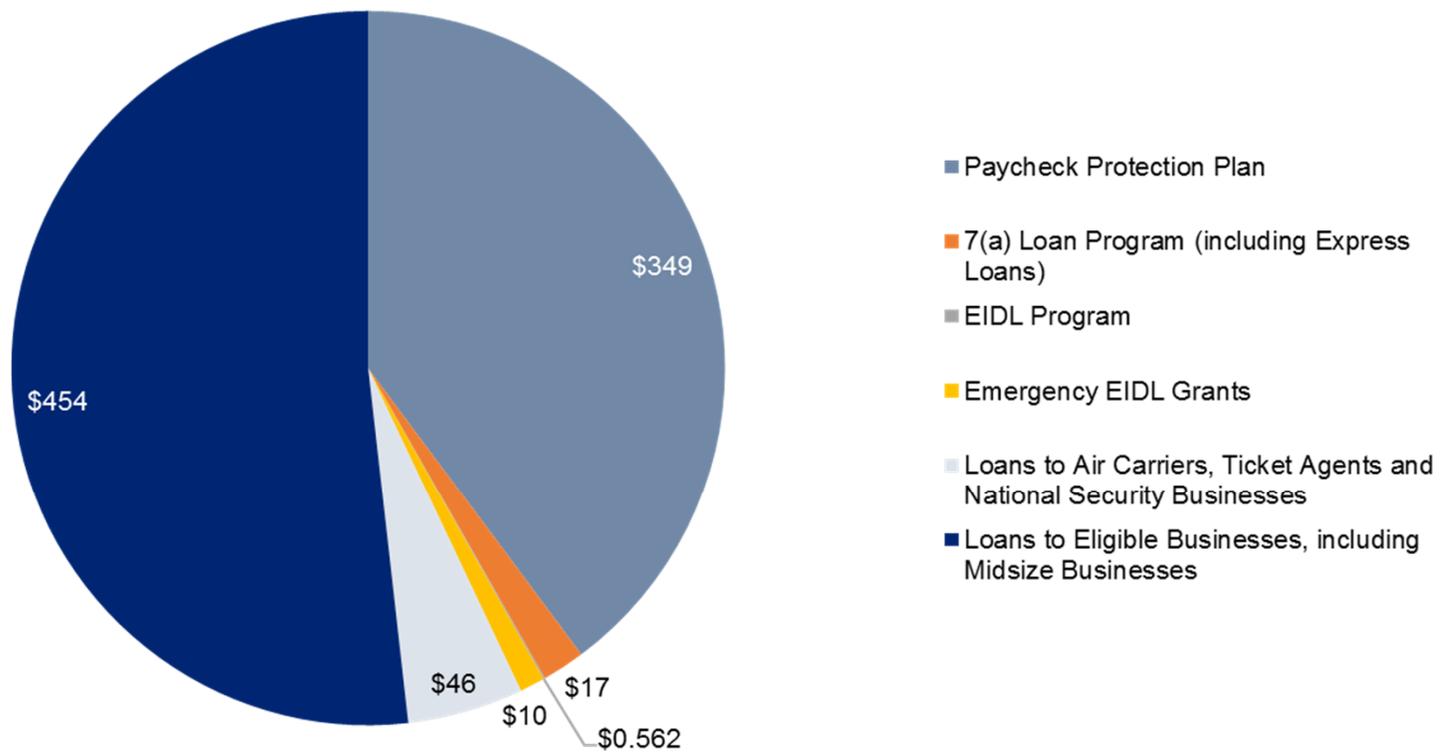
- ✓ Treasury Secretary has discretion to establish a “Main Street Lending Program” to support lending to “small and mid-sized businesses.”
- ✓ If pursued, this program could potentially provide relief to businesses otherwise ineligible for small business or Treasury Lending programs (**e.g., PE and VC portfolio companies**)

Most likely options for most clients: PPP or Treasury (esp. Main Street)

U.S. Small Business Administration (“SBA”) and Treasury are expected to issue additional guidance and regulations to implement the CARES Act, including the programs described in this publication, in the coming weeks.

CARES Act Federal Lending Programs

\$ billions



Small Business Programs

Paycheck Protection Program, EIDL Loans and
Emergency EIDL Grants



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Paycheck Protection Program (“PPP”)

- \$349B expansion of the Section 7(a) loan program administered by the U.S. Small Business Administration (“SBA”) from February 15, 2020 – June 30, 2020
- Loans administered by SBA-approved lenders (list to be expanded by SBA)
- Benefits of the PPP, in a nutshell:
 - Enables payment of payroll, health care, mortgage interest/rent, utilities and pre-existing interest obligations
 - Deferral of payments
 - Loan forgiveness can effectively turn the loan into a **grant**, subject to maintaining headcount and compensation levels
 - No collateral or personal guarantees
 - Hopefully relatively easy to coordinate with existing debt
 - Favorable rates

PPP Features

✓	Loan forgiveness (subject to conditions, with emphasis on limiting headcount reductions and decreases in compensation))	✗	Potential affiliate exclusions for PE/VC portfolio companies
✓	Expanded eligibility	✓	Higher maximum loan amounts
✓	100% SBA guarantee	✓	More allowable uses of funds, compared to other 7(a) loans
✓	Payment deferrals	✓	<u>Watch</u> treatment of payroll in excess of \$100K per person

Summary of PPP Loan Terms

<u>Term</u>	<u>Summary</u>
Maximum Amount (capped at \$10mm):	Lesser of (i) \$10mm or (ii) (a) 2.5 x average total monthly payments for “payroll costs” (see <i>Appendix A</i>) on a TTM basis + (b) outstanding amount (if any) of any EIDL loan made between 1/31/20 and the date of the PPP loan
Guarantee:	100% by SBA; no personal guarantees
Collateral:	None
Maximum Interest Rate:	4%
Permitted Uses:	<ul style="list-style-type: none"> • Payroll costs • Health care benefits • Mortgage interest payments • Rent • Utilities • Interest on pre-existing debt obligations from before covered period

Summary of PPP Loan Terms (cont.)

<u>Term</u>	<u>Summary</u>
Deferral of Payments:	No payments of principle, interest or fees required for at least 6 months and up to 1 year
Amount Eligible for Forgiveness (<i>loan effectively becomes a grant</i>):	<p>Sum of the following expenses made by borrower during 8-week period after loan origination: Payroll costs + mortgage interest payments + rent + utilities</p> <p>Qualifications: (i) Mortgage, rent and utility obligations/services must have been in place prior to Feb. 15, 2020 and (ii) Subject to reduction if headcount or salaries for certain employees are reduced during the 8-week period after loan origination</p>
Prepayment Penalties:	None
Other Notable Features:	<ol style="list-style-type: none">(1) No duty to demonstrate inability to obtain credit elsewhere(2) Borrower to certify, among other items, that uncertainty of current economic conditions makes loan request necessary to support ongoing operations

PPP Loan Eligibility

Borrower must meet at least one of three criteria:

1

“Small Business Concern”

SBA test based on (a) # of employees or receipts or (b) tangible net worth of up to \$15mm and average net income (after federal income taxes) of up to \$5mm for last 2 fiscal years

Magnitude and test depends on applicable industry:

- Employee test : 100 – 1,500
- Receipts test: \$1.0mm – \$41.5mm

2

Employee-Only Test

Among other categories, a business concern employing not more than the *greater* of:

- 500 employees, or
- The size standard (in # of employees) established by the SBA for the applicable industry

3

Accommodation and Food Service Test

For businesses in the Accommodation and Food Services sector (NAICS Code starting in 72), employing not more than 500 employees at each location

Note: certain self-employed individuals, independent contractors and sole proprietors are also eligible



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PPP Loan Eligibility – Employees and Receipts Tests

For purposes of applying the applicable PPP loan eligibility test, the employee and receipts tests (as applicable) are applied as follows:

Employees Test

Equal to the average # of employees per pay period, based upon the # of employees for each of the pay periods for the preceding completed 12 calendar months

- **Employees:** Count every individual employed on a full-time, part-time, or other basis

Receipts Test

Equal to average total receipts for the 3 most recently-completed fiscal years

- **Receipts:** means “total income” plus “cost of goods sold” as reported on federal tax return forms (subject to certain exclusions)

PPP Loan Eligibility – One Major Challenge: **Affiliation** for PE and VC Backed Companies

- The size test for PPP loan eligibility applies to the applicable company and all of its affiliates
- The affiliation rules are broad and involve a complex, fact-specific analysis (see *Appendix B*)
- Perennial challenge for private equity- and venture capital-backed companies:
 - Affiliation can result in exclusion from PPP program, similar to pre-existing exclusion from other SBA programs
 - Possibility of SBA leniency in coming rule-making? (TBD)
 - If no SBA leniency, consider availability of Treasury Programs (see *Slide 20*) to provide relief
 - VC-backed companies – evaluate existing negative covenants / protective provisions which may be deemed to confer control and consider amending / diluting such covenants / provisions
- Three **exceptions** to affiliation rules (see next slide)

PPP Loan Eligibility – The Challenge of **Affiliation** – Three Exceptions

Affiliation rules do not apply to any of the following companies:

1

Pre-Existing SBIC Financial Assistance

- A Recipient of “financial assistance” from a Small Business Investment Company
- A PE-backed company with any pre-existing SBIC debt or equity financing may avoid affiliation
- Need to see SBA rulemaking

2

Food Service or Accommodations with < 500 Employees

- A Business that: (i) has 500 employees max. *and* (ii) as of the date on which the PPP loan is disbursed, has a NAICS Code beginning with 72
- Absent SBA guidance, for purposes of this waiver, the employee headcount is not location-based

3

Franchises

- A Business that is a franchise assigned an SBA identifier code
- PE-backed franchises may avoid affiliation

PPP Existing Debt Considerations

Negative Covenants – Debt Limits

- ✓ Request new exception or basket for PPP debt

Financial Covenant Calculations

- ✓ Leverage calculation: Consider exclusion of PPP Debt from Total Debt
- ✓ Fixed Charge Test: Consider exclusion of PPP principal/interest payments

Possible New Affirmative Covenants

- ✓ Existing lenders may require additional covenant requirements
- ✓ For example, existing lenders may require that borrower covenants to comply with forgiveness requirements under PPP

Possible Intercreditor Issues

- ✓ Lender may require agreement with PPP Lender
- ✓ For example, existing lender may want to require PPP Lender to agree to turn over proceeds of Collateral accidentally received by PPP lender

PPP Nuances/Finer Points – Payroll Costs

- Payroll costs (see *Appendix A* for detailed summary of components)
 - How is payroll important to PPP?
 - Loan amount: based on historic payroll costs
 - Use of proceeds: payroll costs are a permitted use
 - Amount of loan forgiveness: payroll costs during the 8-week period following PPP loan origination are eligible for forgiveness
 - \$100,000 per person annual cap - for purposes of calculating payroll costs, compensation is **limited**:
 - \$100K annual compensation per person (both for employees and independent contractors), pro-rated for Feb. 15, 2020 – June 30, 2020 (i.e., ~\$37,261 per person)
 - Any compensation in excess of this amount will be **excluded** from the calculation

PPP Nuances/Finer Points – Loan Forgiveness – Calculation

Base Amount (*capped at principal*)

Sum of the following expenses made during 8-week period after loan origination (the “covered period”):

Payroll costs + mortgage interest payments + rent + utilities

–

Reductions

- # of FTE employees during covered period is reduced compared to historic averages
- Salary of employees who made <\$100K in 2019 is decreased by >25% during the covered period (vs. the most recent full quarter prior to the covered period).
- Exemptions may be available if remedial action is taken.

+

Increases

- Wages paid to tipped workers

PPP Nuances/Finer Points – Loan Forgiveness

- Supporting documentation required for forgiveness application (receipts, payroll evidence)
- Tax impact:
 - Forgiven amounts are excluded from gross income
 - **But:** no payroll tax deferral if amounts are forgiven
- Remaining Balance (if any): 100% SBA guarantee, maximum 10 year term from time of forgiveness
- SBA to issue implementation guidance and regulations

PPP Open Questions

- Will borrowing demand outstrip availability?
- How to collect necessary borrower information and get in the queue?
- Sources of loans
 - Which new lenders (including non-bank lenders?) will be added to the program per SBA rule making?
 - Talk to existing lenders, if eligible SBA loan originators
 - Talk to existing SBA loan intermediaries, who know the market
- SBA and Treasury rulemaking may create more opportunities and hopefully provide clarity on these questions

EIDL Loans and Emergency Grants

- \$10B of Emergency EIDL Grants in connection with \$562mm expansion of the Section 7(b)(2) Economic Injury Disaster Loan (“EIDL”) program administered by the SBA, to be available from January 31, 2020 – December 31, 2020
- Eligible recipients include small business concerns (as defined under existing SBA regulations) and, among others, businesses and ESOPs with up to 500 employees
- The SBA’s **affiliation** rules apply to these programs (with no relief under the CARES Act), and therefore unlikely to be an option for PE and VC portfolio companies

Emergency EIDL Grants

- **Amount:** Up to \$10K advance in connection with, and granted within 3 days of, EIDL application
- **Permitted uses:** paid sick leave, payroll, rent / mortgage payments
- No requirement to repay advance, even if subsequently denied an EIDL
- **Other:**
 - must self-certify as to eligibility for 7(b)(2) loan
 - If subsequently becomes a PPP borrower, the advance amount will be deducted from forgiveness amount

EIDL Program

- **Amount:** Up to \$2 million
- **Guarantee:** Personal guarantee waived for loans \$200K or less
- **Interest:** 3.75% (for small businesses)
- **Permitted uses:** paid sick leave, payroll, rent/ mortgage payments
- **Other:**
 - New EIDL Loans cannot be obtained for same purpose as PPP loans and application must be submitted before PPP application
 - May be approved based on credit score only; no need to demonstrate inability to obtain credit elsewhere

U.S. Treasury Programs



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Additional Treasury Lending Programs

- Treasury Secretary authorized to make up to \$500B of loans, loan guarantees, and other investments (including purchase of existing debt instruments in the secondary market) in support of “Eligible Businesses,” including midsize businesses
- “Eligible Businesses” - US businesses that have not otherwise received adequate relief under the act (broadly defined)

Treasury Lending Program

- ✓ Elements: loans, loan guarantees, and other investments
- ✓ Eligibility: Includes businesses with between 500 and 10,000 employees
- ✓ Allocation:
 - ✓ \$46B to air carriers, ticket agents and national security-critical businesses
 - ✓ \$454B to other businesses

Possible “Main Street” Lending Program

- ✓ Treasury Secretary has discretion to establish a “Main Street Lending Program” to support lending to “small and mid-sized businesses.”
- ✓ If pursued, this program could potentially provide relief to businesses otherwise ineligible for small business or Treasury Lending programs **(e.g., PE and VC portfolio companies)**

- **Note:** Above Treasury Lending Programs may provide relief for companies that are not eligible for SBA loans (e.g., due to affiliation test)

Additional Treasury Lending Programs (cont.)

	<ul style="list-style-type: none"> Loans to Air Carriers, Ticket Agents and Businesses Critical to National Security need to meet all of the below (including red highlighted criteria) Direct Loans to “other eligible businesses” are subject to criteria in black 	Loans to Midsize Businesses
Eligibility and Financial Requirements	Loans permitted if Secretary determines: <ul style="list-style-type: none"> Applicant is an eligible business (US businesses that have not otherwise received adequate relief under the act (broadly defined)) Credit is not reasonably available at the time of the transaction to Applicant Obligation is “prudently incurred” Business must have incurred or is expected to incur covered losses such that the continued operations of the business are jeopardized 	Eligible borrower must make a good faith certification that: <ul style="list-style-type: none"> Applicant is an eligible business with between 500 and 10,000 employees Uncertainty of economic conditions makes necessary the loan request to support the ongoing operations of the recipient Recipient is not a debtor in a bankruptcy proceeding US Company requirements below are satisfied and that they will comply with Employment Requirements/Restrictions below
Terms and Repurchase Limits	<ul style="list-style-type: none"> Prohibition on repurchase of shares in public markets within 12 months after payment in full (unless previously required by contract) Prohibition on dividends or capital distributions on common stock until 12 months after repayment. Loan or guarantee is sufficiently secured OR made at a rate that reflects the risk and is not less than the rate based on market conditions for comparable obligations pre-outbreak For public companies: Treasurer must receive warrants or equity interests For private companies: Treasurer must receive warrants, equity interests or senior debt instrument. Duration of the loan or loan guarantee is as short as practicable and in any case not longer than 5 years Procedures for application and minimum requirements to be provided within 10 days of enactment. 	<ul style="list-style-type: none"> Annualized interest rate no higher than 2% per annum No principal or interest due for first 6 six months after loan is made (or longer in discretion of the Secretary)
Employment Requirements / Restrictions	<ul style="list-style-type: none"> Limitations on the amount of compensation that is permitted to be paid to senior employees during the term and until 1 year after repayment Must maintain employment levels as of March 24, 2020 to the extent practicable until September 30, 2020 Prohibition on reduction of employment levels by more than 10% from levels on March 24, 2020. 	<ul style="list-style-type: none"> Required to retain at least 90 percent of the recipient’s workforce at full compensation and benefits until September 30, 2020 Required to certify intent to restore not less than 90 percent of the workforce that existed as of February 1, 2020 and restore all compensation and benefits to employees no later than 4 months after the termination date of the public health emergency Prohibition on ability to outsource or offshore jobs until 2 years after repayment. Prohibition on ability to abrogate existing collective bargaining agreements until 2 years after repayment Required to remain neutral in any union organizing effort for term of loan
US Company	Organized in US and with significant operations and majority of employees based in the US.	<ul style="list-style-type: none"> Organized and domiciled in US with significant operations and majority of employees based in the US

Questions

If you have any questions regarding the matters covered in this publication, please contact any of your regular FDH contacts.



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Appendix A – Payroll costs under the Paycheck Protection Program

Payroll costs include

✓	Salary, wage, commission, cash tips
✓	Vacation, parental, family, medical or sick leave
✓	Group health care benefits, retirement benefits
✓	State or local tax assessed on employee compensation
✓	Payments to independent contractors as compensation (up to \$100K, pro-rated for covered period (i.e., ~\$37,261))

Payroll costs exclude

X	Portion of individual employee compensation which exceeds annual salary of \$100K, pro-rated for covered period (i.e., ~\$37,261)
X	Certain federal taxes
X	Compensation to employees based outside of the United States
X	Sick and family leave wages entitled to credits under the Families First Coronavirus Response Act

Appendix B: Affiliation Analysis (SBA Affiliation Chart)

Category	Affiliation may be found if...
Ownership	<ul style="list-style-type: none"> • An individual, concern, or entity owns or has the power to control more than 50% of voting equity • An individual, concern, or entity owns or has the power to control a block of stock that is large compared to others • Two or more persons owns, controls or has the power to control less than 50% of voting equity and such holdings are equal or about equal in size and are large compared to other holdings, SBA presumes that each controls or has the power to control. • If voting equity is widely held and no block is large as compared to all others, then Board and CEO/President will be deemed to control.
Options, convertible securities, agreements to merge (given <i>present effect</i>)	<ul style="list-style-type: none"> • If an individual or entity has control with the exercise of options and/or convertible securities and agreements to merge; however, agreements that are open or merely continue negotiations about a possible merger are not given present effect
Common management	<ul style="list-style-type: none"> • Officers, managing members, partners who control the management of the concern also control the management of another concern • Individuals or entities that control the board of directors of the concern also control the board or management of another concern
Identity of interest	<ul style="list-style-type: none"> • SBA may <i>presume</i> identity of interest among two or more persons/entities, and therefore affiliation, such as: <ul style="list-style-type: none"> • Between family members or individuals/firms with common investments and with identical or substantially identical business or economic interests. • If a firm economically relies on another firm (<u>e.g.</u>, for 70% or more of its receipts).

Source: U.S. Small Business Administration, “Small Business Compliance Guide: Size and Affiliation” (June 2018)



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Appendix B: Affiliation Analysis (SBA Affiliation Chart) (cont.)

Category	Affiliation may be found if...
Newly organized concern	<ul style="list-style-type: none"> The firm's officers, directors, principal stockholders, managing members, general partners, or key employees <i>organize another concern</i> in the same or related industry or field, and serve in such capacity for the new concern and the one furnishes the other with contracts, or other assistance. The firm can rebut the presumption of affiliation by showing there is a clear line of fracture between the two.
Joint ventures	<ul style="list-style-type: none"> Parties to a joint venture that submit an offer for a particular procurement or property sale are affiliated with each other for performance of that particular contract, unless one of the exceptions to affiliation listed apply, such as both partners being small. Generally, the parties to a joint venture will be affiliated with each other for all purposes if that specific joint venture receives more than three contract awards over a two-year period. The two-year period begins on the date of award of the first contract received by the joint venture. The same parties may create different, specific joint ventures that can again qualify to receive three contract awards over a two-year period; however eventually such a long-standing relationship may lead to a finding of general affiliation between the parties. See exceptions to affiliation.
Ostensible subcontractor	<ul style="list-style-type: none"> The firm is a non-similarly situated subcontractor <ul style="list-style-type: none"> that performs or will perform primary and vital requirements of a contract or upon which the concern is unusually reliant.
Franchise and License agreements	<ul style="list-style-type: none"> There is a license agreement and the licensee has no right to profit from its efforts with regard to the agreement and does not bear the risk of loss
Totality of the circumstances	<ul style="list-style-type: none"> Based upon the totality of circumstances, SBA determines that affiliation exists.

Source: U.S. Small Business Administration, "Small Business Compliance Guide: Size and Affiliation" (June 2018)



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