CARES Act

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Banking

Overview: CARES Act Provides Options for Lenders and Small Businesses

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The Coronavirus Aid, Relief, and Economic Security Act ("Act") provides for a 100% Small Business Administration ("SBA") guaranteed, unsecured, forgivable loan program that may be a very attractive component of, or support for, forbearance, restructure or workout agreements for many borrowers that are struggling during the current COVID-19 restrictions and that previously would not have qualified for SBA loan programs.

Specifically, as outlined below, as part of an overall relief package estimated at $2 trillion, the Act provides up to $350 billion in unsecured, forgivable SBA-guarantied loans that could be used by your borrowers to fund payroll, rent, utilities and interest payments on existing debt during the covered period (February 15, 2020 to June 30, 2020). The Act expands the class of eligible borrowers under the program to include sole proprietors, independent contracts and eligible self-employed individuals, as well as businesses with 500 or fewer employees (or, where more than one location exists, 500 or fewer employees per location) that are assigned to the "accommodation and food services" sector (Sector 72) under the North American Industry Classification System (NAICS).

General Description of the Loan Program

The Act amends the existing Small Business Act to create a new Paycheck Protection Program. Through this new program, existing SBA lenders and additional lenders to be approved by SBA for special inclusion in this program, may make loans to eligible businesses for, among other uses:

- Payroll support (including wages, payroll taxes, paid vacation, sick leave, or medical leave),
- Payment for health benefits,
- Interest on existing mortgage obligations and interest on other loan obligations in existence prior to the covered period, and
- Rent and utilities.

Highlights of the Paycheck Protection Program

- 100% guaranteed by SBA (as opposed to standard 75% guaranty).
- Up to $10,000,000 per loan (determined based on the formula below).
- No personal guaranties or collateral will be required.
- Payment deferral (discussed below).
- For amounts not forgiven, two-year maturity from the date the debtor applies for loan forgiveness.
- Interest rate is 1%, but interest and principal payments are deferred for six months.
- No prepayment penalty fees.
- Removal of the current requirement that an eligible recipient must not be able to acquire credit elsewhere.
- Removal of the current affiliate requirements for purposes of determining eligibility of "Sector 72" businesses, which include accommodation and food services businesses.

- Loan proceeds may be used to refinance an SBA Disaster Program Loan made after January 31, 2020.
- Eligible recipient must certify that the loan is necessary to support the ongoing operations of the eligible recipient due to uncertainties of the current economic conditions caused by COVID-19; the funds will be used to retain workers and maintain payroll or cover the expenses described above; the eligible recipient does not have an application pending for another Small Business Act loan; and the eligible recipient has not received amounts for the same purpose and duplicative of the amounts applied for or received under the loan.
- SBA will reimburse processing costs of participating lenders based on the amount of the loan:
    - 5% for loans of not more than $350,000,
    - 3% for loans more than $350,000 and less than $2,000,000, and
    - 1% for loans of not less than $2,000,000.
- The loans are made on a nonrecourse basis. The lender cannot seek collection from any individual shareholder, member or partner of the business. There is an exception to the nonrecourse nature of the loan if the recipient uses the loan proceeds for something other than an authorized use.
- Loans are eligible to be sold on the secondary market.
- The standard SBA guaranty and annual fees are waived for covered loans.

Additional information and applications can be found at the U.S. Small Business Administration's Coronavirus Relief Options Paycheck Protection Program webpage and the U.S. Treasury Department's CARES Act webpage for Small Business Assistance.

Calculating the Maximum Loan Amount

The maximum loan amount is calculated as follows: The lesser of (a) $10,000,000; or (b) 2.5 *multiplied by* (average total monthly payments by applicant for payroll costs incurred during the 1-year period before the date on which the loan is made.

Payroll costs are equal to the sum of payments made in the form of salary, wage, other compensation, cash tips, vacation, medical and sick leave, payments to continue group health benefits, and amounts paid on state and local payroll taxes on such compensation.

Please be advised special rules apply if an eligible recipient is seasonal or not in business between February 15, 2019 and June 30, 2019.

Payment Deferral

Any business operating on February 15, 2020 that is a qualified borrower that makes an application under the Program qualifies for payment deferrals for principal, interest, and fees for six months, but interest will continue to accrue during the deferral period. Lenders are required to allow such deferrals, and in the event a secondary market investor declines to approve a lender's deferral, SBA must then purchase the loan. Additional guidelines on this process are forthcoming.

Loan Forgiveness

Debt obligations are forgivable in an amount not to exceed the principal amount of the loan and equal to the sum of the following costs incurred and payments made during the eight-week period starting when the loan is made and then reduced (as described below):

- Payroll costs;
- Payments of interest on covered mortgage obligations;
- Payments of covered rent obligations;
- Payments of covered utility payments; and

- Payments of interest on any other debt obligations incurred prior to the covered period.

In addition, at least 75% of the loan forgiveness amount must be used for payroll costs and not more than 25% may be used for other allowed expenses, such as rent, utilities and interest. The borrower must document the use of the proceeds for payroll costs for loan forgiveness. The portion of any loan not forgiven will have a two-year term and 1% interest rate.

With respect to the reduction in full-time employees, reductions to the forgiveness amount are made by taking the sum of the above items and *multiplying* them by the average number of FTEs per month – calculated by the average number of FTEs for each pay period falling within a month during the covered period *divided by* either: (a) Average FTEs/month during Feb 2019 to June 2019; or (b) Average FTEs/month during Jan. 1, 2020 to Feb. 29, 2020.

With respect to the reduction in wages, a reduction to the forgiveness amount is calculated by determining the amount of any reduction in total salary or wages of any employee during the covered period that is in excess of 25% of the employee's salary or wages during the employee's most recent full quarter of employment before the covered period.

To encourage businesses to rehire workers who were laid off during the COVID-19 outbreak, businesses can reduce the reduction amount if they rehire previously laid-off employees or make up for wage reductions by June 30, 2020.

Within 90 days after the foregoing forgiveness amount is determined, SBA must remit to the lender an amount equal to the amount of forgiveness, plus interest through the date of payment to such lender. SBA must purchase the expected forgiveness amounts within 15 days. Any amounts forgiven are treated as cancelled indebtedness.

Additionally, the lender, or third-party participant in the secondary market, may report the expected forgiveness amount on a covered loan or pool of such loans to SBA, up to 100% of the principal of the loan. SBA must then purchase the expected forgiveness amount within 15 days of receiving such report.

Regulatory Changes for Lenders

Risk-Based Capital Requirements: Loans made under the Paycheck Protection Program are given a risk weight of 0% under the risk-based capital requirements of the respective Federal banking agencies and the National Credit Union Administration Board.

Troubled Debt Restructuring Disclosures: On or after March 13, 2020, any insured depository institution or insured credit union that modifies a loan under the program, in relation to Covid-19-related difficulties, is not required to comply with the Financial Accounting Standards Board Accounting Standards Codification Subtopic 310-40 (Receivables – Troubled Debt Restructurings by Creditors) for purposes of the Federal Deposit Insurance Act.

Additional Information and Resources

Additional information and applications can be found at the U.S. Small Business Administration's Coronavirus Relief Options Paycheck Protection Program webpage and the U.S. Treasury Department's CARES Act webpage for Small Business Assistance.

As more details, guidelines and regulations become available, Kutak Rock will keep you informed. We ready to discuss any questions or concerns that may arise during the loan process. Please contact a member of the national Banking Group for further information.