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FAQs: Small Business Loans Under the CARES Act

US Congress set to make more than \$350 billion available to eligible small business concerns.

On March 27, 2020, President Donald J. Trump signed the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). The CARES Act is the US Congress' more than \$2 trillion emergency relief bill that attempts to address the financial uncertainty created by the COVID-19 pandemic.

Title I of Division A of the CARES Act includes a number of measures to streamline and increase small business concerns' access to the Small Business Administration's (SBA's) general business loan program (7(a) loans) and economic injury disaster loans (EIDLs), deferments for certain existing loans, and loan forgiveness — all with the goal of preventing workers from losing their jobs and small business concerns from going out of business due to economic losses caused by the COVID-19 pandemic.

This *Client Alert* provides answers to frequently asked questions about the small business loan-related provisions, including what types of loans are available, who is eligible, what the terms and conditions are, and how to apply.

1. What Types of Small Business Loans Are Available?

- **7(a) Loans:** The 7(a) loan program is one of the SBA's primary programs for providing financial assistance to small business concerns. The CARES Act includes a \$349 billion package for the SBA's 7(a) loan program through December 31, 2020. These 7(a) loans would be 100% guaranteed by the federal government through December 31, 2020, and are subject to loan forgiveness up to the entire loan amount subject to certain restrictions discussed below. The goal is to help employers maintain their payroll levels.
- **EIDLs:** The EIDL program is available for certain business concerns located in an area affected by a disaster — such as a public health disaster — that have suffered a substantial economic injury as a result of such disaster. The CARES Act includes a \$10 billion package to expand the SBA EIDL program to additional eligible business concerns impacted by the COVID-19 pandemic. The EIDL grant provisions allow the applicant to request that the SBA provide an advance in the amount

requested — but not to exceed \$10,000 — within three days of when the SBA receives the applicant's application.

2. Who Is Eligible for Loans?

- **7(a) Loans:** The following business concerns are eligible under the CARES Act for the 7(a) loan program:
 - Small business concerns, nonprofit organizations,¹ veterans' organizations,² and Tribal business concerns³ in each case with 500 employees or fewer
 - Business concerns that meet the applicable size standard for their industry as provided by the SBA, if this number is greater than 500 employees or a revenue-based size standard
 - Sole proprietors, independent contractors, and other self-employed individuals
 - Business concerns in the Accommodation and Food Services industries⁴ with more than one physical location so long as that business concern does not have more than 500 employees per physical location⁵
- **EIDLs:** The following entities are eligible for these EIDL grants:
 - Business concerns with not more than 500 employees
 - Small business concerns that meet the applicable size standard for the industry as provided by the SBA, if this number is greater than 500
 - Private nonprofit organizations
 - Small agricultural cooperatives
 - Any individual who operates under a sole proprietorship or as an independent contractor
 - A cooperative with not more than 500 employees
 - An employee stock ownership plan (ESOP)⁶ with not more than 500 employees
 - Tribal small business concerns with not more than 500 employees

3. What Business Concerns Are Excluded?

- **7(a) SBA Loans:** The following business concerns are excluded:
 - Business concerns that appear small but do not meet the requirements due to “affiliation” rules set out by the SBA.⁷ However, there are exceptions to the affiliation rules including for:
 - Business concerns in the Accommodation and Food Services industries with not more than 500 employees
 - Franchises that are approved on the SBA's Franchise Directory

- Small business concerns that receive financial assistance from a Small Business Investment Company (SBIC)
- **EIDLs:** The following business concerns are excluded:
 - Public nonprofit organizations
 - Business concerns that appear small but do not meet the requirements due to affiliation rules set out by the SBA

Unlike the CARES Act waiver of affiliation rules for certain business concerns in the 7(a) loan program, there is not a similar waiver of the affiliation rules for EIDLs.

4. How Does Affiliation Apply to Private Equity or Venture Capital Portfolio Companies?

- **For both 7(a) SBA Loans and EIDLs:** The CARES Act generally still appears to require compliance with the SBA's affiliation rules found at 13 C.F.R. Section 121.301 and Section 121.103(b).
 - Whether a portfolio company of a private equity or venture capital firm is affiliated with its sponsor or with other portfolio companies will depend on the particular facts and circumstances and the existing affiliation standards will apply. If such standards are applied consistent with prior interpretation then (subject to the below) it may limit the ability of private equity or venture capital portfolio companies to access these funds. Relevant factors taken into account will include percentage ownership, minority rights under the operating agreement, and relationships among the parties.
 - The SBA may also issue regulatory guidance which may give a different interpretation of affiliation under the CARES Act.
 - Under the 7(a) SBA Loans, there are affiliation exceptions for business concerns in the Accommodation and Food Services industries with not more than 500 employees, franchises that are approved on the SBA's Franchise Directory, and small business concerns that receive financial assistance from an SBIC.

5. How Is Size Calculated?

- **For Both 7(a) SBA Loans and EIDLs:** The SBA requires the number of employees to be counted based on the business concern applying for the loan and all its affiliates.
 - Business concerns are required to perform this calculation as an average for each of the pay periods for the previous 12 months.
 - Affiliation determinations can be very fact-specific and include consideration of a number of factors including ownership, management, control, economic interdependence, contractual relationships, and minority investor rights.
 - The CARES Act, at least for 7(a) SBA Loans, introduces some new exceptions to the affiliation rules that are unique to this program.

6. Are There any Eligibility Requirements?

- **7(a) SBA Loans:** Yes, an applicant must qualify as an eligible business concern as described above.
- **EIDLs:** In addition to being an eligible business concern under the existing regulatory framework, an applicant must meet several requirements to be eligible:
 - The applicant’s business concern must be located in a declared disaster area.⁸
 - The applicant’s business concern must have suffered “substantial economic injury”⁹ as a direct result of a declared disaster such as COVID-19.
 - The applicant must not own property subject to a judgment lien owed by the US government.

7. How Much Can an Applicant Receive?

- **7(a) Loans:** The size of the loan is the lesser of either (i) a formula-based amount, tied to an applicant’s average total monthly payments for payroll costs¹⁰ plus any outstanding EIDLs to be refinanced, or (ii) \$10 million. Under the formula, the maximum loan amount would be 2.5 times the business concern’s average total monthly payments for payroll costs incurred during the one-year period before the date on which the loan is made.¹¹ Additionally, for purposes of the formula, the size of the loan may be increased by the outstanding amount of an EIDL made under subsection (b)(2) of the Small Business Act between January 31, 2020 and the date on which covered loans under 7(a) are made available, with the EIDL to be refinanced under the covered loan.
- **EIDLs:** The maximum amount available to eligible small business concerns is \$2 million — an amount that is subject to a waiver if the applicant’s business concern is a “major source of employment”¹² — but the actual loan amount is limited to the economic injury as determined by the SBA (less business interruption insurance or other recoveries such as potential contributions available from the business concern and/or its owner(s) or affiliates). The applicant can also request an advance of not more than \$10,000, which the SBA should provide within three days of receiving the applicant’s application.
 - If a recipient of an EIDL needs an additional loan amount, the borrower may make a request for an increase in the loan amount to the SBA generally, provided the borrower does so no later than two years after the SBA approved the original EIDL.¹³ The SBA will consider a number of factors before granting the request.¹⁴

8. Are There any Collateral or Personal Guarantee Requirements?

- **7(a) SBA Loans:** No, collateral is not required for the covered loan and personal guarantees are not required for any covered loan.

EIDLs: The CARES Act waives any existing rules related to the personal guarantee on advances and loans of not more than \$200,000 during the covered period of January 31, 2020 and ending December 31, 2020. The CARES Act does not expressly mention collateral requirements. The existing collateral requirements for EIDLs — which provide that collateral is generally required for loans of more than \$25,000¹⁵ — appear to apply.

9. Are There any Credit Requirements?

- **7(a) SBA Loans and EIDLs:** No, under the CARES Act, the typical requirement that a small business concern show that it is unable to obtain credit elsewhere does not apply to a 7(a) covered loan or EIDL.

10. What Are the Restrictions on Use of 7(a) Loans?

- A recipient can only use the 7(a) loans to cover certain costs. Eligible small business concerns may use the 7(a) loan proceeds for the following:
 - Payroll costs
 - Costs related to the continuation of group healthcare benefits during periods of paid, sick, medical, or family leave, and related to insurance premiums
 - Employee salaries, commissions, or similar compensations
 - Mortgage payments
 - Rent
 - Utilities
 - Interest on any other debt obligations that were incurred before February 15, 2020
- Payroll costs includes the compensation and benefits of any employee or independent contractor up to an annual salary of \$100,000.
- An applicant cannot obtain both a 7(a) SBA loan and an SBA EIDL loan for the same purpose. A borrower who has received an EIDL between January 31, 2020 and the date on which the covered 7(a) loans are made available can still receive a 7(a) loan, but only if the EIDL was for a purpose other than paying for the above costs, including payroll costs.
- An applicant must certify in good faith that a 7(a) loan will only be used to cover the above costs. The CARES Act requires a borrower to make a good-faith certification that (1) the loan is necessary to support the ongoing operations of the eligible recipient; (2) the borrower will only use the funds to cover the costs described above; and (3) the borrower has not received a loan between February 15, 2020 to December 31, 2020 and does not have any other application pending for a loan for the same purpose (*i.e.*, no double dipping). Potential borrowers should make sure that they do not make any false certifications related to trying to obtain a 7(a) loan.

11. What Are the Restrictions on Use of EIDLs?

- A recipient can only use EIDLs to cover certain costs. Traditionally, EIDLs are only expressly permitted for:
 - Working capital necessary to carry the business concern until resumption of normal operations
 - Expenditures necessary to alleviate the specific economic injury, but not to exceed that which the business concern could have provided had the injury not occurred¹⁶

- The CARES Act expands the allowable uses of EIDLs to include:
 - Providing paid sick leave to employees unable to work due to the direct effect of COVID-19
 - Maintaining payroll to retain employees
 - Meeting increased costs to obtain materials unavailable from the applicant's original source because of interrupted supply chains
 - Making rent or mortgage payments
 - Repaying obligations that cannot be met due to revenue losses
- Proceeds of EIDLs may not be used for certain expenses. Recipients cannot use EIDLs to:
 - Refinance indebtedness incurred prior to the disaster event
 - Make payments on loans owned by another federal agency (including the SBA) or an SBIC
 - Pay, directly or indirectly, any obligations resulting from a federal, state, or local tax penalty as a result of negligence or fraud, or any non-tax criminal fine, civil fine, or penalty for non-compliance with a law, regulation, or order of a federal, state, regional, or local agency or similar matter
 - Repair physical damage
 - 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 concern¹⁷

12. What Are the Fees and Interest Rates?

- **7(a) SBA Loans:** From February 15, 2020 through June 30, 2020 with respect to covered loans, the SBA will not collect any fees otherwise applicable. This includes no prepayment fees. Interest rates cannot exceed 4%. A 7(a) loan shall bear an interest rate not to exceed 4%.
- **EIDLs:** The statutory limit for EIDL interest rates is 4% per annum.¹⁸ However, the SBA has lower rates specific for business concerns impacted by COVID-19: 3.75% for small business concerns and 2.75% for nonprofits.¹⁹

13. Is the Loan Guaranteed?

- **7(a) SBA Loans:** Yes, under the CARES Act, the government is guaranteeing the 7(a) loans 100% through December 31, 2020. After this date, the guarantee percentages will return to 75% for loans exceeding \$150,000 and 85% for loans equal to or less than \$150,000.
- **EIDLs:** The CARES Act does not contain any express provisions regarding the guarantee of EIDLs.

14. What Are the Repayment Considerations?

- **7(a) SBA Loans:** Under the CARES Act, a 7(a) loan shall be eligible for forgiveness up to the amount spent by the borrower during an eight-week period after the origination date of the loan on:

- Payroll costs²⁰
- Interest payment on any mortgage incurred prior to February 15, 2020
- Payment of rent on any lease in force prior to February 15, 2020
- Payment on any utility for which services began before February 15, 2020
- There are certain limitations, however, on the amount of the loan that is eligible for forgiveness, including the following:
 - The amount eligible for forgiveness may not exceed the principal.
 - The amount of the loan eligible for forgiveness will be reduced proportionally by the number of employees laid off during the eight-week period beginning on the date of the origination of the covered loan relative to the borrower's prior employment levels for one of two time periods: (1) February 15, 2019 through June 30, 2019, or (2) January 1, 2020 to February 29, 2020. The recipient can elect which period applies. For seasonal employers, the time period of February 15, 2019 to June 30, 2019 applies. The SBA will calculate the average number of full-time equivalent employees by calculating the average number of full-time equivalent employees for each pay period falling within a month.
 - The reduction would also apply if employees' salaries are reduced by more than 25%.²¹
- **EIDLs:** Under the CARES Act, an applicant is not required to repay any amounts of an advance provided under the Act even if the applicant is subsequently denied the EIDL grant. If an applicant receives an advance under the CARES Act but is approved for a 7(a) loan instead, the advance amount is reduced from the amount of the loan eligible for forgiveness under the 7(a) program.

15. Is a Business Concern Eligible for Loan Forgiveness if it Already Laid Off Workers?

- **7(a) SBA Loans:** Yes, borrowers that re-hire employees within a certain period of time that were previously laid off will not be penalized for having a reduced payroll at the beginning of the period.
- **EIDLs:** EIDLs are not eligible for loan forgiveness.

16. Is a Business Concern Eligible for Loan Forgiveness if it Already Reduced Salaries or Wages?

- **7(a) SBA Loans:** Yes, borrowers that remedy reduced salaries or wages within a certain period of time will not be penalized for having reduced salaries or wages for one or more employees at the beginning of the period.
- **EIDLs:** EIDLs are not eligible for loan forgiveness.

17. Is There Loan Deferment?

- **7(a) SBA Loans:** Yes, the CARES Act allows complete deferment of 7(a) loan payments for more than six months to not more than one year. This includes payment of principal, interest, and fees.
- **EIDLs:** The CARES Act does not address deferment for EIDLs.

18. Who Will Be Given Priority?

- **7(a) SBA Loans:** The CARES Act does not expressly contain any priority provisions; however, there is a clause titled “Sense of the Senate” in which the Senate suggests that the SBA Administrator should issue guidance to lenders and agents to ensure that the processing and disbursement of covered loans prioritize certain small business concerns and entities in underserved and rural markets.
- **EIDLs:** The CARES Act does not include priority provisions related to EIDLs.

19. Can a Business Concern Still Qualify if it Implements a Reduction in Force?

- **7(a) SBA Loans:** Yes, the eligibility requirements for the covered 7(a) loans do not inquire into whether business concerns have conducted reductions in force, furloughed, or otherwise laid off employees. However, as discussed above, the amount of the 7(a) loan that is eligible for forgiveness is reduced if a business concern decreases its workforce and does not re-hire employees within a set period of time.
- **EIDLs:** The CARES Act does not address the eligibility requirements for EIDLs regarding whether business concerns have conducted reductions in force, furloughed, or otherwise laid off employees.

20. Who Can Lend?

- **7(a) SBA Loans:** SBA-certified lenders, including banks, credit unions, and other financial institutions can lend. The Secretary of the Treasury is also authorized to expedite the addition of new lenders and make further enhancements to expedite delivery of capital to small employers.
- **EIDLs:** The SBA may make EIDLs directly or in participation with a financial institution.

21. What Factors Does the Lender Consider When Reviewing a Loan Application?

- **7(a) SBA Loans:** Lenders shall consider the following:
 - Whether the small business concern was in operation as of February, 2020
 - Whether it had employees for whom it paid salaries and payroll taxes or paid independent contractors as reported on Form 1099-MISC
- **EIDLs:** The SBA may approve the applicant based solely on the applicant’s credit score and not require a tax return or tax return transcript or use alternative appropriate methods to determine the applicant’s ability to repay the loan.

22. How Can a Business Concern Apply?

- **7(a) SBA Loans:** Applicants can apply through approved third-party lenders. While the CARES Act authorizes the SBA to bring on additional lenders, it is unclear how long this may take.
- **EIDLs:** Applicants apply directly to the SBA.

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Endnotes

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- ¹ "Nonprofit" is defined as a 501(c)(3) organization. See Section 1102(a)(2)(36)(A)(vii) of Division A, Title I of the CARES Act.
 - ² "Veterans' organization" means an organization described in Section 501(c)(19) of the Internal Revenue Code (the Code) that is exempt from taxation under Section 501(a) of the Code. See Section 1102(a)(2) (36)(A)(ix) of Division A, Title I of the CARES Act.

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- ³ “[A] tribal small business concern, as described in section 31(b)(2)(C) of the Small Business Act (15 U.S.C. 657a(b)(2)(C)), with not more than 500 employees.” See Section 1110(a)(2)(E) of Division A, Title I of the CARES Act.
- ⁴ “Accommodation and Food Services” is defined in the “72” series of North American Industry Classification System (NAICS) codes. See 13 CFR § 121.201.
- ⁵ Business concerns with more than one physical location as long as that physical location employs no more than 500 employees per physical location in the Accommodation and Food Services industries must specifically be classified in a NAICS code starting with 72 at the time of disbursement to be eligible. See Section 1102(a)(2)(36)(D)(iii) of Division A, Title I of the CARES Act.
- ⁶ The term “ESOP” is given the definition from Section 3 of the Small Business Act (15 U.S.C. Section 632)). See Section 1110(a)(2)(D) of Division A, Title I of the CARES Act.
- ⁷ The affiliation regulations under 13 C.F.R. Section 121.103 apply with respect to nonprofit organizations and veteran organizations in the same manner as with respect to small business concerns. See Section 1102(a)(2)(36)(D)(vi) of Division A, Title I of the CARES Act.
- ⁸ For geography-specific declarations and a fact sheet, which outlines features of the available loans in the state/county, go to <https://disasterloan.sba.gov/ela/Declarations/Index>.
- ⁹ “Substantial economic injury” means that a business concern is unable to meet its obligations as they mature or to pay its ordinary and necessary operating expenses. Loss of anticipated profits or a drop in sales is not considered substantial economic injury for this purpose. See 13 C.F.R. Section 123.300(a).
- ¹⁰ Under the CARES Act, the term “payroll costs” is defined to include the “sum or payments of any compensation with respect to employees” that is (1) salary, wage, commission, or similar compensation; (2) payment of cash tips or equivalent; (3) payment for vacation, parental, family, medical, or sick leave; (4) allowance for dismissal or separation; (5) payment required for the provisions of group healthcare benefits, including insurance premiums; (6) payment of any retirement benefits; (7) payment of State or local tax assessed on the compensation of employees. The Act also lists specific types of costs that do not qualify as “payroll costs,” including the compensation of an individual employee in excess of \$100,000 as prorated for the covered period. See Section 1102(36)(A)(viii)(I)(aa)(AA)-(GG) of Division A, Title I of the CARES Act.
- ¹¹ For seasonal employers — as determined by the Administrator — the size of the loan would be tied to the applicant’s average total monthly payments for payroll for the 12-week period beginning February 15, 2019, or at the election of the eligible recipient, March 1, 2019, and ending June 30, 2019. See Section 1102(a)(2)(36)(E)(i)(I)(aa)(AA) of Division A, Title I of the CARES Act. If the business concern was not in business during February 15, 2019 to June 30, 2019, the loan amount is tied to the average total of the monthly payments made for payroll costs incurred during the time period January 1, 2020 and February 29, 2020. See Section 1102(a)(2)(36)(E)(i)(II) of Division A, Title I of the CARES Act.
- ¹² A “major source of employment” is a business concern that, on or after the date of the disaster either:
- (i) Employs 10% or more of the work force within the commuting area of the geographically identifiable community (no larger than a county) in which the business concern employing the essential employee is located, provided that the commuting area does not extend more than 50 miles from such community
 - (ii) Employs 5% of the work force in an industry within such commuting area and, if the small business concern is a non-manufacturing small business concern, employs no fewer than 50 employees in the same commuting area, or if the small business concern is a manufacturing small business concern, employs no fewer than 150 employees in the commuting area
 - (iii) Employs no fewer than 250 employees within such commuting area; see 13 C.F.R. Section 123.202.
- ¹³ While the EIDL borrower should make a request for an incremental loan as soon as possible after discovery of the need for an increase, the borrower must do so within two years after the SBA’s approval of the original loan, subject to a waiver upon the SBA’s finding of extraordinary and unforeseeable circumstances. See 13 C.F.R. Section 123.20.
- ¹⁴ The SBA will consider a recipient’s request for an additional EIDL if both:
- (i) The recipient shows that the increase is essential for its business to continue and is based on events occurring after SBA approved the original loan which were beyond the borrower’s control (e.g., delays beyond a borrower’s control which prevent it from resuming its normal business activity in a reasonable time frame).
 - (ii) Such request is related to the disaster for which the EIDL was originally made. See 13 C.F.R. Section 123.19.
- ¹⁵ The existing regulatory framework governing EIDLs indicates that collateral is required for loans that exceed \$25,000. See 13 C.F.R. Section 123.11.
- ¹⁶ See 13 C.F.R. Section 123.303.
- ¹⁷ See 13 C.F.R. Section 123.303.
- ¹⁸ See 13 C.F.R. Section 123.302.
- ¹⁹ See SBA Guidance on SBA Disaster Assistance in Response to the Coronavirus, available at <https://www.sba.gov/disaster-assistance/coronavirus-covid-19>.
- ²⁰ Employers with tipped employees would receive forgiveness for additional wages paid to such employees during the covered time. See Section 1106(d)(4) of Division A, Title I of the CARES Act.
- ²¹ See Section 1106 of Division A, Title I of the CARES Act.