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Congress Passed the Coronavirus Aid, Relief and Economic Security Act ("CARES ACT")

Today, the United States Congress approved a bill known as the **Coronavirus Aid, Relief and Economic Security Act**, or the **CARES Act**. It is expected to be signed by the President and enacted within the next few days.

At 880 pages, the bill is long and complex. For the purposes of this Client Bulletin, we only summarize its principal provisions. If you have questions about the technical exemptions, limits and conditions or specific questions about how the provisions of the Act will apply to you or your company, we recommend that you seek expert advice or directly consult the Act. Note as well that significant aspects of the aid, relief and loan programs require further action by the relevant agencies, which will set regulatory rules and procedures to enable CARE Act's mandates to operate.

Short Term Strategies for Seeking Assistance with Cash-Flow and Employee Costs: SBA Loan Programs

The CARES Act contains a number of provisions providing important support for small- to medium-size businesses, nonprofits, and similar enterprises. Among the most important is a direction for the Small Business Administration to set up a program of loans to help pay operational costs like payroll, some benefits, rent, mortgage interest, and utilities. The Act requires that the Small Business Administration implement the regulations required to roll out this program within 30 days of the bill's enactment.

What makes these loans particularly attractive is the possibility that some or all of the debt will be forgiven if spent relatively quickly on designated expenses and if certain employment targets are met.

The loans can be taken directly from the SBA or through its network of affiliated lenders, just like other SBA loans. We strongly recommend that any enterprise considering applying for these loans should be in contact with one or more potential lenders as soon as possible, even before the final details of the program are established. While the legislation does not set specific capacity limits for this program, as a practical matter, laying the tracks for early action is would be wise.

What Entities are Eligible?

Eligibility is broad. Eligible entities include (i) companies already qualified as "small business concerns" under the SBA rules and (ii) other business concerns, nonprofit organizations,

veterans' organizations and Tribal business with 500 or fewer employees. This numerical limit is subject to some special rules for specific sectors, most notably in the accommodation and food services sector. The SBA's affiliation rules will generally apply for business groups, although here, too, there are some specific exceptions.

How Much Can Be Requested?

The upper limit is \$10 million dollars; but for most recipients, the limit for specific entities is set at 2.5 times the average total monthly payroll costs incurred in the one-year period before the loan is made (with special calculations for seasonal employees), plus the outstanding amount of certain loans made under the SBA's Disaster Loan Program during the period January 31, 2020 to the date of the loan under this program. (More on the Disaster Loan Program below.) Special rules apply for businesses that were not in existence from February 15, 2019 through June 30, 2019.

Terms of the Loans

The loans will have a maximum interest rate of 4%. Their maturity can be up to 10 years. No personal guarantee or collateral can be required, and there will be no recourse against individuals, shareholders, members or partners of an eligible loan recipient for non-payment unless proceeds were used for unauthorized purposes. The permitted uses of the loan proceeds include:

- Uses already allowed under the SBA's Business Loan Program
- Payroll costs
 - Payroll costs include: compensation to employees, which includes salaries, wages, commissions, or similar compensation; cash; paid leave; severance payments; payment for group health benefits, including insurance premiums; retirement benefits; state and local payroll taxes; and compensation to sole proprietors or independent contractors (including commission-based compensation) but *payroll costs for employees who earn more \$100,000 in one year, as pro-rated for the covered period, are excluded.*
 - Tipped employees are included, but only the extent they are directly compensated by the employer.
 - Qualified sick or family leave wages that are covered under Families First Act are *excluded* from these costs. For more information on the Families First Coronavirus Response Act, see our two earlier bulletins at our website – just click on the gold banner at the top of our homepage.
- Group health care benefits and insurance premiums
- Payments of interest on existing mortgage obligations
- Rent or lease payments
- Utilities
- Interest on other debt that preceded loan under this program

Forgiveness

This is the real opportunity – and the real teeth – of the loan program. The goal is to incentivize employers to keep their employees on salary. In order to do so, the Federal Government will provide a direct subsidy, through the mechanism of forgiveness of some or all of these loans, provided that the enterprise either keeps or rehires their employees in accordance with specific rules. Loan forgiveness will apply to expenditures made for payroll costs, interest payments on mortgages, rent and utility payments. This list is a bit more restrictive than the permitted usage list. The expenditures need to be made within the “covered period,” generally the 8 weeks following the initiation of the loan.

The total available for forgiveness, however, will be reduced to reflect reductions in workforce and reductions in payroll in certain specific periods.

Obligations for Keeping or Reinstating Employees

In order to incentivize keeping or reinstating employees, loan forgiveness is reduced by:

- The reduction in force EITHER between the average number of FTEs on 2/15/19-6/30/19 OR 1/1/20-1/29/20 relative to the number in the 8-week period beginning on the date the loan origination; and
- Reductions of more than 25% of individual employee’s salaries or wages from the last quarter prior to the loan period, except that there is special treatment for employees who received salary at an annualized rate of more than \$100,000 any one pay period.

Critically, however, reductions in force or payroll made between February 20, 2020 and 30 days after the law is enacted will NOT be counted towards reduction in loan forgiveness provided that those employees are rehired, and the payroll reductions reversed, by June 30, 2020. This provision is of great importance for enterprises that have already reduced their workforce or will need to do so in the time before these loans could be available to help support payroll costs. If properly reflected in the eventual rules, this would permit them to proceed with workforce reductions, ask their employees to seek unemployment insurance for an interim period, and then proceed with a re-hire once as loan proceeds permit and as business conditions recover. In order to have the expenditures take place in the covered period, re-hiring should be timed to coincide with loan availability. Those seeking to use this strategy should monitor the terms and timing carefully.

SBA Disaster Loan Program

The Cares Act also expands the existing SBA Disaster Loan Program. The covered period is January 31, 2020-December 31, 2020. The maximum loan is \$2 million. Eligible enterprises are expanded to included businesses with 500 or fewer employees, sole proprietors and independent contractors, ESOPs with 500 or fewer employees and tribal small businesses. Eligible uses for loan proceeds include any purpose already authorized under the SBA Disaster Loan Program, which in the COVID—19 context includes crisis related costs for:

- Sick leave to employees unable to work due to “a direct effect” of COVID-19;

- Payroll and supply chain costs;
- Rent or mortgage payments;
- Debts that cannot be paid due to lost revenue

Interest rates vary, capping out at 3.75% on for-profit companies, 2.75% on nonprofits, with deferment possible for up to 4 years.

For businesses in need of immediate cash, applicants may request an emergency advance of \$10,000, which does not have to be repaid even if the loan is later denied. Advances are disbursed within three days of application.

These loans can, in many cases, be folded into a loan made under the forgivable loan program described above, although emergency advance transfers are reduced from forgiveness amounts.

FOR MORE INFORMATION

For more information about how the CARES Act may apply to you or your business, please contact Peter Erly at perly@gravelshea.com; Chip Mason at cmason@gravelshea.com or Cassandra LaRae-Perez at claraeperez@gravelshea.com or your attorney at Gravel & Shea PC.