

March 23, 2020

SBA Loans for Small Business – A Potential Help in Dark Times

On March 6, 2020 the President signed the Coronavirus Preparedness and Response Supplemental Appropriations Act (H.R. 6074) into law. The Act deemed the coronavirus (COVID-19) a disaster under Section 7(b) of the Small Business Act of 1953 (SBA Act), thereby unlocking up to a total of \$7 billion in low interest economic injury disaster loans (EIDLs) to be made to small businesses that have been impacted by financial losses as a result of the coronavirus (COVID-19) outbreak.

These EIDLs have existed under Section 7(b) of the SBA Act and have been used in times of local disaster to extend low interest credit to small businesses hard hit by a disaster. The EIDLs are dependent upon a state or region making a disaster declaration and being approved. As of this writing, virtually all states have made such declaration and have been approved, including all of the states in which Michael Best has a physical office location – Colorado, District of Columbia (D.C.), Illinois, North Carolina, Texas, Utah, Wisconsin.

On March 11, the President directed the SBA to administer the EIDLs. The President also called for an expansion of the loan base from \$7 billion to \$50 billion, but that has not yet been approved. However, on March 19 the U.S. Senate Majority Leader unveiled the Coronavirus Aid, Relief, and Economic Security Act, S. 3548 (CARES Act). If approved, the CARES Act could potentially provide for an additional \$250 - \$350 billion of loans for small businesses, which may or may not be under the SBA's existing EIDL program (or possibly under the SBA's 7(a) loan program). We will provide an update when the CARES Act is in final form, passed by the House and Senate and signed into law by the President.

Before addressing any frequently asked questions about EIDLs and the application process, it is important to note that the SBA has urged all types of small businesses to **APPLY AS SOON AS POSSIBLE**, whether or not you think you will qualify, for the following reasons:

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- **First Come/First Serve Basis:** EIDLs are disbursed on first come/first serve basis, so the earlier you apply and get into the SBA's system, the better your chances of obtaining an EIDL.
- **No Application Fee:** If approved, you are not required to take the EIDL and there's no cost to apply.
- **No Prepayment Penalty:** There is no prepayment penalty, so you can prepay the EIDL back immediately if you no longer need it.

Frequently Asked Questions and Answers

Q: Where can I apply? The SBA has urged all applicants to apply online at the following link <https://disasterloan.sba.gov/ela/> to expedite processing. You can also submit a paper application, but that will take longer and delay your approval timeline.

Q: What forms and information are needed for the application? At a minimum, you will need last year's tax return and a current balance sheet. You should also have the following forms and basic information available for the application:

- Tax Information Authorization (IRS Form 4506T) for the applicant, principals and affiliates.
- Complete copies of the most recent Federal Income Tax Return.
- Schedule of Liabilities (SBA Form 2202).
- Personal Financial Statement (SBA Form 413).
- Profit and loss statements.
- Monthly sales figures (SBA Form 1368).

Q: Is my small business eligible?

- **Employee Headcount:** Depending on what industry a company belongs to, being a small business can mean having a maximum number of employees ranging from a maximum number of 100 to 1,500 employees.
- **Revenue:** Depending on the industry, a small business can have a maximum amount of revenue from a maximum amount of \$750,000 up to \$36.5 million.
- **SBA's Interactive Size Standards Tool:** Ultimately, you aren't going to know for sure until you apply, but you should consult the SBA's size standards interactive tool to determine if you are likely to qualify as an eligible small business.

Q: If I am able to obtain credit elsewhere, can I still apply? You are not technically permitted to apply for an EIDL if you can obtain credit from other non-federal sources (e.g., a traditional lender), but if you have any uncertainties about this requirement you should just apply. The SBA only provides these loans to applicants for whom the desired credit is not otherwise available on reasonable terms from non-Federal sources. If you have an existing line of credit with availability, then you will likely violate this requirement;

however, in this situation, you should consider borrowing as much as possible as quickly as possible on your existing line of credit to ensure you have adequate cash resources available for the upcoming weeks and months and to make a stronger case for SBA qualification. Also, the SBA will complete a thorough analysis to determine your likelihood of obtaining credit elsewhere based on the information you provide to the SBA, but that does not require you to evidence that you've been turned down by a lender.

Q: If my business is a subsidiary of another company that does not qualify, can the subsidiary apply? Yes, but the subsidiary may not satisfy the SBA's size requirements. The SBA determines whether an entity qualifies as a small business concern by counting its receipts, employees or other measures, *including those of all its domestic and foreign affiliates*. The SBA has a specific set of rules that explain when another person, business or entity is considered an affiliate for size purposes. The full set of rules can be found at 13 CFR § 121.103. Generally, affiliation exists when one business controls or has the power to control another or when a third party (or parties) controls or has the power to control both businesses. Control may arise through ownership, management, or other relationships or interactions between the parties. If the SBA determines that affiliation exists, then the SBA will count the receipts, employees, or other measure of size for the subsidiary combined with the receipts, employees, or other measure of size for the subsidiary's affiliates.

Q: What if I have employees in multiple places or only a few employees in a location that's qualified? We expect nearly every state (and the counties therein) in the country to apply and be approved, so this shouldn't be an issue.

Q: What if I have business interruption insurance that will cover me? This will not be a problem for application. If insurance proceeds are disbursed to your business after the loan is funded, the SBA will likely require those proceeds to be used to pay down on the EIDL.

Q: Does it matter whether I am an LLC, Corporation, S-Corporation or sole Proprietorship? No, any form of entity or organization can apply.

Q: How much can my business secure? Up to \$2,000,000. The SBA will look at the last three years historical financials to determine what the business could have paid if the disaster would not have occurred. The loan funds will not provide for lost sales.

Q: Is the loan always disbursed in a lump sum? Typically, yes. However, if collateral is required for the loan, the SBA may pay up to \$25,000 as an initial partial advance without collateral being properly secured and then release the remaining funds once all collateral is appropriately secured.

Q: What are the terms of the loan?

- **Rate:** 3.75% for small businesses and 2.75% for nonprofits.
- **Length:** Commencement of monthly EIDL repayments is deferred for at least four months. Further, SBA offers loans with long-term repayments to keep payments affordable, up to a maximum of 30 years (although most EIDLs have a term of 15-30 years). Terms are determined on a case-by-case basis, based upon each borrower's ability to repay.
- **Collateral:** The SBA is generally looking for collateral, but that won't be dispositive. The SBA will require you to pledge whatever type of collateral is available, whether tangible (real estate, inventory, equipment, etc.) or intangible (receivables, IP, etc.). The SBA will evidence its security

interest in such collateral by filing and/or recording typical security documents, such as mortgages, UCC filings and pledge agreements.

- **Personal Guaranties:** The 20%+ business owner requirement in the EIDL application has to do with the fact that these EIDLs are required to be guaranteed by 20%+ owners, similar to standard SBA 7(a) loans, absent extraordinary circumstances (e.g., excess collateral to be pledged by the business or an owner). The CARES Act might not come under the EIDL program at all, but it could also come under the program either without a change to required conditions (e.g., requiring guaranties) or with different conditions (e.g., no guaranties). Essentially, the current \$7 billion does generally require a personal guarantee from 20%+ owners, and you will need to provide the SBA with certain financials for such owners and authorize the SBA to obtain tax information for such owners.

Q: Can I prepay the loan? Yes, as mentioned above, there is no prepayment penalty.

Q: What can I use the loan proceeds for? These loans may be used to pay fixed debts, payroll, accounts payable and other bills that can't be paid because of the disaster's impact. You do not need to document disaster impact before each payment, as that feature will be reviewed by SBA upon application.

Q: Do I have to be profitable? No, but you will need to show that the business is a viable business, meaning the business has the ability to repay the EIDL. This can be shown to the SBA by providing, for example, one year of financial statements for the business, financial statements for a 20%+ owner, satisfactory physical collateral of the business or a guarantor (e.g., real estate) or a combination of such items. However, there is no minimum level of profitability required, nor is there a certain time period the business needs to be in operation, and this viability requirement should not deter you from applying for an EIDL.

Q: What if my business has other debt? Generally, that shouldn't be an issue for application, but it will become an issue if the existence of that debt causes you to violate the "no other credit" requirement. If you have existing loans with another lender, but no additional availability with such lender (or any other lender), then you have a stronger case to make to the SBA. If you have availability or can get additional loans from other non-Federal lenders, then this requirement will likely become an issue. You will need to be mindful of debt priority and other subordination agreements in various other credit agreements in your business.

Q: Will applying for an EIDL and/or receiving an EIDL affect my eligibility for any other state or federal assistance programs? Probably not, but we will monitor other programs as we become aware of them and determine whether or not there will be any issues with the EIDL program.

Q: What is the process for and turnaround time from loan application to receiving the funds? The loan process can be found at the following link (EIDL Loan Process) and turnaround time is approximately five days for review and the receipt of funds once the loan is approved takes approximately three weeks, as long as all information is provided accurately by the applicant.

Q: What if an applicant is approved for the loan but withdraws their application. Do they have to re-apply all over again? The applicant will have up to six months to reactivate its loan that was approved.

Q. If I am turned down can I reapply? Yes. If the loan request is denied, applicants will be given up to six months after receiving notice of such denial in which to provide new information and submit a written request to the SBA for reconsideration.

Q: What else should I be aware of?

- **Disclosure of Owner Information (Confidentiality, etc.):** You need to disclose certain information about 20%+ owners, which could include disclosure of investor returns, so be aware of this before including such information in your application. For example, each 20%+ owner needs to disclose certain financials and authorize the SBA to obtain copies of three years of its historical income tax returns. You should actively solicit this information as soon as possible from your 20%+ owners, particularly if your owners are venture funds or private equity funds that may not be accustomed to disclosing such information to their portfolio companies.
- **Board Approval:** Be prepared for board and/or manager approval – and consider doing so in advance to avoid any internal delays. Many venture-backed businesses have board or shareholder requirements to take on debt in excess of certain limits. Be sure your board members or shareholders are briefed on the need to be responsive to these requests.
- **Existing Loan Documents (if any):** Review your existing loan documents to determine if any subordination or bank consent / approval will be necessary.
- **Other Assistance:** Check other state and local assistance programs. Several states and localities have come out with additional loan or grant programs to help a variety of small businesses. Also, traditional SBA-backed lending is still available in the form of 7(a) loans.

Q: Are there any specific concerns to be aware of for startups without a long (or any) operating history?

- **Ability to Pay:** Startups will need to show their ability to pay by providing the SBA one year of financial statements.
- **Apply:** All startups are recommended to apply in any event, and they will have a chance to reapply and provide more information if denied.
- **Collateral:** The SBA is generally looking for collateral, but that won't be dispositive. Collateral can include tangible and intangible assets, along with personal guaranties from 20%+ owners of the business.

Given the current economic environment and the rapid movement in both need and larger funding initiatives, we suspect the rules may be applied less stringently (e.g., the guaranty requirement from 20%+ owners). However, pursuit of these EIDLs will require administration – applicants should plan on spending time getting the application in and then waiting for a reply. For venture-backed growth-stage businesses that are not yet profitable, we believe the lack of guidance from the SBA on how much the businesses may qualify for and the current requirement for personal guarantees from 20%+ owners will likely stifle usage by these businesses.

Also, there is real uncertainty about how fast the SBA can push this money to small businesses. Our contacts inform us that there are conversations with various state economic agencies and existing



financial services firms to explore ways to deploy funds much faster. We will keep you apprised of these developments.

As you work through and evaluate the unpredictable effects of the coronavirus (COVID-19) outbreak on your business, we encourage you to reach out to your personal Michael Best attorney or, with respect to SBA issues, to Galen Mason and Vince Morrone. We are monitoring the outbreak on a daily and hourly basis, and we are ready to provide you support as you navigate the challenges and uncertainties.

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