

Overview of SBA Loan Programs Available During the COVID-19 Pandemic

Corporate Alert

03.25.2020

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In these unprecedented times of the COVID-19 pandemic and the resulting disruption of economic activity, we understand the imperative for the very survival of our clients and the business community at large in addressing their liquidity requirements. Set forth below is an overview of some of the loan programs currently available from the U.S. Small Business Administration (SBA). Please do not hesitate to contact us for further information and assistance with respect to the SBA loan programs or dealing with your existing lenders, be they a bank, debt fund or other alternative lender.

SBA 7(a) Loan Program

The most significant SBA loan program is its 7(a) loan program. An SBA 7(a) loan provides for loans of up to \$5 million that are partially guaranteed by the SBA. The program is administered directly by banks and other financial institutions, and a business would apply for the loan directly with a participating bank. Qualified lenders have been granted delegated authority to make eligibility determinations without SBA review.

For loans that are less than \$150,000, the maximum SBA guarantee is 85% of the total loan amount and for larger loan amounts the maximum guarantee is 75%. SBA policy prohibits lenders from charging many of the usual fees associated with commercial loans. Still, a borrower can expect to pay a one-time guaranty fee, which the SBA charges the lender and allows the lender to pass on to the borrower.

Lenders and borrowers can negotiate the interest rate, but it may not exceed the SBA maximum. The SBA interest rate maximums are tied to the Prime Rate (MPR), which is currently 4.25%. For a \$5 million loan maturing in under seven years the maximum rate is MPR plus 2.25% and for maturities of seven years or more is MPR plus 2.75%. For loans of \$50,000, the maximum rate increases by 1% above the foregoing amounts.

As stated above, SBA guarantee fee are typically passed through to the borrower. The guarantee fee ranges from 3% to 3.75% of the SBA-guaranteed amount, depending on the size and term of the loan. For loans exceeding \$350,000, the SBA requires lenders to collateralize the loan to the maximum extent possible, up to the full loan amount, which may include pledges of the equity of the business. Individuals who own 20% or more of an applicable small business will be required to provide an unlimited personal guaranty.

The loans are long-term loans, no matter what a business uses the proceeds for. The SBA sets limits on the maximum terms for various loan uses: (a) up to seven years for working capital, (b) up to 10 years for equipment and (c) up to 25 years for real estate.

The business applying for the loan must operate for a profit and be physically located in the United States. The SBA provides a specific list of businesses or business activities that are ineligible for an SBA 7(a) loan. (See <https://www.sba.gov/partners/lenders/7a-loan-program/terms-conditions-eligibility>.) Generally, businesses engaged in investments, including real estate investments, lending, or gambling, are not eligible for an SBA 7(a) loan.

To determine “small business” status, the standards contained in the North American Industrial Classification System (NAICS) apply, which are based on either (a) the average number of employees over the preceding 12 months (generally between 500 to 1,500) or (b) average annual receipts for the last three years. The determination is made for (i) the industry in which the applicant is primarily engaged (alone and without affiliates) and (ii) the applicant **combined with its affiliates** must not exceed the size standard (employees or annual receipts) designated for either the primary industry of the applicant alone or the primary industry of the applicant and its affiliates, whichever is greater. Click [here](#) for the size standards the SBA has identified by NAICS codes.

Entities are “affiliates” when one controls or has the power to control the other, or a third party controls or has the power to control both, whether or not control is actually exercised. A person or entity that owns, or has the power to control, 50% or more of a concern’s voting stock, or a block of voting stock, controls or has the power to control the concern. In determining whether affiliation exists, the SBA will consider the totality of the circumstances, and may find affiliation even though no single factor is sufficient to constitute affiliation. While there is a specific exemption from affiliation status for portfolio companies of investment funds licensed by the SBA as “small business investment companies,” the exemption does not apply to investment funds not so licensed by the SBA. Needless to say, a knowledgeable practitioner can help guide an applicant through the process. Among the required documents are the [SBA Form 1919](#) for the borrower and the [SBA Form 1920](#) for the lender.

We are tracking proposed legislation being considered in light of the COVID-19 pandemic that that would expand the availability of the SBA’s 7(a) Loan Program for small businesses and enable borrowers to borrow up to \$10 million and use the proceeds for (i) payroll support, including paid sick, medical or family leave, and costs related to the continuation of group health care benefits during those periods of leave; (ii) employee salaries; and (iii) payments on debt obligations. The draft legislation, which is under negotiation, includes features such as (1) an increase in the size standard for eligible businesses; (2) payment deferrals; and (3) a forgiveness feature that would enable portions of the loan to be forgiven without resulting in cancellation of indebtedness income.

The SBA’s Emergency Loan Program for Businesses Impacted by COVID-19

The SBA operates a Disaster Loan Program that provides loans of up to \$2 million to eligible small businesses. In general, to be eligible, the borrower must (a) be located in a designated disaster area (usually identified by county); (b) show that it has suffered substantial economic injury as a result of the event (*i.e.*, the COVID-19 pandemic); and (c) be a “small business.” Click [here](#) for information on designated disaster areas.

As a result of the COVID-19 pandemic, however, any small businesses located in any of the 50 states can apply for a SBA disaster loan whether or not the specific county in which the small business is located has been designated a disaster area.

“Substantial economic injury” means that the business is unable to meet its obligations and to pay its ordinary and necessary operating expenses. Economic Injury Disaster Loans are

intended to provide the necessary working capital to help small businesses survive until normal operations resume after a disaster. The determination of “small business” is the same as with an SBA 7(a) loan described above.

The interest rate on these loans is 3.75% for small businesses. The interest rate for non-profits is 2.75%. The SBA offers loans with long-term repayments in order to keep payments affordable, up to a maximum of 30 years. Terms are determined on a case-by-case basis, based upon each borrower’s ability to repay. To apply for emergency loans directly online.

Loans from Small Business Investment Companies

Another source of funding that businesses should consider are direct loans from Small Business Investment Companies (SBIC). An SBIC is a privately owned and operated company licensed by the SBA that makes long-term investments in American small businesses. Referred to as “leverage,” an SBIC can effectively borrow from the SBA two dollars of relatively cheap long-term debt (*i.e.*, 3%) for each dollar of private equity.

Once formed, an SBIC invests in qualified operating businesses, usually in the form of debt with an equity kicker. In structuring the investment and determining its terms, an SBIC can be more flexible than a bank that is providing an SBA Section 7(a) loan. In addition, the businesses in which an SBIC may invest include not only a “small business,” as defined above, but also businesses with tangible net worth (determined as total net worth less goodwill) of less than \$19.56 million and average after-tax income (exclusive of loss carry-forwards) for the prior two years of less than \$6.5 million.

Finally, the SBA operates a number of other loan programs offering smaller loans, including (i) an express loan program for loans of up to \$350,000 for no more than seven years; (ii) the community advantage program that allows mission-based lenders to assist small businesses in underserved markets with a maximum loan size of \$250,000; (iii) a microloan program providing loans of up to \$50,000 for nonprofit lending organizations to underserved markets; and (iv) programs providing loans for promoting exports that are available generally to U.S. small businesses that export directly overseas, or those that export indirectly by selling to a customer that then exports its products, including a working capital program providing revolving lines of credit or transaction-based financing of up to \$5 million. The starting point for determining whether a business may qualify for any of these loan programs is whether the business qualifies as a “small business” as required under the SBA’s 7(a) Loan Program.

On March 25, 2020, U.S. Senate leaders and the administration passed a \$2 trillion relief package appropriately named the Coronavirus Aid, Relief and Economic Security Act (CARES Act). Based on the limited summary information available yesterday afternoon before the Senate vote, we understand that the CARES Act sets aside \$349 billion for a “paycheck protection program” designed to assist small businesses in meeting their obligations for (i) payroll, including salaries and sick or medical leave; (ii) insurance premiums; (iii) mortgage payments; and (iv) other debt obligations.

The program, which is to be administered by the SBA under its 7(a) Loan Program (i) increases the amount that can be borrowed by 100% to \$10 million through December 31, 2020, and increases the maximum loan amount for express and other SBA loans; (ii) increases the SBA guaranty to 100% of the loan amount; (iii) makes it easier to qualify as a small business by increasing the maximum number of employees an enterprise may have, liberalizing the method of the calculation and waiving the affiliation rules for certain industries on the SBA approved list (*e.g.*, hospitality, restaurants, and franchises) and streamlining the process for small businesses who receive investments for SBICs; (iv) waives collateral and personal guarantees; (v) waives the payment of guarantee fees that are usually passed on to the borrower; (vi) locks in interest rates to the current rates for 7(a) loans; (vii) defers required loan payments for one year; and (viii) forgives a portion of the loan in an amount equal to the amount spent by the borrower during the eight-week period after receipt of the loan proceeds

on payroll costs; interest payments on any mortgage incurred prior to February 15, 2020; payment of rent on any lease in force prior to February 15, 2020; and the payment on any utility for which service began before February 15, 2020.

The CARES Act next must be approved by the House of Representatives before being signed by the President. We will continue to monitor these developments and provide further updates containing the details of the CARES Act.