Latest Insights on the PPP Loan Program

Practical Tips to Help You Navigate the Chaos

ACG® Minnesota
Association for Corporate Growth

WINTHROP & WEINSTINE

Highland Bank

For Today

- Overview of Payroll Protection Program ("PPP").
- Practical advice for submitting applications and obtaining speedy approval and loan funding.
- Sources of frustration for borrowers and lenders.
- Overview of Emergency Injury Disaster Loan ("EIDL") loan program.

PPP Loans

PPP Launch - A Whirlwind 10 Days

- **Friday, March 27**
  - CARES Act signed into law; establishes PPP.
  - Borrowers scramble to determine eligibility and prepare expected required materials.
  - Banks start to ramp up, expecting unprecedented number of loan applications.
- **Tuesday, March 31**
  - Treasury releases PPP application and 1-page “Fact Sheet.”
  - Borrowers begin to complete application and submit to banks.
- **Thursday, April 2**
  - Late at night, SBA releases much-anticipated “Interim Final Rule” and new PPP application.
- **Friday, April 3**
  - Floodgates open.

Who Is Eligible?

- **Any business who is considered "small" by the SBA's size standards.**
  - Depending on the industry, this could either be an employee test or a revenue test.
- **Any business with less than 500 employees.**
  - Special rules in CARES Act – 500 employee limit does not apply to:
    - Restaurants, hotels, or casinos as long as they have <500 employees at each location;
    - Most franchisees; and
    - Businesses who receive "financial assistance" from an SBIC.
- **Any business with (1) maximum tangible net worth < $15M; and (2) average net income after Federal income taxes < $5M for each of the last two full fiscal years.**
- **Independent contractors and sole proprietors.**

In determining whether a business is eligible, be mindful of the SBA's broad "Affiliation" Rules (see next slide), which can be a trap for the unwary.

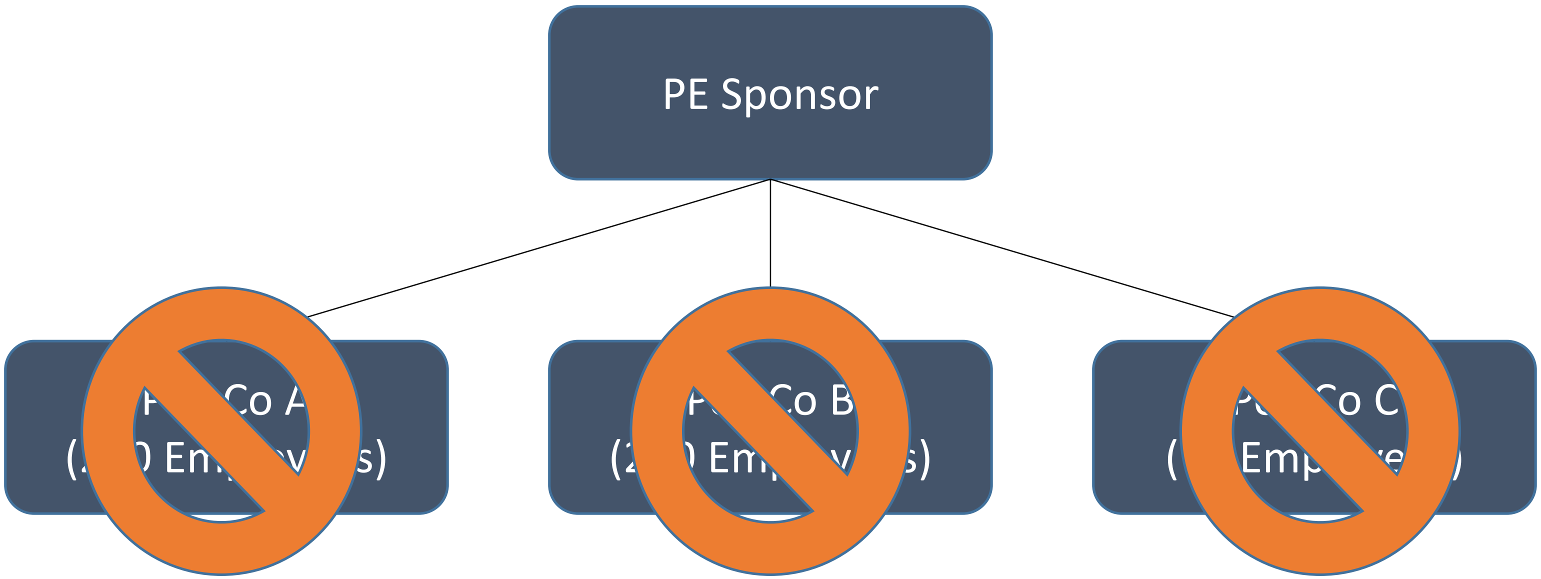
Affiliation Rules and Impact on PE-Owned Companies

- In determining whether a business is “small,” the SBA looks at the business together with its affiliates.
- The SBA definition of “affiliate” is different and generally broader than other typical definitions of that term.
- In determining whether an affiliation exists, the SBA looks at the totality of the circumstances, considering factors such as common ownership, common management, and substantially similar business interests or relationships.
  - Control may be affirmative or negative, such as the ability to block an action of the board of the directors or prevent a quorum at a board meeting.
- This makes it challenging for companies that have taken venture capital or private equity investments to be considered “small” under the SBA rules.
  - **SBIC exception is a possible workaround for some PE-owned companies.**

The PPP application requires a certification, under penalty of perjury, that the business is in fact eligible for the program, including under the affiliation rules.

Lenders are not required to make an independent determination of affiliation.

Affiliation Rules and Impact on PE-Owned Companies



Affiliation Rules and Impact on PE-Owned Companies

Late Friday evening the U.S. Small Business Administration issued an interim final rule regarding affiliation rules applicable to its Paycheck Protection Program created under the Coronavirus Aid, Relief, and Economic Security (CARES) Act.

Despite collective efforts for inclusion, this guidance effectively excludes small businesses with equity investors from the 7(a) loan program under the CARES Act.

ACG has already received notice from many of its members of massive layoffs anticipated because of this decision. Congress intended that the CARES Act be a lifeline to small businesses throughout the country, and this exclusion is most certainly a nail in the coffin for tens of thousands of companies with equity investors.

What Are The Loan Terms?

- Amount: Up to 2.5x the borrower's average payroll costs, up to a maximum loan amount of $10M.
- Interest rate: 1.0%
- Term: 2 years; all payments deferred for at least 6 months.
- Collateral: No personal guaranty or collateral requirements.
- Forgiveness: Up to 8 weeks of payroll, mortgage interest, rent, and utility expenses, 75% of which must be payroll costs.
    - Reductions in staffing and employee compensation may reduce amount of forgiveness.

How Do I Calculate Average Payroll Costs?

INCLUDED Payroll Costs	EXCLUDED Payroll Costs
Salary	*Cash Compensation* to any employee > $100k *[Does not include non-cash compensation like employer contributions to retirement plans, insurance premiums, taxes, etc.]*
Wages	Payments to independent contractors
Commissions	Payments to non-U.S. residents
Paid leave	Federal tax withholdings
Benefits	
State and local taxes	
****** Latest guidance says borrowers can use either previous 12 months or calendar year 2019 as the measurement period***	

Example:

- Annual payroll costs: $1,500,000
- Subtract cash compensation in excess of $100,000: $300,000
- Annual qualifying payroll costs: $1,200,000
- Average monthly qualifying payroll costs: $100,000
- Multiple by 2.5 = $250,000
- Maximum loan amount is $250,000

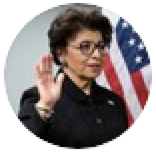
How Does the Loan Forgiveness Work?

- Submit forgiveness "application" to your lender, including documentation verifying:
  - the number of FTEs you employed during the relevant periods and the compensation that you paid them; and
  - payments of mortgage obligations, rent, and utilities.
- Lender is supposed to issue a decision on your loan forgiveness within 60 days of receiving the complete application.
- If the loan has a remaining balance after application of the forgiveness test, the SBA will continue to guarantee it.

When Do I Get The Money?

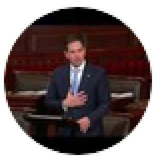
- Lenders have "delegated authority" from the SBA to approve and fund the loan (*i.e.*, the SBA does not "approve" the loan itself).
  - Many lenders are still figuring out their own policies and procedures for completing underwriting and making the loans.
- Actual funding could take days, if not weeks, from the time the borrower submits an application.
  - Should speed up as banks get more comfortable with the process.
- Lenders must fund PPP loans with their own liquidity and seek reimbursement later on from the SBA.
  - Can receive "expected forgiveness amount" after funding the loan, with true-up following actual forgiveness application.
  - Uncollected, non-forgivable portion can be collected from the SBA by enforcing the loan guarantee at maturity.

How’s It Going So Far?



Jovita Carranza, SBA @SBAJovita · Apr 3

UPDATE – At least 9,970 loans have been processed; $3,200,000,000+ originated. #CARESAct & #PaycheckProtectionProgram offers small businesses forgivable loans for 8 weeks of payroll + operating expenses. All hands-on deck @SBAgov @USTreasury #CommunityBanks #LocalLenders



Marco Rubio @marcorubio · Apr 4

Day one saw complications you would expect with unprecedented $349 BILLION emergency plan passed just 7 days ago

Despite this as of 6:06 pm Friday 13,669 #SmallBusiness owners received #Ppploans valued at more than $4.3B

Bloomberg

Trump Calls Virus Relief ‘Flawless’ Despite Bankers’ Struggles

President Donald Trump on Saturday dismissed concerns about the rollout of a $349 billion program to assist small businesses rocked by the coronavirus, saying loan distributions were “way ahead of schedule” even as banks struggle to respond to the flood of requests.

“It’s been flawless so far,” Trump told reporters Saturday at the White House. “Far beyond our expectations. I don’t even hear of any glitch.”

THE WALL STREET JOURNAL.

BUSINESS

Small Business Loan Program Makes Bumpy Start

Some major lenders struggle to process loan applications; business owners voice frustration

NBC NEWS

Thousands of applicants, zero loans: Trump's small businesses lending program is a failure to launch

One day after the launch of a $350B loan program designed to rescue millions of small businesses, technical glitches continue to cripple the process.

The Washington Post

The Finance 202: Banks struggle with confusing rules on small business stimulus loans

Small-business owners desperate for a federal lifeline seem poised to instead encounter chaos and a slew of questions about accessing loans aimed at keeping them running during the coronavirus pandemic. The upshot is that some banks expected to distribute the loans, including some major names, won't yet participate in the program.

. . .

Banks are asking questions about the length of the loans, the interest rates they can charge, and how much due diligence financial institutions are responsible for performing on borrowers

. . .

Headaches will persist for borrowers, too. Small businesses face the specter that the pot of money will dry up too fast — and that the tweaks administration officials are making will make it less helpful as they struggle to operate.

What's Causing the Chaos?

<u>For Borrowers</u>:

- SBA releases "new" loan application hours before the program opened; many companies had already submitted the "old" application.
- No SBA guidance for several unique situations.
- Fear that money will run out creates heightened urgency and frustration with the process.
- Not sure when loans will get funded → puts borrowers at risk of closing, creating anxiety for their employees, suppliers, and customers.
- Many lenders will not take applications from new customers; some lenders are prioritizing "gold star" customers.

What's Causing the Chaos?

<u>For Lenders</u>:

- Funding and liquidity issues.
- SBA guidance has been slow, piecemeal, and confusing.
- Underwriting requirements are unclear.
    - Latest guidance says that lenders should conduct a "minimal" and "good faith" review of payroll costs in order to verify the accuracy of the borrower's calculations
- Too many applications; limited capacity to accept applications from new customers.
- Technical issues with the SBA's E-Tran system.
- Substantive questions – No SBA guidance on many technical issues, including:
    - Loan structure – Are multiple advances permitted?
    - Loan documents – SBA forms or lender forms?
    - Cross-default and forbearance issues – Can PPP loans be cross-defaulted with existing loans. What if existing loans are already in default?
    - Subordination issues – Which loan gets paid first?
    - Collateral issues – What if existing security agreement covers all borrower debt?
    - Use PPP loan proceeds as leverage for negotiations/concessions on existing loans?

EIDL Program

EIDL Program: Basic Overview

- **General**: Preexisting SBA program for small businesses experiencing an economic injury due to an unforeseen disaster. Loans issued directly by U.S. Treasury – no third-party lender involvement.
- **Eligibility**: Similar to PPP loans. Affiliation rules still apply.
- **Amount**: Up to $2M (SBA will determine the loan amount based on the applicant's monthly business expenses and liquidity position).
- **Use of Funds**: Fixed debts, payroll, accounts payable, and other bills that could have been paid had the disaster not occurred.
- **Interest rate**: 3.75% (2.75% for non-profits).
- **Term**: 15 or 30 years, to be determined by the SBA based on repayment ability.
- **Collateral**: Personal guarantees and (maybe) pledges of personal collateral required for loans > $200,000.
- **Forgiveness**: N/A

EIDL Program: Emergency Advances

- Recognizing that the EIDL approval process can be as long as a month, the CARES Act provides that EIDL applicants can receive an "advance" of up to $10,000 within 3 days.
- The applicant will not be required to repay the $10,000 advance, ***even if the SBA ultimately denies the loan application***.
- We are not aware of any applicants who have actually received their $10,000 advance.

Can I Combine a PPP Loan with an EIDL?

- Generally, a business can apply for loans under both the PPP and the EIDL program but must use the EIDL for a different purpose than the PPP loans.
- EXAMPLE:
  - ➢ Use EIDL for inventory purchases and other trade payables.
  - ➢ Use PPP for payroll, rent, interest payments, etc.

Questions?

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