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PAYCHECK PROTECTION PROGRAM (PPP) LOANS UNDER THE CARES ACT

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"). To assist with payroll and rent expenses during the expected shelter-in-place period caused by the pandemic, the CARES Act permits certain businesses to borrow up to \$10 million. While the actual procedures at the Small Business Administration ("SBA") are still in the process of being formulated, below is a summary of key provisions of the CARES Act as it applies to obtaining a business loan.

ELIGIBLE BUSINESSES AND APPLICATION PROCESS

Only certain small business may qualify for a loan under the CARES Act. To qualify, a business, nonprofit organization, veterans organization, or Tribal business must either:

- (a) Employ less than 500 employees; or
- (b) Satisfy the size standard determined by Small Business Administration ("SBA") for the industry of the business, if applicable.

These requirements must be met from February 15, 2020, to June 30, 2020.

The loan program under the CARES Act may also apply to certain independent contractors and sole proprietorships. Additionally, for businesses with multiple locations in the food and accommodations industries (like hotels, RV parks, etc.), the 500-employees requirement applies to each location, not to the business as a whole.

The loan can be obtained through the SBA. The law also allows the SBA to work with certain banks in processing loans. Upon applying for the loan, the business applicant must certify that COVID-19 has caused a necessity in obtaining the loan, that the funds will be used to retain workers and maintain payroll, and that the business is not applying for or receiving other duplicative

loans. The formal application has not yet been made available by the SBA and may include further SBA requests for information from the business such as how COVID-19 has impacted it (i.e., (a) supply chain disruptions; (b) staffing challenges; (c) decreases in gross receipts or customers; or (d) closures.)

IMPORTANT LOAN TERMS

■ Loan Amount

The maximum amount of the possible loan is calculated as follows: 2.5 multiplied by the average total monthly payments by the business for payroll costs incurred during the one (1) year period before the date on which the loan is made. For example, if the average monthly payroll amount from April 1, 2019, to April 1, 2020, is \$100,000, then the maximum loan amount will be \$250,000. Important to this calculation is that payroll costs do not include the amount of compensation in excess of an annual salary of \$100,000. Regardless of the average monthly payroll costs, the loan amount cannot exceed \$10 million.

Note, the loan amount differs for new businesses and businesses with seasonal employees. For businesses that were not in operation between February 15, 2019, and June 30, 2019, the maximum loan amount is calculated by multiplying 2.5 by the average total monthly payroll payments →

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from January 1, 2020, to February 29, 2020. Additionally, those businesses with seasonal employees will calculate the loan amount by using the average payroll amount during either a 12-week period starting February 15, 2019, or the period of March 1, 2019, to June 30, 2019 (the applicant may select which period to use).

OTHER LOAN TERMS

■ Loan Duration

The loan will have a maximum maturity of ten (10) years. The maximum maturity is determined on the date in which the business applies for loan forgiveness (see below).

■ Interest Rate

The interest rate cannot exceed four percent (4%). Note, this is the maximum rate—the interest rates will be determined on a case-by-case basis, which may be lower than 4%.

■ Fees

There are no SBA fees for obtaining a loan under the CARES Act.

■ Nonrecourse, No Collateral, No Personal Guaranty

The loan under the CARES Act will be a nonrecourse loan. Additionally, no collateral or personal guaranty is required to obtain a loan.

■ Obtaining Credit Elsewhere

The terms of the loan are not contingent on the business being unable to obtain credit from other institutions.

■ Refinancing

The CARES Act permits businesses obtaining 7(a) Business Loans under the Small Business Act to refinance those loans under the terms of the CARES Act. If the 7(a) loan was obtained anywhere from January 31, 2020, to June 30, 2020 (the final day to obtain a loan under the CARES Act), then the loan is subject to a refinancing.

■ Deferment

Payment deferrals may be available for a period of six (6) months to one (1) year after obtaining the loan. The deferral process is to be determined by the SBA.

- Payroll costs, including costs related to continuation of group health care benefits during periods of paid sick or family leave;
- Employee salaries or other compensation;
- Interest on mortgage obligations (not including prepayment or payment of principal);
- Rent;
- Utilities; and
- Interest on other debt obligations (note that this excludes payment of the principal).

AFTER OBTAINING A LOAN: LOAN FORGIVENESS AND TAXES

Businesses obtaining a loan under the CARES Act may qualify for loan forgiveness. To qualify for loan forgiveness, the business must incur costs and use the loan proceeds during the Covered Period to pay their:

- Payroll costs;
- Interest on mortgage obligations;
- Rent cost; and
- Utility costs.

In other words, if the loan proceeds are used to pay the four costs above during the Covered Period, then the loan will not have to be repaid—it will be forgiven. For purposes of forgiveness, the “Covered Period” means the 8-week period beginning on the date of the origination of a covered loan. Note, again, payroll costs do not include the amount of compensation in excess of an annual salary of \$100,000. Any amount spent outside of the Covered Period or for costs other than the four costs above will not be considered for loan forgiveness.

Additionally, to determine the final amount subject to forgiveness, the amount determined above (i.e., the loan proceeds spent during the Covered Period) may be reduced by the following:

■ Average Number of Full-Time Employees

The loan forgiveness amount will be reduced by multiplying the ratio of the average number of full-time employees during the Covered Period as compared by the average number of full-time employees during one of the following previous periods (as elected by the applicant):

- February 15, 2019, through June 30, 2019; or
- January 1, 2020, though February 29, 2020.

USING LOAN PROCEEDS

The CARES Act requires loan applicants to use the loan amount in a specific manner. Allowable uses include the following:

For example, if the average number of employees during the Covered Period is ten (10) and the average number of employees from February 15, 2019, to June 30, 2019 is twenty (20), then the ratio will be 10/20. Under this example, the amount of loan forgiveness will be reduced by 50 percent. Essentially, the CARES Act is incentivizing businesses to retain its employees. Note, the amount to be reduced is slightly different for seasonal employers and that there are certain exemptions that may apply to workers that are rehired during other applicable time periods.

■ **Average Salary and Wages**

The loan forgiveness amount will also be reduced by any salary or wage reduction of employees in excess of 25 percent of the total salary or wages of that employee for the last full quarter. For this reduction to apply, the employee must have earned salary or wages in the amount of less than \$100,000 in any single pay period in 2019 (i.e., there is no reduction in the forgiveness amount for any reduction in salary or wages of employees earning more than \$100,000).

For example, if an employee had previously earned \$75,000, and the employee's salary was reduced to \$52,500, a 30 percent decrease, then \$3,750.00 (the amount in excess of a 25 percent decrease) would not be forgivable.

APPLYING FOR LOAN FORGIVENESS

To obtain loan forgiveness, the applicant must provide documentation verifying the use of the loan proceeds and number of full-time employees employed by the business during the applicable periods. The documentation required includes:

- (a) IRS payroll tax filings;
- (b) state income, payroll, and unemployment insurance filings;

- (c) documentation verifying any mortgage, rent, or utility payments;
- (d) a certification by a representative of the business; and
- (e) any other documents that may be required.

The application for forgiveness and supporting documentation will then be reviewed for approval within 60 days— if accepted, the loan will be forgiven.

■ **Loan Forgiveness Not Taxable**

A loan forgiven under the CARES Act is not considered taxable gross income.

NEXT STEPS

Employers should consider whether the CARES Act will benefit their business by evaluating prior payroll records and forecasting future business needs over the next months. The SBA and lenders will be preparing formal applications and a standard process within the upcoming weeks.

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For more information, please contact Daniel P. Scholz, Esq. or Y. Brandon Beshay, Esq. at (858) 737-3100.

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