

What Lenders Should CARE About in the New Stimulus Act

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The Coronavirus Aid, Relief, and Economic Security Act became law on March 27, 2020. While its main purpose is to fund relief and address the coronavirus pandemic, there are several significant finance and business related provisions that will have a direct impact on the performance, prospects and compliance of and by borrowers subject to increased scrutiny by their lenders in this environment.

Small Business Borrowers

The Small Business Administration is empowered by the act until June 30, 2020 to make (and to authorize lenders to make) or refinance loans to businesses having no more than 500 employees in an amount based upon a formula tied to the employer's payroll up to \$10 million. The proceeds may be used to defray payroll costs, group health coverage for employees, debt obligations, rent, etc. These loans, called "covered loans," are non-recourse to individual owners and may be granted unsecured and without a personal guarantee. These loans bear annual interest at 4% and if the borrower is an "impacted borrower" (meaning in business on February 15, 2020 with a pending loan application), it is presumed to be adversely affected by the virus and entitled to complete payment deferment for a period of no less than six months and no more than one year. Lenders making these loans receive significant reimbursement of a portion of the loans. The act provides for a pool of increased funding for these loans and others authorized by the Small Business Act for general business loans up to \$349 billion.

An "eligible recipient" of a "covered loan" is entitled to forgiveness of all or a portion of the principal to the extent, during an 8-week period beginning on the commencement date of the loan, of the sum of the expenses incurred by the business borrower for payroll, interest in an existing mortgage loan, rent, utilities, etc. The amount forgiven is treated as canceled indebtedness. In addition, the principal is further reduced to the extent of a calculation based upon the reduction in the number of employees and amount of wages during the same period of time. The amount forgiven is not taxable as income.

The covered loan program and its forgiveness provisions provide intriguing options for borrowers impacted by the pandemic. The availability of unsecured debt to replace lost income to pay and maintain a working force and operate is a remedial option that may be attractive to existing borrowers who are struggling to comply with loan covenants and to operate efficiently. Layoffs may be averted or delayed

to afford time to survive the pandemic and its hopeful remediation. Time to recover and maintain a healthy relationship with a lender is a worthy goal. Existing lenders may want to incorporate these options into a forbearance arrangement with a borrower where additional funds to maintain the business are not being provided solely by the lender and instead via the act. Lenders may wish to participate in the funding of a covered loan particularly since the amount forgiven shall be purchased by the SBA as if the amount had been guaranteed under the Small Business Act.

Mid-Sized Business Borrowers

Widely publicized are the provisions which provide up to \$500 billion of financial support for air carriers adversely impacted by the pandemic. Section 4001, *et seq.* deals with that, including special provisions which condition the loans and guarantees provided to carriers who are public companies such that the Treasury Department must receive securities, warrants or comparable equity interests as consideration. Section 4003 (b) has a provision that provides financing to lenders who finance “eligible businesses,” defined as “a United States business that has not otherwise received adequate economic relief...under this act”. While other sections allocate the financing to air carriers, Sec 4003 (b) (4) has no such limitation for businesses that support such carriers and businesses “critical to national security.” Pending implementation of procedures and requirements, this section provides funding up to \$454 billion (plus any unused funds allocated to subsections (1-3)) to programs established by the Federal Reserve as a non-taxpayer financed additional source of relief for troubled and adversely affected borrowers in the form of “liquidity to the financial system that supports lending to eligible businesses.”

The attraction to lenders is that the source of ultimate payment is the government as the Treasury has the option of purchasing these financing arrangements directly from the issuers, purchasing the obligations in the secondary market or making direct loans. A special subsection for “mid-sized” businesses extends these provisions to eligible businesses having between 500 and 10,000 employees including “direct loans” from the Treasury at an interest rate no higher than 2% and payments deferred for the first six months of the loan. Among the certifications that must be made by the loan applicant are that the funds will be used to restore no less than 90% of the workforce that existed as of February 1, 2020 until September 30, 2020.

These additional financing provisions of the act for adversely affected businesses that otherwise do not qualify for relief under the Act are also intriguing in a forbearance scenario. Lenders faced with struggling borrowers have access to another source of funding relief outside their own to enable borrowers to satisfy their existing liabilities to the lender and/or package the funding as short-term alternatives to more severe remedies.

Business Tax Relief

The act, as an amendment to the Internal Revenue Code, affords eligible employers a credit against employment taxes equal to 50% of qualified wages (including payments for health care coverage for employees) for each employee for an applicable quarter. Eligible employers are those carrying on a business which is fully or partially suspended by an order of the government limiting commerce, travel or group meetings. Section 2302 delays the payment of payroll taxes which would be payable by January 1, 2021 such that 50% is payable by

December 31, 2021 and the balance by December 31, 2022. Section 2023 permits a corporation a net operating loss carryback for any losses between December 31, 2017 and January 1, 2021 to be treated as a loss carryback to each of the five taxable years preceding the taxable year of the loss. Section 2024 permits a favorable loss carryback for other business entities and individuals such that any “excess” loss for any taxable year from December 31, 2020 until January 1, 2026 “shall not be allowed.” Limitations on deductions for interest payments are favorably modified for taxable years beginning in 2019 and 2020 by increasing the limitation from 30% to 50% in Section 2306. If the business has converted from a distillery to a purveyor of hand sanitizer, there is a temporary exception until January 1, 2021 for payment of excise taxes in Section 2308.

All of the foregoing tax incentives adjust the financial and tax presentation of a borrower. Its modified payment obligations and its motivation to maintain its employees and employment structure may influence a lender’s assessment of the prospects of the borrower to survive the debt relationship. These amendments are relevant as much as access to funding provided by the act in assessing whether there is or will be a material adverse change in the borrower’s business, which could impact the calculation of covenant compliance including things as basic as the borrower’s EBITDA.

Conclusion

Touted as a relief vehicle for individual taxpayers, employees, and federal/state agencies and governments to address the coronavirus and defeat it, the commercial stimulus and remedial provisions of the act are noteworthy as they stimulate financing and economic support for businesses which are retracting as their supply chains and access to funds have been affected. Lenders who finance such businesses find themselves in the unenviable position of having to enforce loan agreement breaches, anticipatory breaches and present /potential adverse changes. Flexibility in the approach to these issues can be facilitated by the funding and remedial provisions of the act as a valuable tool for the lender and its borrower.

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