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Update on Emergency Financing for Small Businesses through the SBA

Small businesses across the country are facing an unprecedented economic challenge arising from the onset of the coronavirus ("COVID-19") and the related government issued closures of business operations. The Small Business Administration ("SBA") has existing programs available to help U.S. small businesses (as defined under SBA regulations that vary the permitted business size by industry)—the most useful existing programs are (i) economic injury disaster loans and (ii) the Section 7(a) loan program. Both of these programs are expected to receive substantial increased funding and lending authority as part of pending legislation in Congress that is expected to be enacted before March 23. Small businesses should consider their options as these programs and increased funding become available. Our expectation is that small businesses will likely not be able to take advantage of both programs, so they should be strategic in deciding to seek an economic injury disaster loan immediately or wait for the enhanced 7(a) loan program.

It appears that at least part of the $50 billion in expanded funding for SBA will go toward making **economic injury disaster loans,** which are low interest loans to small businesses and nonprofits *administered directly by SBA* and designed to provide working capital to pay business expenses that cannot be paid because of the adverse effects of the COVID-19 crisis. To be eligible, small businesses must be located in geographic areas that have been declared disaster areas by applicable (primarily state) governmental authorities. Small businesses wishing to avail themselves of up to two million dollars in low interest (four percent or less) loans can apply directly through the SBA's website at sba.gov/disaster. The SBA website has information about whether businesses located in a particular area qualify for assistance through the economic injury disaster loan program, and most small businesses should be able to make an application without assistance of counsel. SBA's helpful outline of the disaster loan process can be found here.

We also expect pending legislation to result in an unprecedented expansion of lending authority under the **Section 7(a) loan program**—increasing the program by nearly ten times by an additional $300 billion. This increase represents a significant opportunity for both small businesses and lenders that participate in the program. In general, under the 7(a) loan program, banks or other non-bank lending institutions make loans, that are guaranteed by the SBA, to small businesses. We expect that pending legislation will: (i) increasing the permitted size of businesses that can qualify for these loans; (ii) increase the maximum loan size to **$10 million** (up from the current limit of five million dollars); (iii) expand the permitted **use of proceeds** to include payroll payments; (iv) delegate SBA **underwriting authority** to the financial institutions (meaning that SBA approval in order to obtain the

guarantee would be waived); (v) lenders can underwrite these loans without considering the borrowers ***current ability to repay*** (permitting lenders to assess repayment ability as of March 1, 2020—before the COVID-19 crisis had begun to have widespread impact on small businesses); and (vi) permitting small businesses to **defer repayment or interest payments** for up to one year. The hope is that financial institutions will be empowered to start funding these loans as early as the week of March 23. This massive increase in the scope of the 7(a) loan program should be of substantial interest to small businesses and our lender clients who participate in the 7(a) loan program. Blank Rome lawyers have substantial knowledge of the 7(a) loan program and have been involved in helping the SBA and other market participants in shaping the pending legislation. As a result of our experience, we are well suited to advise lenders who are participants or would like to become participants in the 7(a) loan program on navigating the opportunity.

It is probable that the contours outlined here may shift as the legislation is negotiated and completed. We will provide updates once the final details become clear and as other economic assistance and stimulus packages come forward in the near future.

MORE INFORMATION ABOUT THE CURRENT 7(A) LOAN PROGRAM

Under the 7(a) loan program, banks or other non-bank lending institutions make loans to small businesses. Loans under the legacy program may be up to five million dollars and be made for acquisition of real estate or business property, working capital, or other credible purposes. A portion of each loan (up to 75 percent) is guaranteed by SBA. The guaranty to the lender is conditioned on the loan complying with regulatory requirements.

Because the guaranteed portions of the 7(a) loans are 100 percent full faith and credit obligations of SBA, they are often sold by the lender in a secondary market transaction. There are a number of broker dealers who participate in this market. Like guaranteed portions can be pooled and SBA guaranties can be obtained for fractional interests in such pools as well. The guaranties on the guaranteed portions and fractional interests are unconditional.

In addition, under SBA regulations, the unguaranteed portions of 7(a) loans may be participated or securitized with SBA's permission. We are able to provide the following assistance:

- Representation of lenders, both banks and non-banks, that participate in the 7(a) program by making guaranteed loans. We already have a very large presence in this type of representation as many of our bank and nonbank clients participate in the 7(a) program.
- Representation of broker dealers and specialty financial entities that participate in secondary market and securitization activity.

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