Introduction to Title I Loan Relief Under the CARES ACT

By Mary Margaret Beecher, Napa Legal Institute

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Executive Summary

1. Title I of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) contains remarkable and almost unprecedented financial relief for small businesses, including nonprofit organizations that are exempt from income tax under Section 501(c)(3) of the Internal Revenue Code (collectively, "**exempt organizations**").

2. This financial relief comes through two types of loans:
    a. Economic Injury Disaster Loans ("**EIDL**"), and
    b. Small business loans ("**7(a) loans**" or "**Paycheck Protection Loans**"[1]).

3. Economic Injury Disaster Loans ("**EIDL**")
    a. EIDL are available directly from the Small Business Administration ("**SBA**"), the federal agency which is tasked with implementing the loan program.
    b. EIDL offer short term general operating funds to exempt organizations, including an advance of $10,000, which generally will not need to be repaid.[2]

4. Paycheck Protection Loans
    a. Paycheck Protection loans are available through SBA-approved private lenders and can be used for specific "allowable expenses," which include certain payroll costs and rent.[3]
    b. Exempt organizations applying for a Paycheck Protection loan should consider how much funding they should request and how they should allocate the loan funds for each of categories of the allowable uses, bearing in mind that at least 75% of the loan proceeds must be used for "payroll costs."[4]
    c. The Paycheck Protection loan maximum amount is 2.5 months of average "payroll costs" for the twelve-month period before the date the loan is

[1] Not all 7(a) loans are Paycheck Protection Loans. Paycheck Protection Loans are a sub-type of 7(a) loan, described in 15 USC § 636(a)(36).
[2] *See* 13 CFR § 123.303 for a list of permissible and prohibited uses of EIDL loan funds.
[3] Sec. 1102(a)(2), which will become 15 USC § 636(a)(36)(F).
[4] The 75% requirement applies to the loan proceeds for the entire lifespan of the loan; not only during the eight-week period. Sec. 1106(b) of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"); see also, SBA Interim Final Rule on Paycheck Protection Program, Title III § 2(r), available at https://home.treasury.gov/system/files/136/PPP--IFRN%20FINAL.pdf.

made [5] Payroll costs can only include the first $100,000 (on an annualized basis) for each employee.[6]

d. Up to eight weeks of allowable expenses can be forgiven (provided that at least 75% of the loan proceeds are used for payroll costs).[7] The forgivable amount will be reduced based on changes in salary levels from prior years.
e. In general, if an organization requests more Paycheck Protection loan funds than it has allowable expenses in the eight-week period, the excess will not be forgivable and must be repaid within two years at a 1.00% interest rate.[8]

5. Special Considerations for Faith-Based Exempt Organizations
    a. The SBA issued clarifying guidance on April 3, 2020 regarding the ability of faith-based exempt organizations to participate in both the Paycheck Protection and EIDL programs.[9]
    b. The guidance explained that religious organizations loan recipients will continue to have autonomy with respect to employment and membership, even during the period funds are received.
    c. However, during the period the organization is receiving loan funds, recipient organizations must comply with SBA nondiscrimination regulations with respect to goods, services, and accommodations offered to the public.
    d. For organizations with programs and facilities open not only to members of their particular faith, but also to the general public, these nondiscrimination requirements could restrict the organization's ability to continue these programs in a manner consistent with their religious mission.
    e. With respect to the Paycheck Protection program, organizations should evaluate their planned activities during the period after the loan funds are disbursed and before the loan is forgiven or paid off (which can be up to 2 years from loan origination), to ensure that the nondiscrimination provisions do not involve any restrictions that would jeopardize the organization's religious mission.
    f. With respect to participation in the EIDL, recipient organizations are likewise subject to nondiscrimination requirements during the period the loan is outstanding. With EIDL, the terms of each loan are different, and the maturity can be up to thirty years. Organizations seeking EIDL should

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[5] Under the Act, payroll costs include, among other elements, salary, leave, and certain benefits. See Sec. 1102(a)(2), which will become 15 USC § 636(a)(36)(A)(viii)(II)(aa).
[6] Sec. 1102(a)(2), which will become 15 USC § 636(a)(36)(E).
[7] *Id*; see also see also, SBA Interim Final Rule on Paycheck Protection Program, Title III § 2(r), available at https://home.treasury.gov/system/files/136/PPP--IFRN%20FINAL.pdf.
[8] Sec. 1102(a), section which will become 15 USC § 636(a)(36)(K)(ii) and (L); https://home.treasury.gov/news/press-releases/sm961.
[9] https://www.sba.gov/sites/default/files/2020-04/SBA%20Faith-Based%20FAQ%20Final.pdf.

evaluate their planned activities during the entire lifespan of the loan to determine whether the restrictions will interfere with the organization's religious mission.

Paycheck Protection Loans: Key Strategic Considerations

Paycheck Protection loans implicate strategic questions for the organization's board. As with any financial decision, the organization's leadership should consider the short and long-term financial and strategic impact of the loan before applying.

Some example considerations include the following:

- **Start-Ups and the Maximum Loan Amount.** The maximum Paycheck Protection loan amount is calculated as a multiple of the average payroll cost for the immediately preceding twelve-month period. Months with zero payroll costs will bring down the average monthly payroll cost.[10] For organizations which had significant increases in their workforce in the latter part of 2019 or in 2020, the maximum Paycheck Protection loan amount will likely not be high enough to cover payroll costs during the covered period.

- **School Programs and Other Seasonal Employers.** The methods used to calculate the maximum loan amount and forgivable loan amount can lead to surprising results for organizations (such as schools) which have staffing levels which change throughout the year. These organizations in particular should run the numbers before applying for these loans.[11]

- **Loan Amount and Allowable Expenses in Covered Period.** Any Paycheck Protection funds which are not used during the covered period will roll into a traditional loan with a two-year maturity and an interest rate of 1.00%.[12] Organizations should be consider how this will impact their long-term financial plans and religious identity, as described in the subsequent section, "Religious Liberty: Eligibility and Usage."

[10] Sec. 1106(a)(2), which will become 15 USC § 636(a)(36)(E).
[11] Sec. 1106(d)(2).
[12] Sec. 1102(a), section which will become 15 USC § 636(a)(36)(K)(ii); https://home.treasury.gov/news/press-releases/sm961.

Organizations should explore the possibilities offered by these funding options and should work with counsel and their board of directors to choose the timing, loan amount, and loan uses which will best protect their organizations and their missions.

Initial Analysis

Two Types of Loans

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) provides financial relief to small businesses, including exempt organizations, through two types of loans: (1) Economic Injury Disaster Loans ("EIDL"), and (2) 7(a) small business loans ("Paycheck Protection Loans").

Economic Injury Disaster Loans

Available directly from the Small Business Administration ("SBA"), EIDL are meant to help organizations make ends meet during times of disaster. The allowable uses for the EIDL funds cover most general operating expenses.[13]

EIDLs are attractive at first glance, especially given that the current EIDL program allows organizations to receive a $10,000 cash advance which does not have to be repaid, even if the organization's loan application is ultimately declined.[14] However, as described below, during the period when the EIDL loan is outstanding, borrowers of EIDL loans must comply with certain SBA regulations which may impact a faith-based organization's ability to pursue its religious mission. .

Paycheck Protection Loans

As described in more detail below, the Paycheck Protection loan program of the CARES Act dramatically expands both the list of 7(a)-loan eligible organizations and the spectrum of allowable 7(a) loan fund uses. The Paycheck Protection Loans can be used for several key expenses, such as payroll costs and rent. These loans are issued by SBA-authorized private lenders. The SBA is working to expand the network of authorized lenders to make the loan administration process efficient and accessible.[15]

Religious Liberty: Eligibility and Usage

As discussed previously, during the period the loan is outstanding, borrowers must comply with SBA nondiscrimination regulations, including with respect to goods, services, and

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[13] *See* 13 CFR § 123.303 for a list of permissible and prohibited uses of EIDL loan funds.
[14] Sec. 1110(d)(5).
[15] Sec. 1102(a)(2), section which will become 15 USC § 636(a)(36)(F)(iii).

accommodations offered to the public.[16] The regulations allow faith-based organizations to maintain autonomy with respect to employment and membership decisions, but also state that loan "recipients may not discriminate on the basis of race, color, religion, sex, handicap, age, or national origin with regard to the goods, services, or accommodations offered." [17]

In application, this means that, while the loan is outstanding, religious organizations can continue to hire based on religious criteria and limit their membership according to their theological criteria. However, under these regulations, in general, faith-based organizations must make their goods, services, and facilities available to the general public. Religious organizations that have programs that are open not only to members of their faith but also to members of the general public may find that the nondiscrimination obligations restrict the organization's ability to pursue its mission.

For PPP, the period the loan is outstanding (and during which the nondiscrimination regulations apply) could be relatively short (eight weeks plus the period it takes to secure loan forgiveness) or as long as two years. For EIDL, the period the regulations are outstanding depends on the lifespan of the specific loan and could be up to thirty years.

Religious organizations planning to borrow under either of these SBA loan programs should consider their specific planned activities during the lifespan of loan to evaluate whether the restrictions will interfere with their religious mission.

In Depth: The CARES Updates to 7(a) Loans

Loan Forgiveness

As mentioned above, for exempt organizations, the most remarkable feature of the amendments to the current 7(a) loan criteria is the Paycheck Protection Program and its loan forgiveness program.

Under the Paycheck Protection Program's loan forgiveness feature, if certain requirements are met, organizations can apply to have all or a portion of their Paycheck Protection Loans forgiven.[18]

[16] See Frequently Asked Questions Regarding Participation of Faith-Based Organizations in the Paycheck Protection Program (PPP) and the Economic Injury Disaster Loan Program (EIDL), pp. 2-3, available at https://www.sba.gov/sites/default/files/2020-04/SBA%20Faith-Based%20FAQ%20Final.pdf.
[17] 13 CFR § 113.3-1(a).
[18] Sec. 1106(a)(3); 1106(b).

Other Notable Features of the Paycheck Protection Program

The Act introduces a number of generous benefits for Paycheck Protection loan recipients.

The bottom line is that there will be fewer restrictions on how the loan money can be used, more funds will be available, the loan terms will be more favorable, and the loan processing time should be faster.

1. **501(c)(3) Eligibility.** As described above, nonprofit organizations, including religious organizations, that are tax-exempt under Internal Revenue Code Sec. 501(c)(3) are permitted to borrow Paycheck Protection Loans.[19]
2. **Employee Threshold.** Generally, organizations with 500 or fewer employees are eligible for PPP loans. Organizations may also be eligible if they meet certain SBA size criteria.[20] The SBA recently released a religious exemption to SBA affiliation rules when the reason for the affiliation is based on the organization's theology. This religious exemption may expand the availability of funds for dioceses and other hierarchical religious organizations. Religious organizations can claim this exemption through an addendum attached to the PPP loan application itself. An example is provided at the end of the SBA guidance to faith-based organizations.[21]
3. **Maximum Loan Amount.** The maximum loan amount is set at the lesser of 2.5x average monthly "payroll costs" in the twelve month period before the date the loan is made (i.e., pro rata portion of salary and wages (but only the first $100,000 of each employee's annual compensation), certain leave payments, health insurance benefits, and state and local payroll taxes) plus the outstanding amount on certain debt obligations, up to $10,000,000.[22]
4. **Guarantee and Collateral.** Typically, 7(a) loans require a personal guarantee. However, the CARES Act waives the personal guarantee requirement for "Paycheck Protection Program" loans. Additionally, no collateral for the loans will be required.[23]

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[19] Sec. 1102(a)(2), section which will become 15 USC § 636(a)(36)(E)(ii).

[20] April 23, 2020 update: See "Paycheck Protection Program Loans - Frequently Asked Questions," p1, Question 2, available at https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf.

[21] See Part III, Section 2 of the SBA Interim Final Rule on Affiliation, available at https://home.treasury.gov/system/files/136/SBA%20IFR%202.pdf. See also https://home.treasury.gov/system/files/136/Affiliation%20rules%20overview%20%28for%20public%29.pdf.

Also see "Frequently Asked Questions Regarding Participation of Faith-Based Organizations in the Paycheck Protection Program (PPP) and the Economic Injury Disaster Loan Program (EIDL)," p5, available at https://www.sba.gov/sites/default/files/2020-04/SBA%20Faith-Based%20FAQ%20Final.pdf.

[22] Sec. 1102(a), section which will become 15 USC § 636(a)(36)(E). Organizations which obtained an EIDL before March 27, 2020 may also add the balance on that loan to the 2.5 months of payroll costs to calculate their maximum loan amount. See Sec. 1102(a)(2), which will become 15 USC § 636(a)(36)(E)(i)(I)(bb) and (II)(bb).

[23] Sec. 1102(a), section which will become 15 USC § 636(a)(36)(J).

5. **Allowable Uses.** The loans cannot be used for all operating expenses. However, the "allowable uses" include key areas of financial pressure including payroll costs, rent, benefits, mortgage interest, utilities, and other interest payments on obligations incurred before February 15, 2020.[24] Notably, payroll costs are only covered up to the first $100,000 of an employee's annualized compensation.[25] The SBA's interim final rule indicates that 75% of loan proceeds must be used for payroll costs .[26]
6. **No Credit Elsewhere Requirement.** In the past, 7(a) loans were only available to organizations which could not qualify for loans from nongovernment lenders.[27] Under the CARES Act this requirement is waived on loans made through June 30, 2020.
7. **Interest Rate.** The Treasury Secretary and SBA set the interest on the loans at 1.00%.[28] If an organization has a balance remaining after applying for loan forgiveness, the maximum maturity (final date of payment) for the balance of the loan is set at two years from the date the borrower submitted the loan forgiveness application.[29]
8. **Deferral.** Payments on these loans do not need to start for six months from the date of the loans.[30] At that point, to the extent that the loan is not forgiven, the borrower must begin making fully-amortizing payments of principal and interest.
9. **Loan Forgiveness.** As mentioned above, all or a portion of up to eight weeks of these allowable expenses will be forgiven, provided that (a) the loan proceeds are applied only to the "allowable uses", (b) the borrower's employee headcount is maintained for the 8-week period following origination of the loan, and (c) employee salaries are not reduced by more than 25% during the same period.[31] The SBA's Interim Final Rule requires that, to qualify for forgiveness, an organization must spend at least 75% of the funds on payroll costs.[32] The forgivable amount

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[24] Sec. 1102(a), which will become 15 USC § 636(a)(36)(F)(i)
[25] Sec. 1102(a)(2), which will become 15 USC § 636(a)(36)(A)(viii)(II)(aa).
[26] The 75% requirement applies to the loan proceeds for the entire lifespan of the loan; not only during the eight-week period. Sec. 1106(b) of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"); see also, SBA Interim Final Rule on Paycheck Protection Program, Title III § 2(r), available at https://home.treasury.gov/system/files/136/PPP--IFRN%20FINAL.pdf.
[27] 15 USC § 636(a)(1)(A); 13 CFR § 120.101.
[28] https://home.treasury.gov/system/files/136/PPP--Fact-Sheet.pdf.
[29] Sec. 1102(a), section which will become 15 USC § 636(a)(36)(K)(ii); https://home.treasury.gov/news/press-releases/sm961.
[30] Sec. 1102(a), section which will become 15 USC § 636(a)(36)(M)(ii)(I).
[31]Sec. 1102(a), which will become 15 USC § 636(a)(36)(F).
[32] The 75% requirement applies to the loan proceeds for the entire lifespan of the loan; not only during the eight-week period. Sec. 1106(b) of the Coronavirus Aid, Relief, and Economic Security Act ("CARES Act"); see also, SBA Interim Final Rule on Paycheck Protection Program, Title III § 2(r), available at https://home.treasury.gov/system/files/136/PPP--IFRN%20FINAL.pdf.

must be reduced by any paid leave for which a payroll tax credit is available under the Families First Coronavirus Relief Act.

Notably, the maximum loan amount, and, therefore, the maximum amount of loan forgiveness, may not cover eight weeks of allowable expenses in full if these costs exceed 250% of the average monthly payroll costs in the prior year.

10. **Applying for Loan Forgiveness.** Borrowers must affirmatively apply to the lender for loan forgiveness.[33] The loan forgiveness application must be supported by documentation including records such as payroll tax filings and confirmation of payment on relevant lease or mortgage obligations.
11. **Rehiring.** Employers which placed employees on furlough due to the recent crisis may re-hire their employees and still participate in the Paycheck Protection loan forgiveness program.[34] The rehiring must be completed by June 30, 2020.
12. **Fee Waivers.** Under the previous law, applying for a 7(a) loan required both borrowers and lenders to pay fees. Under the CARES Act, these fees are waived through the end of 2020.
13. **Covered Period.** The Paycheck Protection Program and related loan forgiveness program is currently only available on loans made before June 30, 2020.[35]

A Note of Caution

Organizations should be aware that they cannot receive both Paycheck Protection loans and EIDL for the same uses.[36]

If an organization applied for an EIDL to cover payroll costs and rent before the CARES Act expanded the availability of the 7(a) loan, the organization may be able to refinance the EIDL as a 7(a) loan to take advantage of the generous 7(a) loan forgiveness program.[37]

Conclusion

Even if your organization has historically not applied for loans or interacted with the SBA, your organization has employees, your leadership should consider whether participating in the Paycheck Protection loan program will be in the best interests of the organization.

In making this decision, there are a number of strategic questions and considerations for the organization's board, in part due to the way the maximum loan amount is calculated and the

[33] Sec. 1106(e).
[34] Sec. 1106(d)(5).
[35] Sec. 1102(a)(2), section which will become 15 USC § 636(a)(36)(A)(iii).
[36] Sec. 1102(a), which will become 15 USC § 636(a)(36)(Q).
[37] Section 1106(a)(2), section which will become 15 USC § 636(a)(36)(F)(iv).

way the forgivable amount is calculated. Additionally, organization should consider how long their loan will be outstanding and ensure that their obligations as a borrower will not interfere with their religious mission. Organizations should work with counsel and their board of directors to choose the timing, loan amount, and loan uses which will best protect their organizations and their missions.

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