an Your Business Benefit from SBA Economic Injury Disaster Loans During COVID-19?

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For small businesses researching funding sources and financial support to manage the impact of COVID-19, the Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020, deemed COVID-19 a disaster for purposes of the SBA Economic Injury Disaster Loans (EIDL) program. Any EIDL assistance declaration issued by the SBA makes loans available across the country to small businesses and private, non-profit organizations to help alleviate economic injury caused by this coronavirus.

On March 25, 2020, the U.S. Senate passed the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act" or "Act"), to provide emergency assistance and health care response for individuals, families and businesses affected by the COVID-19 pandemic. Section 1107 of the CARES Act makes $10 billion available for emergency EIDL grants. This article summarizes the EIDL program including modifications made to the program under the CARES Act for the covered period (January 31, 2020 through December 31, 2020).

What is a Small Business Administration Economic Injury Disaster Loan (SBA EIDL)?

If you have suffered **substantial economic injury** and are one of the following types of businesses with fewer than 500 employees located in a declared disaster area, you may be eligible for an SBA EIDL:

- Small business
- Small agricultural cooperative
- Small aquaculture business
- Private nonprofit organization
- Tribal business
- Cooperative
- ESOP
- Individuals operating as a sole proprietor or an independent contractor

The SBA's EIDLs offer up to $2 million in assistance and can provide working capital to help small businesses survive until normal operations resume after a disaster. The interest rate is 3.75% for small businesses and 2.75% for non-profits. SBA offers loans with long-term repayments in order to keep payments affordable, up to a maximum of 30 years, and determines the loan terms on a case-by-case basis, depending on each borrower's ability to repay.

Who Is Eligible and How Do You Apply?

The CARES Act requires the SBA to waive the following requirements of an EIDL loan:

- Personal guarantee on advances and loans below $200,000
- Applicant need to be in business for the 1-year period before the disaster, and
- Applicant does not have credit available elsewhere

The CARES Act also allows the SBA to approve and offer EIDL loans based solely on an applicant's credit score, or to use an appropriate alternative method for determining an applicant's ability to repay the loan. SBA's EIDL funds come directly from the U.S. Treasury. Applicants are not required to apply through a bank, rather they can apply directly to SBA's Disaster Assistance Program at: DisasterLoan.sba.gov.

Applicants must establish that the claimed economic injury is substantial and is a direct result of the declared disaster. Substantial economic injury generally means a decrease in income from operations or working capital resulting in the business's inability to meet its obligations and pay ordinary and necessary operating expenses in the normal course of business.

How Soon Can You Obtain Funds?

The CARES Act establishes an Emergency Grant to allow an eligible entity who has applied for an EIDL loan due to COVID-19 to request an advance on that loan, of not more than $10,000, which the SBA must distribute within 3 days. Applicants are not required to repay advance payments, even if subsequently denied for an EIDL loan. In advance of disbursing the advance payment, the SBA must receive certification under penalty of perjury by the applicant that they are eligible. The advance payment may be used for providing paid sick leave to employees, maintaining payroll, meeting increased costs to obtain materials, making rent or mortgage payments and repaying obligations that cannot be met due to revenue losses.

What Purposes Qualify for an EIDL?

EIDLs may be used to pay fixed debts, payroll, accounts payable and other operating expenses that can't be paid because of the disaster's impact. Your loan will be designated for specific purposes, and the penalty for misusing disaster funds is immediate repayment at one and a half times the original amount of the loan.

EIDLs do not allow you to use the loan to expand your business operations, pay cash dividends or bonuses, or disburse payments to owners, partners, officers or stockholders not directly related to the performance of services for the business. The SBA will not refinance long-term debts or provide working capital that was needed by the business prior to the disaster.

How Does the SBA Determine the Amount of the Loan?

Your loan amount will be based on your ***actual economic injury*** and your company's financial needs. You may request an EIDL for the amount of economic injury and operating needs, but not in excess of what your business could have paid had the disaster not occurred. In determining your eligible amount, the SBA will look at: (a) the total of your debt obligations; (b) operating expenses that mature during the period affected by the disaster, plus the amount you need to maintain a reasonable working capital position during that period; and (c) expenses you could have met and a working capital position you could have maintained had the disaster not occurred. Each COVID-19 disaster loan exceeding $25,000 is required to be secured by some form of collateral.

How Can You Demonstrate Your Business Suffered Substantial Economic Injury?

Substantial economic injury means the business is unable to meet its obligations and to pay its ordinary and necessary operating expenses. The Disaster Business Loan application requires the applicant business to enter the amount of loan being requested, if known. The loan amount requested should be based on the applicant business's actual economic injury. Neither lack of profit or loss of anticipated sales *alone* are sufficient to establish substantial economic injury. However, comparing weekly, monthly and/or quarterly financial Key Performance Indicators ("KPIs") in the pre-disaster vs. disaster period can be utilized to demonstrate this. These KPIs may include the following:

Sales Dollars and Volumes

- Declining sales during the disaster period may indicate a business has been economically injured

Profit Margins

- Losses or reduced profits during the disaster period may also indicate a business has been economically injured

Cash Burn Rate

- The cash burn rate indicates how much additional cash a business needs each month to meet obligations and pay operating expenses

Current Ratio, Quick Ratio and Days Sales Outstanding

- Worsening ratios may indicate that the business is experiencing reduced liquidity and is, therefore, having difficulty meeting their short-term debt obligations

Accounts Receivable Aging and Turnover

- Turning receivables slower indicates a business may have less working capital available to meet obligations and pay expenses

Inventory Turnover

- Declining turnover typically indicates weakening sales

Accounts Payable Aging and Turnover

- Delinquency of payables indicates that a business may not able to meet its obligations

Debt Service Coverage

- This ratio is a measure of the cash flow available to pay current debt obligations and is calculated as net operating income divided by total debt service (principal repayments, interest payments and lease payments). A declining debt service coverage ratio indicates a deterioration in a business's potential ability to meet future debt payments.

It is also important to consider that businesses may experience additional costs, as well as potential costs savings as a result of a disaster. These additional and saved costs would need to be considered in any economic injury calculation and may include the following:

Saved Expenses

- These include the impact of reduced or saved operating expenses as a direct result of the disaster. For example, variable costs such as cost of sales and reduced labor costs from decreased headcount.

Increased Expenses

- These include non-reoccurring but necessary expenses, such as increased facility remediation/cleanup costs, severance, marketing and communications, and promotions/discounts. These costs will not be reflected in your pre-disaster financial results and may not be fully reflected in your year-to-date financial results during the disaster period. If you anticipate incurring these types of expenses during the disaster period, it is important to include them in your economic injury calculation as increased costs.

There are other factors that the SBA will evaluate when reviewing EIDL applications and requested loan amounts. These factors may include:

Causation

- The applicant's business must have suffered working capital losses due to the declared disaster, not due to a downturn in the economy or other reasons. The EIDL is intended to provide coverage for obligations and operating expenses that the business can no longer pay as a result of the disaster. As such, if the business was experiencing liquidity concerns or declining financial performance prior to the disaster, this will need to be considered and excluded in any calculation of economic injury.

Other recoveries

- Actual economic injury and the requested loan amount would need to be offset by city, county or state grants and other types of disaster assistance received.

Non-operating assets

- Availability of non-operating assets that can be sold to determine if part or all of your economic injury might be remedied by using such assets.

What Type of Information Will Be Required?

Applicants will be required to submit the following:

- SBA Form 5 or Form 5C (Loan Application Form)
- IRS Form 4506-T (Tax Information Authorization)
- Schedule of Liabilities listing all fixed debts (Form 2202)
- Complete copies, including all schedules, of the most recent Federal income tax returns for the applicant business;
- Personal Financial Statement (SBA Form 413D) completed, signed and dated by the applicant, each principal owning 20 percent or more of the applicant business and each general partner or managing member. The SBA requires the principals of the business to personally guarantee repayment of the loan.
- Monthly sales figures (you may estimate if actual figures are not available) beginning 3 years prior to the disaster and continuing through the most recent month available (Form 1368). The total for each year should reconcile to the sales figures on your tax returns for the corresponding fiscal year.
- Supporting Information (Form P-019).

The following information, while not required, would be helpful to the applicant business in quantifying their actual economic injury in support of the requested loan amount:

- Monthly or quarterly profit-and-loss statements and balance sheets for the three years prior to the disaster (in order for the SBA to compare your financial condition and operating results preceding the disaster with those during and since the disaster period).
- Any budgets, forecasts or projections to indicate what the revenues and expenses for the business were anticipated to be in the absence of the disaster.
- Financial forecast to illustrate what the revenues and expenses for the business will be during the period affected by the disaster until normal operations resume.
- Calculation of historical working capital needs of your business over time.
- Short-term debt obligations.

We understand how important it is for you to focus on recovery and operations during this time, so Weaver is ready to assist you with the SBA EIDL process by quantifying your actual economic injury and preparing the supporting documentation to submit with your loan application. We provide the necessary information for the SBA to process your loan application so you receive the funding needed to get through the disaster period and on your way to recovery