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Considerations for Approvals of PPP and EIDL SBA Loans by Existing Commercial Real Estate Lenders

In response to the COVID-19 pandemic, the CARES Act established eligibility for two SBA loan programs: Section 7(a) Payroll Protection Program loans (“PPP”) and Economic Injury Disaster loans (“EIDL”). Many existing loan documents prohibit such additional debt without lender consent and existing lenders are likely to be approached by borrowers requesting approval to enter into such loans. Below are items to be considered by existing lenders.

PPP Loans

PPP loans are designed primarily to facilitate small businesses maintaining their levels of employment through the pandemic. These loans are potentially forgivable if used for the permitted purposes, described below.

Eligibility for PPP loans requires that an entity have employees, however the applicable company, together with its affiliates, must have less than 500 employees. The entity could qualify based on certain alternative size standards, including industry-specific standards based on number of employees, net worth or average annual revenue of the entity. The SBA rules for defining affiliates are complicated and fact specific, but are generally quite expansive; however, the CARES Act provides an exception to the affiliation rules for hospitality properties and restaurants (any organization with an NAICS Classification code starting with 72). These entities are eligible so long as they have no more than 500 employees at any one location.

Under existing SBA regulations, certain businesses are ineligible for PPP loans. These include shopping centers, apartment buildings, mobile home parks, residential facilities that do not provide medical services and other businesses primarily engaged in owning or purchasing real estate and leasing it for any purposes (hotels, RV parks, marinas, campgrounds, nursing homes and assisted living

facilities are explicitly exempted from this ineligibility and self-storage properties are generally considered to be eligible). However, developers and landlords in those asset classes should encourage their tenants to apply for PPP loans. These entities would still be eligible to obtain EIDL loans to the extent they otherwise qualify.

The maximum amount of a PPP loan may be up to 2.5x the monthly payroll of the PPP borrower, capped at \$10mm. Although the CARES Act provides that the loans may have terms of up to 10 years with an interest rate up to 4.5%, the SBA has since provided guidance that the loans will have 2-year terms (measured from the date on which the borrower applies for loan forgiveness) and an interest rate of 1.0%, to the extent not forgiven. Payments under the loans will be deferred for six months from the date of disbursement. No collateral and no guaranty is required for these loans. The first disbursement under a PPP loan must be made within 10 days of approval of the application, which may affect the timeline for existing lender approval of a PPP loan that was applied for by an existing borrower without prior approval.

As PPP loan eligibility is based on an entity's payroll expenses, and many SPE borrowers have no direct employees, most SPE borrowers will not qualify for PPP loans directly. A common scenario will be a request for the property manager to obtain such a loan. Regardless of whether the manager is an affiliate or a third-party, the PPP loan could be used for payroll costs and certain other expenses of the manager, but not to pay mortgage payments or other obligations of the SPE borrower. In such a scenario, the management agreement may need to be amended to eliminate the SPE borrower's obligation to reimburse the property manager for payroll costs which are paid using PPP loan proceeds that are ultimately forgiven.

Another request may be for an upper-tier entity, managing member or other affiliate of the SPE borrower to obtain a PPP loan and use the proceeds to pay expenses of the SPE borrower. We do not believe this is permitted by the CARES Act without further guidance to the contrary from the Treasury Department.

Although PPP loans are forgivable under certain circumstances, such forgiveness is not automatic. In order to be fully forgiven (1) the PPP loan must be used for payroll costs, mortgage interest

payments (but not principal), rent payments, utility payments, interest payments on other debt obligations or refinancing EIDL loans taken out earlier in 2020, and must be used within eight weeks of obtaining the loan, (2) 75% of the PPP loan proceeds must be used for payroll expenses and (3) the PPP borrower must maintain the same full-time employment and compensation levels as measured on June 30 compared to pre-Feb. 15 levels. Failure to comply with clause (3) will result in a pro rata reduction in forgivable amounts. As such, in the event that an existing lender approves the obtaining of a PPP loan, such lender should consider underwriting all or part of the PPP loan based on the assumption that it may become a 2-year loan with an interest rate of 1.0%.

In addition, the following structural enhancements in the existing loan documents should be considered (or should be included with respect to a new loan): (i) representations that the borrower properly applied for and obtained the PPP loan, (ii) a covenant that the borrower will comply with the terms of the PPP loan documents and that the proceeds of the PPP loan will be used only for forgivable uses and (iii) to the extent the loan is nonrecourse, a recourse carveout for amounts not forgiven under the PPP program or failure to comply with the covenant in clause (ii). Note that the PPP application requires the borrower to certify that funds will be used for an eligible purpose and failure to comply with that certification could subject the borrower to civil and criminal penalties. The eligible purposes do not include the payment of principal on existing debt, so an existing lender cannot require the borrower to apply PPP proceeds to payments or prepayments of principal.

EIDL Loans

The EIDL loan program existed prior the COVID-19 pandemic and is designed to help companies affected by federal emergencies. The CARES Act expanded eligibility to include most companies affected by the COVID-19 pandemic. EIDL loans can be used to pay fixed debts, payroll, accounts payable and other bills that could have been paid if the disaster had not occurred. These loans are capped at \$2 million, with terms of up to 30 years and an interest rate of

3.75%.

Unlike PPP loans: (1) EIDL loans are not forgivable, (2) EIDL loans over \$25,000 require collateral and (3) EIDL loans over \$200,000 require a guaranty. Although the act doesn't specify the collateral that will be required for these EIDL loans, loans under existing SBA programs are generally secured by a first lien mortgage. We anticipate that the required collateral for these EIDL loans will be a first lien mortgage on the real property owned by the borrower; however, we have heard some indication that a second lien mortgage may be permitted. Additional guidance from the Treasury Department or the SBA is needed.

EIDL loans to property managers or affiliates of SPE borrowers pose similar issues as PPP loans. As EIDL loans are not based on payroll, they may be available to SPE borrowers who would not qualify for PPP loans. EIDL Loans are also available to a wider range of asset classes, including owners of shopping centers, apartment complexes and office buildings.

If an existing lender is willing to consent to an EIDL loan, the following structural enhancements should be considered: (i) representations that the borrower properly applied for and obtained the EIDL loan, (ii) a covenant that the borrower will comply with the terms of the EIDL loan documents and that the proceeds of the EIDL loan will be used only for permissible uses and (iii) to the extent the loan is nonrecourse, a recourse carveout for failure to comply with the covenant described in clause (ii). Note that the EIDL application requires the borrower to certify that funds will be used for an eligible purpose and failure to comply with that certification could subject borrower to civil and criminal penalties. The eligible purposes do not include the prepayment of principal on existing debt, only the payment of "fixed debts," so an existing lender cannot require borrower to apply EIDL proceeds to prepayments of the loan.

Please note that many of the items discussed herein are simplified for the sake of brevity and will require additional guidance on a case-by-case basis. In addition, the interpretation and application of the above programs continues to evolve at a rapid pace and many of the most pressing questions remain unanswered. The

Treasury Department, SBA and other sources continue to publish additional guidance on a frequent basis. As such, please note that the information herein is subject to change and we will endeavor to keep you updated as to any significant changes.

For more information please contact [Josh Brock](#) or any attorney in Frost Brown Todd's [Financial Services Industry Team](#).

To provide guidance and support to clients as this global public-health crisis unfolds, Frost Brown Todd has created a [Coronavirus Response Team](#). Our attorneys are on hand to answer your questions and provide guidance on how to proactively prepare for and manage any coronavirus-related threats to your business operations and workforce.

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