Paycheck Protection Program (PPP)/COVID-19 Economic Injury Disaster Loan (COVID-19 EIDL)

Qualifications, Differences, and the Potential Impact on Financial Analysis and Underwriting Practices

Rounding out 2021, most of us have heard about the Paycheck Protection Program (PPP) and the Economic Injury Disaster Loan (EIDL). But something we may not have considered is what differentiates these assistance programs and how this may impact Underwriting Practices in the near future. Do we need to consider these differently when considering a customer's financial standing and cash flow capabilities? Do we fully understand how the customer is adjusting for these on their financial statements? In order to answer these questions and make these internal decisions, one needs to understand these programs and how they have evolved since inception.

Beginning in 2020, the Government offered financial assistance to businesses through several products including PPP and the COVID-19 EIDL. These loans were made available through the Small Business Administration (SBA) under the CARES Act. While PPP ended on May 31, 2021, the COVID-19 EIDL was offered for further assistance beginning in April 2021 with the last day for applications to be approved on this program being December 31, 2021. It should be noted that businesses are able to qualify for multiple assistance programs.

PPP Loans were intended to be forgiven but this is not an automatic process. The business will need to apply and be approved for forgiveness. While it is assumed 100% of the PPP Loan will be forgiven, it may only be a percentage depending on use of the funds and if the business applies. To qualify for forgiveness, the borrower must apply during the 8-24 week covered period following loan disbursement for both first and second draw PPP loans. According to the SBA website, the borrowers must show:

- Employee & compensation levels were maintained
- The loan proceeds were spent on payroll costs and other eligible expenses; and
- At least 60% of the proceeds are spent on payroll costs

Paycheck Protection Plan (PPP)	
Product	Provide direct incentive for small businesses to keep their workers on payroll. A second draw of PPP was available if the borrower previously received a First Draw PPP loan and will or has used the full amount only for authorized uses, has no more than 300 employees, and can demonstrate at least a 25% reduction in gross receipts between comparable quarters in 2019-2020
Use of Proceeds	Payroll expenses (including benefits), mortgage interest, rent, utilities, worker protection costs related to COVID-19, uninsured property damage costs caused by looting or vandalism during 2020, and certain supplier costs and expenses for operations
Loan Term	Loans issued prior to June 5, 2020: 2 years Loans issued after June 5, 2020: 5 years
Interest Rate	1%
Payment Deferment	Loan payments will be deferred for borrowers who apply for loan forgiveness until SBA remits the borrower's loan forgiveness amount to the lender. If a borrower does not apply for loan forgiveness, payments are deferred 10 months after the end of the covered period for the borrower's loan forgiveness (between 8-24 weeks).
Fees	Neither the government nor lenders will charge small businesses any fees
Collateral	Not required
Personal Guaranty	Not required

As PPP loans become forgiven, the businesses need to account for these accordingly on their financial statements. Some key takeaways:

- Once the loan is forgiven (partial or in full), the forgiven amount would be taken out of the company's liabilities and added to income on their financial statements.
- It is advised that the funds will be considered income for book purposes but are not considered taxable income.
- Lenders and Financial Institutions reviewing financials for these businesses need to take these situations and timelines into account.
- Since PPP Loans can have term lengths of 2 or 5 years and the business can request forgiveness anytime up until the maturity of the loan these adjustments may be present for many years.
- Understanding if forgiveness has been given, requested, or if the business is intending to keep the debt on their balance sheet can impact the cash flow calculation depending on internal thresholds and practices.
- The amount of the loan can also determine if any internal calculations or adjustments need to be made to determine cash flow.
- As of recent, nearly half of the PPP loans granted have applications for forgiveness but since the businesses have some time to apply for forgiveness and there is no stated timeline for how long it may take for the forgiveness to be granted, financial statements may need to be adjusted accordingly for some time.

Unlike a PPP Loan the EIDL must be repaid over time and is not forgivable, with an exception being advances up to $15,000. This means a business will account for this loan on their balance sheet for the duration of the loan. EIDL will also require business assets as collateral on loans over $25,000 and a personal guaranty on requests over $200,000.

Businesses that are eligible for COVID-19 EIDL:

- Small businesses, including affiliates, that have 500 or fewer employees or are defined as small per SBA size standards
- Sole proprietorships and independent contractors
- Cooperatives that, including affiliates, have 500 or fewer employees
- Employee Stock Ownership Plans (ESOPs) that, including affiliates, have 500 or fewer employees
- Tribal small business concerns with 500 or fewer employees
- Agricultural enterprises with 500 or fewer employees
- Privately owned non-profit organizations, including religious non-profits, regardless of size if they meet the other program eligibility requirements

Eligibility Requirements:

- Credit Score of 570 or above for personal guaranty
- In business, or evidence of investment to be in business, on or before 1/31/2020
- All owners of 20% or more of the business must have an EIN (if owner is a legal entity), be a US citizen with a valid SSN or Non-US Citizen classified as a "non-citizen national" or a "qualified alien." Qualified aliens include permanent residents with a current green card."

COVID-19 Economic Injury Disaster Loan (COVID-19 EIDL)	
Product	Loan directly from SBA that must be repaid. Low-interest, fixed-rate, long-term loan to help overcome the effects of the pandemic by providing working capital to meet operating expenses
Uses of Proceeds	Normal operating expenses and working capital
Loan Cap	$500,000
Loan Term	30 years
Interest Rate	Businesses: 3.75% fixed Private nonprofit organizations: 2.75% fixed
Payment Deferment	Payments can be deferred for 18 months for loans made in 2021. No penalty for prepayment
Fees	$100 UCC Filing Fee for loans over $25,000
Collateral	Required for loans greater than $25,000
Personal Guaranty	Required for loans greater than $25,000

References:
Nancy Geary, CPA, CLFP – ECS Financial Services, Inc.
U.S. Small Business Administration website:
https://www.sba.gov/funding-programs/loans/covid-19-relief-options
https://www.sba.gov/funding-programs/loans/covid-19-relief-options/paycheck-protection-program/ppp-loan-forgiveness
https://www.sba.gov/document/support-faq-regarding-covid-19-eidl

https://www.sba.gov/funding-programs/loans/covid-19-relief-options/eidl/targeted-eidl-advance-supplemental-targeted-advance

EDocumentation

With the changing business landscape attributed in part to the worldwide pandemic, our industry has seen a significant increase in the number of transactions utilizing digital signing platforms and electronic signatures. Utilizing these types of products is certainly beneficial from a process improvement and efficiencies standpoint. It comes with its own set of challenges though, that should be considered when making the shift to a more digital process. Considerations that are necessary in order to protect you, your asset, and your lien position. Below are some items to take into consideration when deciding what type of process is best for you and your business.

(DocuSign Whitepaper "Guide to Electronic Signatures for Business 05/07/21)

In 2000, the U.S. federal government passed The ESIGN Act, which, in tandem with the Uniform Electronic Transactions Act (UETA), confirms that electronic signatures constitute legally binding documents if all parties choose to sign digitally. Electronic signatures are valid in all U.S. states and are granted the same legal status as handwritten signatures under state laws.

Electronic documents can be admissible in court, although verifying that they are tamper-resistant, contain a secure audit trail and utilize a strong authentication method are strongly recommended. Common forms of authentication include email address, access code, SMS, phone call, ID verification or Knowledge-based, which is the use of "out of wallet" questions to validate a person's identity.

While pen-and-paper signatures can easily be forged and tampered with, electronic signatures have multiple layers of security and authentication built into them. E-signatures come with an electronic record that serves as an audit trail and proof of the transaction. This trail includes the history of actions taken with the document, such as when it was opened, viewed, and signed. Depending on the provider, if the signer agreed to allow access to their location, the record will also show geolocation where it was signed. If a signer disputes their signature or there is any question about the transaction, this audit trail can resolve such objections. More detailed certificates of completion can include specific details about each signer on the document, including the signature image, key event timestamps, the signer's IP address and other identifying information.

Utilizing an e-signature process can create a better customer experience, generate productivity improvements, reduce processing costs, result in fewer errors and inaccuracies, allow for increased privacy and security, reduce the need to store paper documents, and reduce your environmental footprint.

What is equally important to the actual authentication and signing process, is the storage of the resulting authoritative copy. Especially if you intend to either sell or purchase electronic chattel paper.

(eOriginal Whitepaper "Electronic Vault (eVault) Solutions: What every Lender and Finance Leader Needs to Know)

Within the context of digital lending, eVault technology works by permanently binding electronic signatures to a document and creating a tamper-proof audit trail that demonstrates ownership and compliance. The process of eVaulting a document within a secure, trusted environment fulfils the legal and regulatory requirements for uniqueness and negotiability of the document as a digital financial asset. These compliant Digital Original® assets are often referred to as an Authoritative Copy or Transferable Record. As interaction with the document occurs throughout its lifecycle, the eVault also enables the owner or secured party to control the access rights to the asset and tracks all activity regarding the asset: from signing, maintenance, sale, pledging, collateralization, and securitization through to its ultimate disposition or destruction.

Step 1: Transaction parties sign electronically
Step 2: Once the signatures are applied, the document is instantly deposited into the eVault—establishing the authoritative original document—where it is held and managed via controlled access by authorized parties throughout its lifecycle.
Step 3: All activities and functions affecting the original documents are controlled and logged by the eVault.

Why Financial Institutions Need an eVault

In an increasingly complex regulatory environment, financial institutions face growing compliance requirements for assets associated with commercial and mortgage loans. Digital solutions deliver more cost and time savings for asset storage and management.

However, compliant electronically signed documents require a higher threshold of security and accessibility than provided by some document management providers. Documents must remain protected and accessible to authorized parties throughout the lifecycle of a transaction. The best way to address all of these requirements is with compliant eVaulting.

Three Key Benefits of Electronic Vault

1. Compliance: Storing signed, verified, and confirmed digital documents safely is invaluable for physical data security as well as legal defenses.
2. Risk mitigation: Organizations using an electronic vault benefit from better records management, faster access to documents, and a clear audit trail across for the document's full lifecycle.
3. Transparency: To ensure compliance with the myriad of legislative statutes that govern electronic contracts and signatures, financial institutions need electronic vaulting solution to manage the entirety of the digital lending lifecycle.

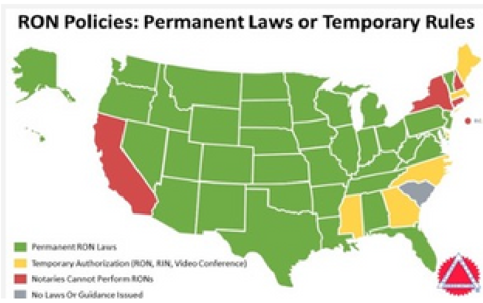
One of the challenges that has historically hindered full adoption though, is the need for notarization in some instances. That being said, with the increased use of electronic signatures the past 18 months, states are finally coming to understand the importance of adopting or legislating for some type of electronic or remote online notarization (RON) process. Either temporarily as part of an emergency order during the pandemic, or full policies surrounding long term acceptance of RON's.

(National Notary Association "Remote Notarization: What You Need to Know")
What is remote notarization?
With remote notarization, a signer personally appears before the Notary at the time of the notarization using audio-visual technology over the internet instead of being physically present in the same room. Remote online notarization is also called webcam notarization, online notarization, or virtual notarization.

Many people confuse electronic notarization with remote notarization, believing they are the same. They are not.

The confusion arises from the fact that Webcam notarizations typically involve digital documents that are signed and notarized electronically. However, they go a step further in that the transaction is conducted online rather than in person.

There are 33 states that have fully implemented RON or have a registration process in place to perform remote online notarizations. The image below displays the states and their adoption of RON.



Even with the widespread adoption of RON, one area that has continued to experience challenges with electronically notarized documents is rolling stock and the documents required for the transfer of motor vehicle titles. As a result, it will be important to validate the requirements with each individual state prior to utilizing RON for use on the transfer of vehicle titles.

So, as we continue to navigate this ever-changing digital landscape, and you begin to develop or solidify your go forward eSigning strategy, here are some important items to consider:

(ELFA Webinar: 5 Takeaways from eSigning and eLeasing: What Do You Want to Know?)

1. **Equipment finance companies are recognizing the benefits of e-signing and e-leasing.**
2. **E-leases are not simply copies of ink-signed documents.**
3. **Digital documents are enforceable by three material statutes. The Electronic Signatures in Global and National Commerce Act (E-SIGN), the Uniform Electronic Transactions Act (UETA) and Article 2A of the UCC**
4. **Electronic documents are subject to the same challenges to enforceability as paper contracts.**
5. **If you don't have a fully e-signed lease, it can still be converted into e-chattel paper.**

What is ESG and why is it important to Lessors?

Environmental, social and governance (ESG) is a set of standards for how a company operates in regard to the planet and its people.

Environmental criteria
Environmental criteria examine how a company performs as a steward of the planet. Some examples include a company's energy use, the waste and pollution it creates, how it conserves natural resources, and the way it treats animals.

Social criteria
Social criteria examine how a company manages relationships with employees, suppliers, customers, and the communities where it operates. Does the company have a high regard for employee health and safety? Does the company allocate a percentage of its profits to its local community? Do company employees engage in volunteer work? Are other stakeholders' interests considered?

Governance
Governance defines a set of rules and best practices, along with a series of processes that determine how an organization is managed and controlled. In looking at a company's governance, we want to ensure that it is accurate and transparent in its accounting and reporting methods. Investors will also look at how a company treats its shareholders and their right to vote on important issues. Investors will seek assurances that the company doesn't engage in illegal practices and avoids conflicts of interest when it chooses its board members.

ESG is important because socially conscious investors now use ESG criteria to screen investments thus potentially impacting access to capital in the marketplace for those companies that score poorly. Accordingly, Lessors must also review ESG impact on the companies that lease equipment from them as lack of ESG can hurt a company and increase risk for Lessors.

Lessors now understand that ESG criteria go beyond ethical concerns. With robust ESG criteria, companies can avoid practices that involve undue risk. For example, Volkswagen's emissions scandal rocked the company's share price, causing investors to lose billions in value. For a Lessor, the increased risk impacts the credit worthiness of the firm and its ability to service debt. That's why Lessors must incorporate an ESG evaluation into its underwriting and risk appetite framework and train all personnel to be on the look-out for potential negative impact on our Lessees in this area.

Although ESG metrics are not currently a required part of financial reports for publicly traded companies, a growing number of companies are including them in their reported statements or a separately issued document. Increasingly, there is consensus among many regulators that some form of standardized ESG disclosures will be required. In fact, the Securities and Exchange Commission (SEC) is promulgating such reporting and established an Enforcement division task force this year to proactively identify ESG related misconduct. Furthermore, there are approximately 30 notable ESG rating agencies and data providers around the world to evaluate ESG for a number of publicly traded firms.

In summary, we as a leasing community need to ensure that we are properly assessing ESG risk as part of our ongoing underwriting and evaluation of a credit. Further we must train all of our employees in this matter (especially our sales, credit, and documentation staff) to ESG sensitivity. Finally, ESG evaluations are relevant to TPOs when they select which banks and funding sources with whom they choose to partner.

Simply stated -- ESG is here to stay!!

*** Multiple sources including the Corporate Governance Institute*

New York & California Changes

New York
On December 23, 2020, the Governor of New York signed Senate Bill No. 5470 (now codified as new Article 8) of the New York Financial Services Law and the effective date is January 1, 2022. This bill is known as the Commercial Financing Disclosure Law or CFDL.

All providers must comply, and the term "provider" is defined as: A person who extends a specific offer of commercial financing to a recipient. Unless otherwise exempt, a "provider" also includes a person who solicits and presents specific offers of commercial financing on behalf of a third party, which includes brokers.

The following institutions and transactions are exempt:
- Financial institutions
- A technology service provider;
- A lender regulated under the Federal Farm Credit Act;
- A commercial financing transaction secured by real property;
- A lease as defined in Section 2-A-103 of the UCC;
- A provider who makes no more than 5 commercial financing transactions in the state in a 12 month period;
- An individual commercial transaction in an amount over $2,500,000;
- Motor vehicle dealers and rental vehicle companies (as defined under NY law).

What Type of Financing Is Covered by The Law?
"Commercial financing" means open-end financing, closed-end financing, sales-based financing, factoring transactions, or other forms of financing, the proceeds of which the recipient does not intend to use primarily for personal, family or household purposes. However, a "Lease" as defined by UCC 2-A-103 is exempt.

Disclosure Requirements
Disclosure requirements are robust and vary based on the type of financing. The disclosure must be delivered to the prospective borrower at the time of extending a specific offer for the covered financing, **not at the time the financing documents are signed.**

The disclosures must be made in the form required by law. Some examples of disclosure requirements are:

- The total amount of commercial financing and the disbursement amount, if different from the financing amount, after any fees deducted or withheld at disbursements;
- The finance charge (broadly defined);
- The annual percentage rate using only the words annual percentage rate or the abbreviation "APR" expressed as a yearly rate, inclusive of any fees and finance charges that cannot be avoided by a recipient;

- The term of financing;
- The total repayment amount (disbursement plus finance charge);
- A description of the collateral requirements or security interests, if any.

Finally, the provider must obtain the recipient's signature (may be eSignature), on all disclosures before authorizing the recipient to proceed further with the application.

If a provider has been found to have violated the provisions of the articles, it shall pay a civil penalty in an amount not to exceed $2k for each violation or where such violation is willful, $10k for each violation.

If a provider is found to have knowingly violated the article, the provider may face additional penalties, which may include restitution or a permanent or preliminary injunction on behalf of any recipient affected by the violation.

California Disclosure Law
On September 30, 2018, Senate Bill 1235 was signed into law in the State of California. Senate Bill 1235, which is now codified as Financial Code, Sections 22800 through 22805, requires a "provider," (a person who extends a specific offer of "commercial financing" in an amount of $500k or less) to a "recipient" (a person who is presented a commercial financing offer by a provider that is equal to or less than $500k and whose business is principally directed or managed from California) to give certain disclosures at the time the provider extends the offer. It is anticipated to be effective on January 1, 2022.

Final regulations have not yet been issued and many questions remain.
The following institutions are exempt:

- A depository institution (e.g., banks, trust, S&L, etc.)
- A lender regulated under the Federal Farm Credit Act;
- Motor vehicle dealers and rental vehicle companies (as defined under CA law).
- Any person who makes no more than one commercial financing transaction in California in a 12-month period or any person who makes five or fewer commercial financing transactions in California in a 12-month period that are incidental to the business of the person relying on the exemption. What may or may not be incidental to a provider's business is not clear under the California Financing Law.

Similar to the CFDL, "true leases" are exempt.

What Must Be Disclosed?
All Disclosures must be made in writing to the recipient at the time of making a specific offer, not as part of the documentation process. The recipient of the offer must sign and date the offer and eSignatures are allowed.

At the start of the Disclosures, it must state in **bold** font, **"OFFER SUMMARY".**
The following must be disclosed:

1. The total amount of funds provided.
2. The total dollar cost of the financing.
3. The term or estimate terms.
4. The method, frequency and amount of payments.
5. A description of prepayment policies.
6. The total cost of the financing expressed as an annualized rate.

At the bottom of the Disclosures, it must state:
"California law requires this information be provided to you to help you make an informed decision. By signing below, you are confirming you have received this information."

- The Terms must be expressed in terms of years and months with remaining days expressed as days as a portion of a month.
- The months must be expressed as 30 days in each month 360 days in every year.
- The rate must be expressed in interest to the nearest 10 basis points.
- The calculation of APR is to be based upon Truth In lending laws 12 CFR Part 1026 - (Reg. Z)

This law varies from the California Finance Lenders Law in that subsidiaries of banks, while exempt from licensing, are not exempt from the disclosure law as they are not depository institutions.

Non-bank entities may be subject to the disclosure law whether or not they are required to have a California Finance Lenders License as a lender or a broker.

****All information was obtained through the ELFA Legal Forum Presentation titled, "California, New York & Federal Disclosures" as presented by Moorari Shah, Esq., Robert S. Cohen, Esq., and Marshall F. Goldberg, Esq.*