PRIVATE EQUITY SERVICES

Diligence Insights: Treatment of PPP Loans in a Transaction

Covid-19 has impacted most of our deals this year in various ways, both on the buy side and sell side. Currently, a common issue we are facing on smaller middle market deals relates to the treatment of loans received pursuant to the CARES Act Payroll Protection Program (PPP). The PPP, which closed to new loan applications on August 8, 2020:

- Allowed founder-owned businesses to receive a loan to help them to continue to make payroll during the pandemic.
- Was administered through the Small Business Administration (SBA) and amounts distributed through commercial banks.
- Was not provided to sponsor backed businesses.

The loans issued were meant to be forgiven if businesses maintained qualified payroll levels as well as other various requirements. However, due to the ever-evolving nature of the program and the backlogs at banks and the SBA, the forgiveness of many of these loans for businesses that have met the qualifications, has not yet occurred. As such, sponsors who were originally excluded from the program, now have to navigate how to treat these loans as they invest in founder-owned businesses where these loans remain intact subject to forgiveness. Earlier this month, the SBA came out with guidance on three different ways these PPP loans can be handled in a transaction:

- **Repayment:** The company can repay the loan at or prior to close and leave the sponsor with no liability post close. This method allows the sponsor to not assume any loans via a transaction, however, typically requires negotiation as to who (the seller or the sponsor), pays the repayment. If this approach is taken, we typically see the sponsor incur most of this cost.
- **Complete the forgiveness process:** If the process is complete and a loan forgiveness notification has been received, the SBA has stated that the sponsor will not retain a liability. This is the optimal option for both parties, however, due to backlogs at the bank and the SBA, this option tends to take time and can delay a deal. As such, unless the company started the process early, we rarely see this route taken.

- **Submit forgiveness application and leave the amount in escrow:** As part of its guidance, the SBA provided a third option to resolve the PPP, which has been the most popular option. Transactions can now happen without being delayed if the forgiveness application has been submitted and the amount of the PPP loan is maintained in escrow. This path allows deals to get done sooner, which is typically preferred by both parties, and eliminates sponsors exposure. **Sellers will have to wait to receive the funds, which they sometimes push back on, however, now that this guidance has been provided, there is more flexibility with sellers agreeing to this option.**

Alvarez & Marsal provides financial accounting, tax, and operational due diligence services for middle market transactions. This piece is a follow up to our earlier article on the impacts of Covid-19 on middle market transactions in the software and technology space. The previous article can be viewed here. If you have any questions on this guidance or are interested in A&M please reach out.

For SBA's guidance, click here.

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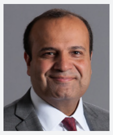

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