CARES Act: SBA Regulatory Guidance for Paycheck Protection Program

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INTRODUCTION

The linchpin of the recently-adopted Coronavirus Aid, Relief and Economic Security (CARES) Act is the Paycheck Protection Program (PPP)—a program designed to rapidly infuse cash into the U.S. economy through forgivable Small Business Administration (SBA) loans targeted to paying employee expenses. The CARES Act was only adopted on March 27, 2020, and the Department of the Treasury had hoped to begin processing loan applications beginning April 3, 2020.

On March 31, 2020, the Treasury Department had published two "fact-sheets" concerning the PPP, and a form application. Late in the day on April 2, 2020, however, the SBA leased its own Interim Final Rule governing the PPP, which substantially and substantively changed the process announced by the Treasury Department two days before. The Final Rule clarifies certain ambiguities in the statutory language and resolves many of the questions that had troubled lenders and borrowers alike. Discussed below are some of the significant provisions contained in the Final Rule.

IMPORTANT INFORMATION FOR BORROWERS

Eligibility

A person or entity is eligible for a PPP loan if it has 500 or fewer employees, whose principal place of residence is in the United States, and (1) it is (a) a small business concern, as defined under the Small Business Act, or (b) a tax-exempt nonprofit organization described in section 501(c)(3), and (2) it was in operation on February 15, 2020, and either had employees for whom it paid salaries and payroll taxes, or paid independent contractors. Sole proprietors and independent contractors also are eligible for PPP loans subject to their provision of certain payroll information confirming payroll expenses. The Final Rule also lists those ineligible from receiving a PPP loan, including those who are in default or delinquent on any federal loans, those who are engaged in illegal activities, and those who apply as household employers.

Payroll Costs

The term "payroll costs" plays a significant role in the PPP. It is used both to determine the amount of loan and the extent of loan forgiveness. The Rule provides:

> Payroll costs consist of compensation to employees (whose principal place of residence is the United States) in the form of salary, wages, commissions, or similar compensation; cash tips or the equivalent (based on employer records of past tips or, in the absence of such records, a reasonable, good-faith employer estimate of such tips); payment for vacation, parental, family, medical, or sick leave; allowance for separation or dismissal; payment for the provision of employee benefits consisting of group health care coverage,

> including insurance premiums, and retirement; payment of state and local taxes assessed on compensation of employees; and for an independent contractor or sole proprietor, wage, commissions, income, or net earnings from self-employment or similar compensation.

Independent contractors ***do not*** count as employees for purposes of PPP loan calculations.

Usage of Loan Proceeds

The CARES Act defines the appropriate uses for PPP loan proceeds, including (i) payroll costs; (ii) costs related to the continuation of group health care benefits; (iii) mortgage interest payments; (iv) rent payments; (v) utility payments; and (vi) certain other limited purposes. The Final Rule, however, contains a new and significant qualification: at least 75 percent of the PPP loan proceeds must be used for payroll costs. Although borrowers already will have to demonstrate that at least 75 percent of the loan was used for payroll costs in order to obtain loan forgiveness, the PPP application will now require an affirmative representation that the borrower will use at least 75 percent of the PPP loan proceeds for payroll costs. The newly-issued applications now contain the following representation:

> The funds will be used to retain workers and maintain payroll or make mortgage interest payments, lease payments, and utility payments; I understand that if the funds are knowingly used for unauthorized purposes, the federal government may hold me legally liable such as for charges of fraud. As explained above, not more than 25 percent of loan proceeds may be used for non-payroll costs.

The Final Rule states that borrowers will be directed to repay any PPP funds used for unauthorized purposes. Further, the SBA will have recourse against any shareholder, member, or partner who uses PPP funds for unauthorized purposes.

Term and Rate

Although the statute permits loans of up to 10 years, the SBA has determined that the term for all PPP loans will be two years. The SBA has determined that the interest rate for the PPP loan will be 1 percent per annum. That is an increase over the 0.50 percent posted on March 31, 2020.

All applications for PPP loans must be submitted on or before June 30, 2020. PPP loan funds will be allocated on a "first-come/first-served" basis, and there is no guarantee that funds will be available for all eligible applicants.

Loan Forgiveness

The amount of loan forgiveness can be up to the full principal amount of the loan and any accrued interest. That is, the borrower will not be responsible for any loan payment if the borrower uses all of the loan proceeds for forgivable purposes described above and employee and compensation levels are maintained. While the Act provides that borrowers are eligible for forgiveness in an amount equal to the sum of payroll costs and any payments of mortgage interest, rent, and utilities, the Administrator has determined that the non-payroll portion of the forgivable loan amount should be limited to effectuate the core purpose of the statute and ensure finite program resources are devoted primarily to payroll. Thus, not more than 25 percent of the loan forgiveness amount may be attributable to non-payroll costs.

IMPORTANT INFORMATION FOR LENDERS

Modified Lending Criteria for Lenders

The SBA had substantially modified loan criteria for lenders. The SBA will allow lenders to rely on certifications of the borrower in order to determine eligibility of the borrower and use of loan proceeds and to rely on specified documents provided by the borrower to determine the qualified loan amount and eligibility for loan forgiveness. Lenders who comply with the applicable lender obligations set forth in the Final Rule will be held harmless for borrowers' failure to comply with program criteria.

Underwriting of PPP Loans

The PPP provides extremely limited underwriting requirements for lenders. They must:

i. Confirm receipt of borrower certifications contained in PPP Application;

ii. Confirm receipt of information demonstrating that a borrower had employees for whom the borrower paid salaries and payroll taxes on or around February 15, 2020;

iii. Confirm the dollar amount of average monthly payroll costs for the preceding calendar year by reviewing the payroll documentation submitted with the borrower's application; and

iv. Follow applicable Bank Secrecy Act requirements.

Loan Forgiveness

Lenders may rely on borrower documentation for loan forgiveness purposes, and the lender does not need to conduct any verification if the borrower submits documentation supporting its request for loan forgiveness and attests that it has accurately verified the payments for eligible costs.

CONCLUSION

The COVID-19 pandemic has resulted in the adoption and implementation of legislation and policy at nearly lightning speed. As a result, the actual parameters of the PPP have changed markedly in the week since its adoption. One thing stands out from the Final Rule, however—the government intends to act quickly to disburse program funds to applicants, and applicants must act quickly to assure their PPP loan proceeds.

If you have questions about the CARES Act or SBA "PPP" loans, please contact your Lawrence Kamin attorney.

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