SBA Releases Details on Paycheck Protection Program

The *Coronavirus Aid, Relief, and Economic Security Act* (CARES Act) was issued expeditiously to provide much needed relief to individual Americans, health care workers, small businesses and industries hit hard by COVID-19. Federal agencies and regulators are quickly responding with additional clarifications and guidance to help ensure the CARES Act is working as intended.

On April 2, 2020, the U.S. Small Business Administration (SBA) released an interim final rule on its Paycheck Protection Program (PPP). In a departure from the normal rule-setting process, even though these are proposed rules, they are effective immediately upon publication in the Federal Register. The SBA will consider any feedback received and the need for additional rule setting.

Most of the interim final rule is in a Q&A form. Highlights of the additional details include:

- The interim rule **narrows** some CARES Act provisions; notably, the maximum loan term is limited to two years, only one PPP loan is available per eligible borrower, 75 percent of the PPP loan must be used for payroll costs (as defined) and loan forgiveness on the nonpayroll portion of the loan is limited to 25 percent of the computed loan forgiveness amount. In addition, the payment deferral of principal is limited to six months
- The loan rate will be 1 percent
- Bankers' responsibilities have been clarified. A bank's due diligence will consist of borrower certifications, submissions and representations, rather than an independent check by the bank. **The SBA will hold harmless any lender that relies on borrower documents and attestations**
- Clarification of documentation requirements for payroll costs and loan forgiveness
- PPP loans can be sold into the secondary market, which will help to create liquidity. In addition, a lender may request that the SBA purchase the expected forgiveness amount of a PPP loan or pool of PPP loans at the end of week seven of the covered period. The SBA will issue further guidance regarding any advance purchase for loans sold in the secondary market
- SBA is planning additional guidance on loan forgiveness and affiliation rules applicability

PPP (Section 1102)

The 7(a) loan program, administered by the SBA, provides financial assistance to small businesses. The CARES Act authorizes an additional $349 billion for general 7(a) business loans. For SBA Express loans, the statutory $350,000 limit is increased to $1 million through December 31, 2020. In general, the SBA responds to Express loans within 36 hours (compared to standard 7(a) loans, which may take weeks to process).

Recipients of 7(a) loans may be eligible for loan forgiveness on covered loans in an amount equal to the sum of the costs incurred for an eight-week period starting on the origination date of the loan between February 15, 2020, and June 30, 2020, due to payroll cost, qualified mortgage interest payments, qualified rent or utility payments. The CARES Act also gives the SBA authority to provide paycheck protection loans to help employers cover costs, including wages, paid leave, certain medical and retirement benefits and state taxes on employee wages. These benefits are available to employers of not more than the greater of 500 employees or, if applicable, the number of employees per organization within the industry as determined by SBA's sizing standards, including 501(c)(3) nonprofit organizations. The remaining balance after forgiveness of any amounts as noted above is still guaranteed by the SBA at 100 percent.

Borrower and lender fees are waived. The "credit elsewhere" test and personal guarantee requirements also are waived. In return for processing and booking the loan, the lender will receive a processing fee payable within five days of disbursement, based on the loan's size. For loans up to $350,000, the fee is 5 percent. For loans between $350,000 and $2 million, the fee is 3 percent, and for loans greater than $2 million, the fee is 1 percent.

A borrower is limited from receiving PPP assistance and an Economic Injury Disaster Loan (EIDL) through SBA for the same purpose. A borrower who has an EIDL loan unrelated to COVID-19 that was made after January 31, 2020, can apply for a PPP loan, with an option to refinance the EIDL loan into the PPP loan. The emergency EIDL grant award of up to $10,000 would be subtracted from the amount forgiven under the PPP.

Eligibility

Am I eligible?

You are eligible for a PPP loan if you have 500 or fewer employees whose principal place of residence is in the U.S., or are a business that operates in a certain industry and meets the applicable SBA employee-based size standards for that industry (see NAICS Class codes).

Other entities are eligible if they were in operation on February 15, 2020, and either had employees with paid salaries and payroll taxes or paid independent contractors, as reported on a Form 1099-MISC:

- A small business concern as defined in §3 of the *Small Business Act* and subject to SBA's affiliation rules except for the CARES Act specific waivers. **SBA is planning additional guidance on the applicability of affiliation rules**

The CARES Act permanently waives the new SBA affiliation rules that disqualify certain franchise and other small businesses from SBA lending as follows:

- Any business concern with no more than 500 employees that, as of the date on which the covered loan is disbursed, is assigned a NAICS code beginning with 72, Accommodation and Food Service. This group includes establishments primarily engaged in providing customers with lodging and/or preparing meals, snacks and beverages for immediate consumption

- Any business concern operating as a franchise that is assigned a franchise identifier code by the Administration

- Any business concern that receives financial assistance from a company licensed under §301 of the Small Business Investment Act of 1958

- A 501(c)(3) tax-exempt nonprofit organization, a 501(c)(19) tax-exempt veterans' organization, tribal business concerns as described in §31(b)(2)(C) of the *Small Business Act* or any other business

Sole proprietorships, independent contractors or eligible self-employed individuals are eligible if they were in operation on February 15, 2020. Supporting eligibility documentation could include payroll processor records, payroll tax filings, Form 1099-MISC or income and expenses from a sole proprietorship. Borrowers without such documentation can demonstrate the qualifying payroll amount with bank records or other documentation.

Could I be ineligible even if I meet the eligibility requirements in (a) above?

You are ineligible for a PPP loan if, for example:

- You are engaged in any activity that is illegal under federal, state, or local law
- You are a household employer (individuals who employ household employees such as nannies or housekeepers)
- An owner of 20 percent or more of the equity of the applicant is incarcerated, on probation or on parole; presently subject to an indictment, criminal information, arraignment or other means by which formal criminal charges are brought in any jurisdiction; or has been convicted of a felony within the last five years
- You, or any business owned or controlled by you or any of your owners, have ever obtained a direct or guaranteed loan from SBA or any other federal agency that is currently delinquent or has defaulted within the last seven years and caused a loss to the government

How do I determine if I am ineligible?

Businesses that are not eligible for PPP loans are identified in 13 CFR 120.110 and described further in SBA's Standard Operating Procedure (SOP) 50 10, Subpart B, Chapter 2.

The CARES Act overrides these general provisions for 501(c)(3) nonprofit organizations noted above.

Some common exclusions include financial services in lending, passive businesses owned by developers and landlords, pyramid sales distribution plans, gambling, private clubs, life insurance or religious businesses and casinos.

Borrowing Limits

How much can I borrow?

The maximum loan amount is the lesser of $10 million or an amount calculated using the payroll-based formula, as explained below.

How do I calculate the maximum amount I can borrow?

The following methodology, which is one of the methodologies contained in the CARES Act, will be most useful for many applicants.

Step 1: Aggregate payroll costs from the last 12 months for employees whose principal place of residence is the United States.

Step 2: Subtract any employee compensation paid in excess of an annual salary of $100,000 and/or any amounts paid to an independent contractor or sole proprietor in excess of $100,000 per year.

Step 3: Calculate average monthly payroll costs (divide the amount from Step 2 by 12).

Step 4: Multiply the average monthly payroll costs from Step 3 by 2.5.

Step 5: Add the outstanding amount of an EIDL loan made between January 31, 2020, and April 3, 2020, less the amount of any "advance" under an EIDL COVID-19 loan (because it does not have to be repaid).

Example 1 – No employees make more than $100,000

Annual payroll: $120,000

Average monthly payroll: $10,000 Multiply by 2.5 = $25,000

Maximum loan amount is $25,000

Example 2 – Some employees make more than $100,000

Annual payroll: $1,500,000

Subtract compensation amounts in excess of an annual salary of $100,000: $1,200,000

Average monthly qualifying payroll: $100,000

Multiply by 2.5 = $250,000

Maximum loan amount is $250,000

Example 3 – No employees make more than $100,000, outstanding EIDL loan of $10,000

Annual payroll: $120,000

Average monthly payroll: $10,000

Multiply by 2.5 = $25,000

Add EIDL loan of $10,000 = $35,000

Maximum loan amount is $35,000

Example 4 – Some employees make more than $100,000, outstanding EIDL loan of $10,000

Annual payroll: $1,500,000

Subtract compensation amounts in excess of an annual salary of $100,000: $1,200,000

Average monthly qualifying payroll: $100,000

Multiply by 2.5 = $250,000

Add EIDL loan of $10,000 = $260,000

Maximum loan amount is $260,000

What qualifies as "payroll costs"?

Payroll costs consist of compensation to employees (U.S. principal residence) 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.

Is there anything that is expressly excluded from the definition of payroll costs?

The CARES Act expressly excludes the following:

- Any compensation of an employee whose principal place of residence is outside of the United States

- The individual employee compensation in excess of an annual salary of $100,000, prorated as necessary
- Federal employment taxes imposed or withheld between February 15, 2020, and June 30, 2020, including the employee's and employer's share of FICA (*Federal Insurance Contributions Act*) and *Railroad Retirement Act* taxes, and income taxes required to be withheld from employees
- Qualified sick and family leave wages for which a credit under the *Families First Coronavirus Response Act* (see BKD article Families First Coronavirus Response Act to Provide Employer Tax Credits for more information)

Do independent contractors count as employees for purposes of PPP loan calculations?

No, independent contractors have the ability to apply for a PPP loan on their own so they do not count for the purposes of a borrower's PPP loan calculation.

Loan Terms

What is the interest rate on a PPP loan?

The interest rate will be 100 basis points or 1 percent.

What will be the maturity date on a PPP loan?

The maturity is two years.

While the CARES Act provides up to a 10-year maturity from the application date, the SBA concluded a two-year loan term is sufficient. Specifically, the considerable economic disruption caused by COVID-19 is expected to abate well before the two-year maturity date such that borrowers will be able to recommence business operations and pay off any outstanding balances on their PPP loans.

Can I apply for more than one PPP loan?

No eligible borrower may receive more than one PPP loan. This means that if you apply for a PPP loan, you should consider applying for the maximum amount.

While the CARES Act does not expressly provide that each eligible borrower may only receive one PPP loan, the SBA has determined that because all PPP loans must be made on or before June 30, 2020, a one-loan-per-borrower limitation is necessary to help ensure that as many eligible borrowers as possible may obtain a PPP loan.

Can I use e-signatures or e-consents if a borrower has multiple owners?

Yes, e-signature or e-consents can be used regardless of the number of owners.

Is the PPP "first-come, first-served"?

Yes.

When will I have to begin paying principal and interest on my PPP loan?

You will not have to make any payments for six months following the loan disbursement date. Interest will continue to accrue on PPP loans during this six-month deferment. **The CARES Act authorized the SBA to defer loan payments for up to one year.**

Can my PPP loan be forgiven in whole or in part?

Yes. 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 the loan proceeds for forgivable purposes described below and employee and compensation levels are maintained.

The actual amount of loan forgiveness will depend, in part, on the total amount of payroll costs; payments of interest on mortgage obligations incurred before February 15, 2020; rent payments on leases dated before February 15, 2020; and utility payments under service agreements dated before February 15, 2020, over the eight-week period following the date of the loan. **No more than 25 percent of the loan forgiveness amount may be attributable to nonpayroll costs.**

The SBA has determined that the nonpayroll portion of the forgivable loan amount should be limited to effectuate the core purpose of the statute and help ensure finite program resources are devoted primarily to payroll. The SBA has determined that 75 percent is an appropriate percentage in light of the Act's overarching focus on keeping workers paid and employed.

SBA will issue additional guidance on loan forgiveness.

Do independent contractors count as employees for purposes of PPP loan forgiveness?

No, independent contractors can apply for a PPP loan on their own, so they do not count for purposes of a borrower's PPP loan forgiveness.

What forms do I need and how do I submit an application?

The applicant must submit SBA Form 2483 (PPP Application Form) and payroll documentation, as described above. The lender must submit SBA Form 2484 (PPP Lender's Application for 7(a) Loan Guaranty) electronically in accordance with program requirements and maintain the forms and supporting documentation in its files.

How can PPP loans be used?

The proceeds of a PPP loan are to be used for:

- Payroll costs
- Costs related to the continuation of group health care benefits during periods of paid sick, medical or family leave, and insurance premiums
- Mortgage interest payments (but not mortgage prepayments or principal payments)
- Rent payments
- Utility payments
- Interest payments on any other debt obligations that were incurred before February 15, 2020
- Refinancing an SBA EIDL loan made between January 31, 2020, and April 3, 2020. If you received an SBA EIDL loan from January 31, 2020, through April 3, 2020, you can apply for a PPP loan. If your EIDL loan was not used for payroll costs, it does not affect your eligibility for a PPP loan. If your EIDL loan was used for payroll costs, your PPP loan must be used to refinance your EIDL loan. Proceeds from any advance up to $10,000 on the EIDL loan will be deducted from the loan forgiveness amount on the PPP loan

At least 75 percent of the PPP loan proceeds shall be used for payroll costs. To determine the percentage of proceeds used for payroll costs, the amount of any EIDL refinanced will be included. For purposes of loan forgiveness, however, the borrower will have to document the proceeds used for payroll costs to determine the amount of forgiveness.

While the CARES Act provides that PPP loan proceeds may be used for the purposes listed above, the SBA believes that finite appropriations and the structure of the CARES Act warrant a requirement that borrowers use a substantial portion of the loan proceeds for payroll costs, consistent with Congress' overarching goal of keeping workers paid and employed. The SBA has determined that 75 percent is an appropriate percentage that will align this element of the program with the loan amount, 75 percent of which is equivalent to eight weeks of payroll. This limitation on use of the loan funds will help ensure that the finite appropriations available for these loans are directed toward payroll protection, as each loan that is issued depletes the appropriation, regardless of whether portions of the loan are later forgiven.

What happens if PPP loan funds are misused?

If you use PPP funds for unauthorized purposes, the SBA will direct you to repay those amounts. If you knowingly use the funds for unauthorized purposes, you will be subject to additional liability such as charges for fraud. If one of your shareholders, members or partners uses PPP funds for unauthorized purposes, the SBA will have recourse against the shareholder, member or partner for the unauthorized use.

What certifications need to be made?

On the PPP application, an authorized representative of the applicant must certify in good faith to all the below:

- The applicant was in operation on February 15, 2020, and had employees for whom it paid salaries and payroll taxes or paid independent contractors, as reported on a Form 1099-MISC
- Current economic uncertainty makes this loan request necessary to support the applicant's ongoing operations
- The funds will be used to retain workers and maintain payroll or make mortgage interest, lease 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. No more than 25 percent of loan proceeds may be used for nonpayroll costs
- Documentation verifying the number of full-time equivalent employees on payroll, as well as the dollar amounts of payroll costs, covered mortgage interest payments, covered rent payments and covered utilities for the eight-week period following this loan, will be provided to the lender
- Loan forgiveness will be provided for the sum of documented payroll costs, covered mortgage interest payments, covered rent payments and covered utilities. No more than 25 percent of the forgiven amount may be for nonpayroll costs
- During the period beginning on February 15, 2020, and ending on December 31, 2020, the applicant has not and will not receive another loan under this program
- I further certify that the information provided in this application and the information provided in all supporting documents and forms is true and accurate in all material respects. I understand that knowingly making a false statement to obtain a guaranteed loan from SBA is punishable under the law, including under 18 USC 1001 and 3571 by imprisonment of not more than five years and/or a fine of up to $250,000; under 15 USC 645 by imprisonment of not more than two years and/or a fine of not more than $5,000; and, if submitted to a federally insured institution, under 18 USC 1014 by imprisonment of not more than 30 years and/or a fine of not more than $1 million
- I acknowledge that the lender will confirm the eligible loan amount using tax documents I have submitted. I affirm that these tax documents are identical to those submitted to the IRS. I also understand, acknowledge and agree that the lender can share the tax information with SBA's authorized representatives, including authorized representatives of the SBA Office of Inspector General, for the purpose of compliance with SBA loan program requirements and all SBA reviews

For Lenders

Who is eligible to make PPP loans?

All SBA 7(a) lenders are automatically approved to make PPP loans. As authorized under the CARES Act, the SBA and the Treasury Secretary have authorized the following lenders to make PPP loans unless they currently are designated in Troubled Condition by their primary federal regulator or are subject to a formal enforcement action with their primary federal regulator that addresses unsafe or unsound lending practices:

- Any federally insured depository institution or any federally insured credit union
- Any Farm Credit System institution (other than the Federal Agricultural Mortgage Corporation) that applies the requirements under the Bank Secrecy Act (BSA) and its implementing regulations as a federally regulated financial institution, or functionally equivalent requirements that are not altered by this rule
- Any depository or nondepository financing provider that originates, maintains and services business loans or other commercial financial receivables and participation interests; has a formalized compliance program; applies the requirements under the BSA as a federally regulated financial institution, or the BSA requirements of an equivalent federally regulated financial institution; has been operating since at least February 15, 2019, and has originated, maintained and serviced more than $50 million in business loans or other commercial financial receivables during a consecutive 12-month period in the past 36 months, or is a service provider to any insured depository institution that has a contract to support such institution's lending activities in accordance with 12 U.S.C. §1867(c) and is in good standing with the appropriate federal banking agency

What do lenders have to do in terms of loan underwriting?

Each lender shall:

- Confirm receipt of borrower certifications contained in the SBA PPP Application form
- 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
- 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
- Follow applicable BSA requirements:
    - Federally insured depository institutions and federally insured credit unions should continue to follow their existing BSA protocols when making PPP loans to either new or existing customers who are eligible borrowers under the PPP. PPP loans for existing customers will not require reverification under applicable BSA requirements, unless otherwise indicated by the institution's risk-based approach to BSA compliance
    - Entities that are not presently subject to the BSA requirements should—prior to engaging in PPP lending activities, including making PPP loans to either new or existing customers who are eligible borrowers under the PPP—establish an anti-money laundering (AML) compliance program equivalent to that of a comparable federally regulated institution. Depending on the comparable federally regulated institution, such a program may include a customer identification program (CIP), which includes identifying and verifying their PPP borrowers' identities (such as date of birth, address and taxpayer identification number), and, if that PPP borrower is a company, following any applicable beneficial ownership information collection requirements. Alternatively, if available, entities may rely on the CIP of a federally insured depository institution or federally insured credit union with an established CIP as part of its AML program. In either instance, entities also should understand the nature and purpose of their PPP customer

relationships to develop customer risk profiles. Such entities also will generally have to identify and report certain suspicious activity to the U.S. Department of the Treasury's Financial Crimes Enforcement Network (FinCEN). If such entities have questions about meeting these requirements, they should contact the FinCEN Regulatory Support Section at FRC@fincen.gov. In addition, FinCEN has created a COVID-19-specific contact channel, via a specific drop-down category, for entities to communicate COVID-19-related concerns to FinCEN while adhering to their BSA obligations. Entities that wish to communicate such COVID-19-related concerns to FinCEN should go to www.FinCEN.gov, click on "Need Assistance" and select "COVID19" in the subject drop-down list

Each lender's underwriting obligation under the PPP is limited to the items above and reviewing the "Paycheck Protection Application Form." Borrowers must submit such documentation as is necessary to establish eligibility such as payroll processor records, payroll tax filings or Form 1099-MISC, or income and expenses from a sole proprietorship. For borrowers that do not have any such documentation, the borrower must provide other supporting documentation, such as bank records, sufficient to demonstrate the qualifying payroll amount.

Can lenders rely on borrower documentation for loan forgiveness?

Yes. 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. **The SBA will hold harmless any lender that relies on such borrower documents and attestation from a borrower.**

What Do Both Borrowers & Lenders Need to Know & Do?

What are the loan terms and conditions?

Loans will be guaranteed under the PPP under the same terms, conditions and processes as other 7(a) loans, with certain changes including but not limited to:

- The guarantee percentage is 100 percent
- No collateral will be required
- No personal guarantees will be required
- The interest rate will be 100 basis points or 1 percent
- All loans will be processed by all lenders under delegated authority and lenders will be permitted to rely on certifications of the borrower to determine eligibility of the borrower and the use of loan proceeds

Are there any fee waivers?

There will be no upfront guarantee fee payable to SBA by the borrower or lender's annual service fee (ongoing guaranty fee) payable to SBA. There will be no subsidy recoupment fee or no fee payable to SBA for any guarantee sold into the secondary market.

Who pays the fee to an agent who assists a borrower?

The lender will pay agent fees out of the fees the lender receives from SBA. Agents may not collect fees from the borrower or be paid out of the PPP loan proceeds. The total amount that an agent may collect from the lender for assistance in preparing an application for a PPP loan (including referral to the lender) may not exceed:

- 1 percent for loans of not more than $350,000
- 0.50 percent for loans of more than $350,000 and less than $2 million
- 0.25 percent for loans of at least $2 million

Can PPP loans be sold into the secondary market?

Yes. A PPP loan may be sold on the secondary market after the loan is fully disbursed. A PPP loan may be sold on the secondary market at a premium or a discount to par value. **SBA will issue guidance regarding any advance purchase for loans sold in the secondary market.**

Can SBA purchase some or all of the loan in advance?

Yes. A lender may request that the SBA purchase the expected forgiveness amount of a PPP loan or pool of PPP loans at the end of week seven of the covered period. The expected forgiveness amount is the amount of loan principal the lender reasonably expects the borrower to expend on payroll costs, covered mortgage interest, covered rent and covered utility payments during the eight-week period after loan disbursement. At least 75 percent of the expected forgiveness amount shall be for payroll costs.

To submit a PPP loan or pool of PPP loans for advance purchase, a lender shall submit a report requesting advance purchase with the expected forgiveness amount to the SBA. The report shall include: the PPP Application Form (SBA Form 2483) and any supporting documentation submitted with such application; the PPP Lender's Application for 7(a) Loan Guaranty (SBA Form 2484) and any supporting documentation; a detailed narrative explaining the assumptions used in determining the expected forgiveness amount, the basis for those assumptions, alternative assumptions considered and why alternative assumptions were not used; any information obtained from the borrower since the loan was disbursed that the lender used to determine the expected forgiveness amount, which should include the same documentation required to apply for loan forgiveness such as payroll tax filings, canceled checks and other payment documentation; and any additional information the SBA may require to determine whether the expected forgiveness amount is reasonable.

The SBA determined that seven weeks is the minimum period necessary for a lender to reasonably determine the expected forgiveness amount for a PPP loan or pool of PPP loans, since the PPP is a new program and it is likely that many borrowers will be new clients of the lender. The expected forgiveness amount may not exceed the total amount of principal on the PPP loan or pool of loans. The SBA will purchase the expected forgiveness amount of the PPP loan(s) within 15 days of the date on which the SBA receives a complete report that demonstrates that the expected forgiveness amount is reasonable.

Conclusion

BKD will continue to follow this developing situation. As with most topics related to COVID-19, changes are being made rapidly. Please note that this information is current as of the date of publication. Visit BKD's COVID-19 Resource Center to learn more. If you have questions, contact your **BKD Trusted Advisor**™ today.

Contributor

Anne Coughlan
Director
317.383.4000
acoughlan@bkd.com