

Chapman Client Alert

March 31, 2020

Current Issues Relevant to Our Clients

Small Business Administration: The Paycheck Protection Program under the CARES Act

On March 27, 2020, the Coronavirus Aid, Relief, and Economic Stability Act, known as the CARES Act, became law. It is the third piece of federal legislation related to the 2020 coronavirus pandemic and provides approximately \$2 trillion in sweeping emergency measures to mitigate the resulting public health and economic crisis facing individuals, families, and businesses. The cornerstone of the CARES Act's relief package for small businesses is the Paycheck Protection Program (PPP), under which the Small Business Administration (SBA) will guarantee up to \$349 billion in small business loans. The following questions and answers describe the major features of the PPP as we know them at the current time.

What Is the PPP?

In ordinary course, the SBA provides financial assistance to small businesses primarily through its flagship lending program known as the Section 7(a) program, pursuant to which the SBA connects small businesses and SBA-approved private lenders and then typically guarantees a large portion of the resulting small business loans. The PPP is a new Section 7(a) program designed to help small businesses keep their workers employed by providing financial support for payroll and certain other expenses through June 30, 2020.

It significantly expands the SBA's Section 7(a) lending activities to include, among things, a 100% guarantee of PPP loans, a waiver of certain collateral and personal guarantee requirements applicable to other types of Section 7(a) loans, short-term forbearance, and the possibility of loan forgiveness.

Who Can Borrow under the PPP?

The following small businesses that were operational as of February 15, 2020 are eligible for PPP loans:

- a small business with fewer than 500 employees,¹ regardless of revenue
- a small business that otherwise meets the SBA's size requirements

- sole proprietors, independent contractors, and self-employed individuals who regularly carry on any trade or business, including those in the "gig economy"
- a hospitality or food service business (those with an NAICS code beginning with 72) if it has fewer than 500 employees per physical location
- a non-profit entity under Section 501(c)(3) of the Internal Revenue Code of 1986, as amended (Internal Revenue Code), so long as that entity has fewer than 500 employees
- a veterans organization under Section 501(c)(19) of the Internal Revenue Code that meets the SBA's size requirements
- a tribal business entity that meets the SBA's size requirements

It is important to note that the SBA applies complex affiliation requirements, which generally require a business to aggregate all of its parent companies, affiliates, and subsidiaries in determining whether the business meets the small business size requirements and borrowing criteria. These affiliation requirements still generally apply under the PPP, except that they are waived for:

- a hospitality or food service business classified under an NAICS code beginning with 72

¹ In this context, the definition of "employees" includes all employees, whether full-time, part-time, or some other status.

- a business operating as a franchise that is an SBA-assigned franchise identifier code
- any entity that receives financial assistance from a company licensed under Section 301 of the Small Business Investment Act of 1958, as amended

In addition, the CARES Act rescinds the SBA's interim final affiliation rules published on February 10, 2020.

Do Borrowers Need Certain Credit Profiles to Qualify for a PPP Loan?

Existing SBA lending programs generally require lenders to, among other things, assess the borrower's repayment ability, require a personal guarantee and collateral to secure the loan, and receive a certification from the borrower that it cannot secure the credit elsewhere. Many of these requirements appear to be significantly relaxed under the PPP, with lenders allowed to make and approve PPP loans based on proof that:

- the business was in operation on February 15, 2020; and
- the business had employees for whom the business paid salaries and payroll taxes or paid an independent contractor.

However, the CARES Act does not explicitly indicate whether and/or how other underwriting criteria will apply to PPP loans. We expect the SBA to issue implementing guidance within the near future that may provide more clarity about underwriting requirements for PPP loans.

Lenders are encouraged to process and disburse PPP loans that prioritize small businesses and entities:

- in underserved and rural markets, including veterans and the military community;
- owned and controlled by socially and economically disadvantaged individuals and women; and
- in operation for less than two (2) years.

Are There Any Collateral, Personal Guarantee, Origination Fee, or other Similar Requirements for PPP Loans?

No. The CARES Act waives the SBA's ordinary course requirements regarding pledges of collateral, prepayment penalties, personal guarantees, borrower and lender fees, and other traditional SBA loan requirements. The requirement to

certify that the borrower could not secure credit elsewhere also is waived.

What Does a Borrower Need to Provide to a Lender to Obtain a PPP Loan?

A borrower must make the following good-faith certifications:

- the uncertainty of current economic conditions makes the loan necessary to support its ongoing operations;
- the funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments;
- it has not applied for or received any other Section 7(a) loan that is duplicative, in amount or purpose, of the PPP loan.

What Are the Terms of a PPP Loan, Including Principal, Interest, and Maturity?

The PPP provides for loans up to \$10 million. An eligible borrower may receive (a) the lesser of (i) \$10 million and (ii) 2.5 times its "payroll costs" plus (b) any outstanding amount owed by the borrower under an SBA Economic Injury Disaster Loan (EIDL) received by it between January 31, 2020 and the date that PPP loans become available. It is important to note that, pursuant to clause (b) above, a PPP loan can be used to repay or refinance certain EIDLs recently made by the borrower.

Payroll costs are generally defined as the borrower's average monthly payroll for the 12 months before the PPP loan is made. They broadly **include** wages, tips, commissions, leave, insurance and retirement benefits, severance, and related taxes. They **exclude** compensation paid to individual employees over \$100,000 (prorated for the period from February 15, 2020 to June 30, 2020), compensation for employees residing outside the U.S., and certain other leave benefits with respect to which credits are otherwise available under the CARES Act. Payroll costs for sole proprietors and independent contractors are similarly defined and include annual compensation, commissions, or similar payments up to \$100,000 (prorated for the period from February 15, 2020 to June 30, 2020). There are special rules relating to the calculation of payroll costs for seasonal businesses and those that were not in operation on February 15, 2020.

The maximum interest rate for a PPP loan is 4%.

As noted above, many traditional SBA requirements are waived, including the collateral and personal guarantee

requirements and the need to show that credit is unavailable elsewhere.

PPP loans have a maximum maturity of 10 years, with no prepayment penalties. As discussed in more detail below, PPP loans may be deferred and, in some cases, forgiven.

PPP loans are non-recourse to the borrower and are 100% guaranteed by the federal government (as compared to the SBA's 75% guarantee of traditional Section 7(a) loans).

Who Can Be a PPP Lender?

The CARES Act provides existing SBA-approved lenders with delegated authority to make and approve PPP loans under Section 7(a). As well, additional lenders to be determined by the U.S. Treasury Department and the SBA will be similarly authorized to make such PPP loans.

The CARES Act further provides that the U.S. Treasury Department, in consultation with the SBA, and the Farm Credit Administration will establish criteria for insured depository institutions, insured credit unions, insured Farm Credit System institutions, and other lenders not already participating in SBA lending programs to make PPP loans until the expiration of the COVID-19 national emergency. The U.S. Treasury Department will establish the terms and conditions of participating in this additional loan program, but participation cannot compromise a lender's safety and soundness and the program's terms and conditions generally need to be consistent with those applicable to PPP loans made under Section 7(a).

We expect that lender eligibility requirements will be addressed in upcoming guidance by the relevant federal agencies.

How Can PPP Loans Be Used?

In addition to the approved uses for a Section 7(a) loan made in the ordinary course, a PPP loan may, for the period from February 15, 2020 to June 30, 2020, be used for the following:

- payroll costs;
- insurance benefits;
- employee salaries, commissions, or similar compensations;
- mortgage payments;
- rent payments;
- utilities;
- interest on existing debt; and
- as noted above, to repay or refinance an EIDL incurred by the borrower between January 31, 2020 and the date on which PPP loans become available.

Can PPP Loans Be Deferred and/or Forgiven?

Yes, PPP loans may be deferred and, in some cases, forgiven.

The CARES Act presumes that a business will have been adversely impacted by COVID-19 if it was in operation on February 15, 2020 and has a pending or approved PPP loan application on or after enactment of the CARES Act. Accordingly, for any such business, lenders are required to defer payments of principal, interest, and fees on PPP loans for at least six (6) months and up to one (1) year. The SBA is required to provide guidance on such deferments within 30 days of enactment of the CARES Act.

As an incentive to retain employees or rehire laid off employees, the CARES Act provides that certain portions of a PPP loan may be forgiven. Subject to certain conditions, businesses are eligible for loan forgiveness equal to the amount of payroll costs (using the same definition used to determine loan eligibility) and certain mortgage interest, rent, and utilities payments that are incurred during the 8-week period after the loan origination date. If a PPP loan has a balance remaining after any loan forgiveness, the SBA will guarantee that balance.

The loan forgiveness amount of a PPP loan cannot exceed that loan's principal amount and any loan forgiveness amount will **not** be treated as gross income for federal income tax purposes.

To further incent retention of employees at existing salaries, the amount of loan forgiveness calculated above will be reduced if there is a reduction in the number of employees or a reduction of more than 25% in salaries paid to employees. If a borrower reduced the number of employees or salary levels between February 15, 2020 and 30 days after enactment of the CARES Act, those reductions will not decrease the amount of loan forgiveness **if** the borrower restores the number of employees or the salary levels by June 30, 2020.

A borrower must apply for loan forgiveness, with detailed documentation requirements to verify staffing and salary levels and other eligible expenses, and a lender will have 60 days from receipt of the application to decide whether to grant (and the amount of) the forgiveness. The amount of any such loan forgiveness, including accrued interest, will be remitted by the SBA to the lender within 90 days of the lender determining how

much to forgive, thereby limiting exposure to the lender. If a lender requests that the SBA purchase any forgiven amounts on a PPP loan or pool of PPP loans in anticipation of granting forgiveness, then the SBA will remit the forgiven amount within 15 days. Further, if a lender receives verified documentation from a borrower, the CARES Act provides that the lender will be held harmless from enforcement actions or penalties imposed by the SBA.

Are There Any Capital or Other Benefits for Lenders in the PPP?

The CARES Act provides a number of incentives for lenders participating in the PPP, including favorable regulatory treatment and reimbursement for processing fees:

- PPP loans on a lender's balance sheet will receive a 0% risk weight under the risk-based capital requirements applied by the Federal Reserve, the OCC, the FDIC, and the NCUA
- federally insured banks and federally insured credit unions will not have to report a PPP loan that is modified for COVID-19-related reasons as a troubled debt restructuring, until required to do so by the applicable federal financial regulatory agency
- the SBA will reimburse lenders for PPP loan processing fees, based on the disbursed loan amount: 5% for PPP loans up to \$350,000; 3% for PPP loans greater than \$350,000 and less than \$2 million; and 1% for PPP loans of \$2 million or more

Can PPP Loans Be Sold on the Secondary Market?

Yes. If a PPP loan is sold on the secondary market, and the related investor does not approve a permitted deferral, the SBA must repurchase that loan and provide the deferral.

For More Information

We will be monitoring developments in the PPP, as well as other SBA lending programs to address the coronavirus pandemic, and we will advise you of any changes or updated information.

If you would like further information concerning the matters discussed in this article or any matter related to the COVID-19 pandemic, please visit our [COVID-19 Insights](#) webpage or contact the Chapman attorney with whom you regularly work.

Chapman and Cutler LLP

Attorneys at Law · Focused on Finance®

This document has been prepared by Chapman and Cutler LLP attorneys for informational purposes only. It is general in nature and based on authorities that are subject to change. It is not intended as legal advice. Accordingly, readers should consult with, and seek the advice of, their own counsel with respect to any individual situation that involves the material contained in this document, the application of such material to their specific circumstances, or any questions relating to their own affairs that may be raised by such material.

To the extent that any part of this summary is interpreted to provide tax advice, (i) no taxpayer may rely upon this summary for the purposes of avoiding penalties, (ii) this summary may be interpreted for tax purposes as being prepared in connection with the promotion of the transactions described, and (iii) taxpayers should consult independent tax advisors.

© 2020 Chapman and Cutler LLP. All rights reserved. Attorney Advertising Material.