



Paycheck Protection Program (PPP) update, with our own "Frequently Asked Questions"

May 14, 2020

Anyone closely considering or utilizing the PPP has undoubtedly heard about the U.S. Small Business Administration's (SBA's) so-called "Frequently Asked Questions" (FAQs) that the agency has been issuing and updating on a periodic - sometimes daily - basis. The agency's most recent updates to its FAQ were on May 13, 2020, with Question/Answer #46 and #47, pertaining to a new "safe harbor" deadline to repay the PPP loan by May 18, 2020.

This update reviews the SBA's latest FAQ document on the PPP, as well as several Interim Final Rules issued by the SBA, including the most recent issuances on May 8, 2020, pertaining to the "safe harbor" extension and May 13, 2020, pertaining to the good-faith certification. With this review, we will indicate our own "frequently asked questions" as we and millions of PPP borrowers across the country prepare for additional guidance forthcoming from the SBA.

Lathrop GPM FAQ #1 - Should I use the new "safe harbor" and give my PPP loan back? Some PPP borrowers have come under scrutiny for not deserving or qualifying for the PPP loan, and this hinges on five things: 1) the provisions of the CARES Act authorizing the PPP[1]; 2) the underlying Small Business Act and its regulations interpreting SBA definitions, especially the 7(a) Loan Program[2]; 3) nine PPP Interim Final Rules[3], and Frequently Asked Questions (guidance) issued by the SBA in the wake of the CARES Act; 4) PPP Application Form (OMB No. 3245-0407 SBA Form 2483) certifications and authorizations; and 5) the borrower's tolerance for a financial review/audit and any public scrutiny that may accompany such review.

Lathrop GPM FAQ #1a - How do I show I faced "economic uncertainty"? For this first part of the Application certification in question, it should be relatively easy for PPP applicants to show they faced "economic uncertainty" due to COVID-19 at the time of application. Considerations include the stability of workforce, sales trends, and other potential business interruptions. These factors go to the state of mind of the applicant at the time of the application, and should be documented to the extent possible.

Lathrop GPM FAQ #1b - How do I show my loan was "necessary to support the ongoing operations" of my business? The second part of this Application certification is more nebulous, and hinges on what level of liquidity is "necessary" to support ongoing operations. Considerations may include cash flow analysis, delinquency of accounts receivables, financial obligations, and business



interruption or work flow issues facing the business.

Lathrop GPM FAQ #1c - What are "adequate sources of liquidity"? SBA FAQ #31 (public companies) and #37 (private companies) gives limited guidance to help PPP applicants evaluate if their loan was "necessary to support the ongoing operations" of the business, and the question hinges on what might be considered "adequate liquidity."^[4] Considerations to evaluate this include the level of cash reserves on hand, context of those reserves relative to financial obligations, and restrictions or covenants on reserves, endowments, or lines of credit. Public companies with substantial market value and access to capital markets will need to explain these positions.

Lathrop GPM FAQ #1d - How is it relevant whether my business could "access other sources of liquidity sufficient to support ... ongoing operations"? Access to other sources of liquidity is relevant, but again, context is important. The borrower should be prepared to explain what "access" to other sources really means for the business, including encumbrances or covenants that may apply, whether the liquidity in question is really liquid/available, and past uses of cash reserves to support normal (and abnormal/unanticipated) operations. For instance, what is the burn rate of available liquidity, given the uncertainties of COVID-19, and how would that use affect the financial position of ongoing business operations?

Lathrop GPM FAQ #1e - What is "significantly detrimental" in terms of liquidity I could access? The SBA FAQ #31 offers a qualifier to liquidity that may be available to the borrower, stating that if accessing this working capital, credit, or cash reserves has a significant detriment to the business, the SBA may see this as a mitigating factor (in the borrower's favor).^[5]

Lathrop GPM FAQ #1f - How does the "safe harbor" work? The SBA's FAQ #31 issued on April 23, 2020, was the first formal issuance of guidance on PPP eligibility relative to an applicant's good faith certification that economic uncertainty existed, making the loan necessary to support the ongoing operations of the business. Answer #31 stated that a "borrower that applied for a PPP loan prior to the issuance of this guidance and repays the loan in full by May 7, 2020 will be deemed by SBA to have made the required certification in good faith." SBA's FAQ #43, published May 5, 2020, extended this "safe harbor" date to May 14, 2020, and FAQ #47 published on May 13 extended the date to May 18, 2020.

The SBA published FAQ #46 on May 13, 2020. While Answer #46 does not shed any new light on how the SBA will evaluate a good-faith certification concerning the necessity of a loan request, it provides new "safe harbor" opportunities: "[a]ny borrower that ... received PPP loans with an original principal amount of less than \$2 million will be deemed to have made the required certification concerning the necessity of the loan request in good faith." And furthermore, regarding borrowers with loans greater

than \$2 million, they "will be subject to review by SBA for compliance with program requirements.... If SBA determines ... that a borrower lacked an adequate basis for the required certification concerning the necessity of the loan request, SBA will seek repayment of the outstanding PPP loan balance and will inform the lender that the borrower is not eligible for loan forgiveness. If the borrower repays the loan after receiving notification from SBA, SBA will not pursue administrative enforcement or referrals to other agencies...." Meaning, if the SBA determines a borrower's loan in excess of \$2 million was not "necessary," the borrower can repay the loan without facing enforcement action or penalties.

Lathrop GPM FAQ #2 - How is PPP loan forgiveness going to work and how will I apply? Suffice it to say many questions exist on how to maximize PPP loan forgiveness, and some ambiguity within the PPP provisions of the CARES Act doesn't help.[6]

Lathrop GPM FAQ #2a - Does it matter when employees are paid during the 8-weeks? It is clear that the "covered period" consisting of the 8-weeks beginning on the date of the origination of the PPP loan is very important, in that the SBA will measure forgiveness according to: 1) employee (FTE) numbers retained/re-hired and 2) eligible costs paid during the 8-week period. We anticipate the SBA will review payroll costs made on a *cash basis* during the 8-weeks, beginning on the day the lender first makes a loan disbursement.

Lathrop GPM FAQ #2b - Do I have to spend 75% of my total loan amount on payroll costs to maximize forgiveness? In short, yes. This is important. In the Interim Final Rule published on April 14, 2020, the SBA created this new 75% threshold, not originally contained in the CARES Act, stating that "75 percent is an appropriate percentage in light of the Act's overarching focus on keeping workers paid and employed. Further ... applying this threshold to loan forgiveness is consistent with the structure of the Act...."[7] (20814.) The interim final rule goes on to say "at least 75 percent of the PPP loan proceeds *shall* be used for payroll costs...."[8] (Emphasis added. 20816.) Does this mean that if only 74% of the loan is spent on payroll costs that all forgiveness will be ruined? We don't think so, but this is possible when the SBA issues further guidance.

For borrowers aiming to utilize at least 75% of the loan on payroll costs, it is important to note that the wages portion of payroll costs likely cannot exceed \$15,385 per employee, the pro rata equivalent to the \$100,000 annualized salary limit during eight weeks. Also, other eligible payroll costs including employer contributions to defined-benefit retirement plans, group health care benefits, and state or local taxes assessed on compensation are allowed toward the 75% in addition to wages.[9]

Lathrop GPM FAQ #2c - How many FTEs should I have on payroll during the 8-weeks to maximize forgiveness? To maximize forgiveness, during the 8-week period borrowers should employ at least the same number of average monthly FTEs as were employed for the period February 19,



2019 - June 30, 2019 OR January 1, 2020 - February 29, 2020. To the degree the number of FTEs are not re-hired or employed during the 8-week period as compared to the base period, the amount of loan forgiveness will be subject to a reduction on a pro rata basis.

SBA FAQ #40 published May 3 stipulates that an employer's forgiveness will not be reduced for employees that were laid-off and declined to return during the 8-week period so long as the employer documents a written offer and rejection.

Ultimately the borrower has until June 30, 2020, to eliminate any reduction in the number of FTEs.

Lathrop GPM FAQ #2d - Can you explain the other 75% test for level of wages I need to pay employees? The CARES Act stipulates that to avoid a reduction to forgiveness, employees' wages during the 8-week period must be at least 75% of what their wages were "during the most recent full quarter during which the employee was employed before the [8-week] period."^[10] (Sec. 1106(d)(3)(A).) This comparison of an employee's wages from the 8-week period to the most recent quarter (12 weeks) is confusing, and suggests the SBA may examine employee-by-employee wage levels. But if employees are compensated at the same level during the 8-week period of the PPP loan as compared to their previous wage from the most recent quarter, that is the most sure way to avoid a reduction in forgiveness.

Lathrop GPM FAQ #2e - What are the eligible uses of the loan other than payroll costs? In addition to payroll costs (at least equal to 75%), other eligible uses of the PPP loan include mortgage interest payments, rent, utility^[11] payments, and interest payments on any other debt obligation that were incurred before February 15, 2020. These other eligible uses should not exceed 25% of the total loan amount to jeopardize forgiveness.

Lathrop GPM FAQ #2f - How will the application process work for forgiveness? We are awaiting guidance from the SBA on how and when a borrower can apply for forgiveness with their lender and the SBA.

Lathrop GPM FAQ #2g - What if some of my loan is not forgiven? That variance will be converted into the two-year note at 1% interest with a six-month deferral of the first payment.

For more information, please contact Daryn McBeth, Luke Greiner, or your regular Lathrop GPM contact.

[1] See Coronavirus Aid, Relief, And Economic Security Act ("Cares Act"), P.L. 116-136, March 27, 2020, 134 Stat. 281.

[2] 15 U.S.C. § 632 et seq.

[3] Business Loan Program Temporary Changes; Paycheck Protection Program—Additional Eligibility Criteria and Requirements for Certain Pledges of Loans, 85 Fed. Reg. 21747-21751 (to be codified at 13 C.F.R. Part 120); Business Loan Program Temporary Changes; Paycheck Protection Program, 85 Fed. Reg. 20817-20821 (to be codified at 13 C.F.R. 120); Business Loan Program Temporary Changes; Paycheck Protection Program—Additional Eligibility Criteria and Requirements for Certain Pledges of Loans, 85 Fed. Reg. 21747-21751 (to be codified at 13 C.F.R. Part 120); Business Loan Program Temporary Changes; Paycheck Protection Program—Requirements—Promissory Notes, Authorizations, Affiliation, and Eligibility, 85 Fed. Reg. 23450-23452 (to be codified at 13 C.F.R. Parts 120, 121).

[4] Small Business Administration, Paycheck Protection Program Loans, Frequently Asked Questions, https://www.sba.gov/sites/default/files/2020-05/Paycheck-Protection-Program-Frequently-Asked-Questions_05%2013%2020.pdf (last visited May 13, 2020).

[5] *Id.*

[6] 85 Fed. Reg. 20811, 20812.

[7] 85 Fed. Reg. 20811, 20814.

[8] 85 Fed. Reg. 20811, 20816.

[9] Small Business Administration, Paycheck Protection Program Loans, Frequently Asked Questions, #7.

[10] Cares Act, Sec. 1106(d)(3)(A).

[11] In the third interim final rule issued April 20, 2020, the SBA indicated gas used in driving a business vehicle qualifies as a utility cost for self-employed individuals using the PPP. Page 9.