FRIED FRANK

To Our Clients and Friends

Memorandum

June 10, 2020

New Rules on Use and Forgiveness of PPP Loans

On June 5, 2020, the "Paycheck Protection Program Flexibility Act of 2020" (here) was enacted. The Flexibility Act modifies the CARES Act provisions relating to the Paycheck Protection Program (PPP), particularly by affording borrowers additional flexibility with respect to eligibility for the forgiveness of PPP loans.

According to the U.S. Treasury Department, as of June 6, 2020, about $130 billion of funds remain available for PPP loans. Reportedly, demand for PPP loans has declined dramatically since the inception of the program due to concerns by some businesses that, because they have remained closed in accordance with governmental shut-down orders, they would not be able to comply with the requirements for use and forgiveness of the loans. It remains to be seen whether the additional flexibility provided by the Flexibility Act will be sufficient to spark a renewal in demand for PPP loans.

The changes effected by the Flexibility Act apply to PPP loans issued before or after enactment of the Flexibility Act (except as otherwise described below). They key changes are as follows:

Forgiveness of PPP Loans

- **Reduction of the requirement that borrowers use 75% of the loan proceeds for payroll costs.** Prior to enactment of the Flexibility Act, under the CARES Act, to be eligible for forgiveness of a PPP loan, the borrower was required to use at least 75% of the loan proceeds for payroll purposes and could use only up to 25% for the other permitted purposes (rent, mortgage interest, and utilities). In addition, regulations issued by the SBA under the CARES Act have required that, irrespective of forgiveness, a PPP borrower has to use at least 75% of the proceeds for payroll costs and can use only up to 25% for the other permitted purposes. Now, under the Flexibility Act, to be eligible for loan forgiveness, the borrower must use at least 60% (rather than 75%) of the proceeds for payroll costs and can use up to 40% (rather than 25%) for the other permitted purposes. In addition, a statement issued by the SBA on June 8, 2020 indicates that the SBA will issue new regulations to provide that, irrespective of forgiveness, a borrower must use at least 60% of the proceeds on payroll costs and only up to 40% on the other permitted purposes. The June 8 statement also clarifies that if a borrower uses less than 60% of the proceeds for payroll costs, partial forgiveness of the loan will still be available.
- **Extension of the 8-week period for use of the loan proceeds.** Prior to enactment of the Flexibility Act, to be eligible for forgiveness of a PPP loan, the borrower had to use the proceeds within 8 weeks following the date of disbursement of the loan. Under the Flexibility Act, the 8-week period has been extended to the earlier of (i) 24 weeks after the date of disbursement of the

loan or (ii) December 31, 2020. (The Flexibility Act permits borrowers who obtained loans before enactment of the Flexibility Act to elect to continue with the existing 8-week period.) We note that the lead sponsors of the Flexibility Act have clarified that the change of the definition of "covered period" to extend it to (at the latest) December 31, 2020 (i) is intended to allow borrowers who received PPP loans before June 30, 2020 to continue to make expenditures for allowable purposes after June 30, but (ii) does not affect the existing deadline of June 30, 2020 for PPP loan applications to be approved.

- **Extension of the June 30 date, and the addition of "safe harbors," for rehiring employees and restoring wages.** Under the CARES Act, the amount of forgiveness for which a PPP loan borrower is eligible is determined based on (i) the ratio of (a) the average number of monthly full-time equivalent employees (FTEs) during the covered period divided by (b) the number of average monthly FTEs during one of two reference periods elected by the borrower, and (ii) reductions in the cash compensation of employees by more than 25% between February 15 and April 26, 2020. However, reductions in FTEs are not counted to the extent they were implemented between February 15 and April 26, 2020 and then were restored by June 30, 2020; and reductions in compensation are disregarded if the previous compensation level was restored by June 30, 2020. The Flexibility Act changes the June 30 deadline for restoration to December 31, 2020. In addition, under previous guidance, the SBA had clarified that borrowers could exclude from the count of terminated FTEs any employees who had refused good faith offers by the borrower for rehiring. Now, under the Flexibility Act, a borrower also can exclude terminated employees from the FTE count to the extent that the borrower can document that (i) it was unable to rehire individuals who were employees on February 15, 2020 (and was unable to hire "similarly qualified" individuals for unfilled positions by December 31, 2020); or (ii) it was unable to return to the same level of business activity it had on February 15, 2020, due to compliance with requirements established or guidance issued, between March 1, 2020 and December 31, 2020, by the U.S. Health and Human Services (HHS), the Centers for Disease Control and Prevention (CDC), or the Occupational Safety and Health Administration (OSHA), relating to "the maintenance of standards for sanitation, social distancing, or any other worker or customer safety requirement related to COVID-19."

Other Terms--Maturity Date; Payment Deferral; Payroll Taxes Deferral

- **Extension of the maturity date.** Under the Flexibility Act, PPP loans issued after June 5, 2020 will have a minimum maturity term of 5 years. PPP loans issued previously have a maturity term of 2 years; and, with respect to these loans, the Flexibility Act states that nothing in the Flexibility Act, the CARES Act or the PPP program shall be construed to prevent the borrower and the lender from mutually agreeing to modify the maturity terms of the loan.

- **Extension of the deferral period for payment.** Prior to enactment of the Flexibility Act, the borrower's payment of principal, interest and fees under a PPP loan was deferred for 6 months from the date of disbursement of the loan. The Flexibility Act extends the deferral period to the date on which the SBA remits the borrower's loan forgiveness amount to the lender. If a borrower fails to apply for forgiveness within 10 months after the last day of the forgiveness covered period (*i.e.*, 10 months after the earlier of (a) 24 weeks after disbursement of the loan or (b) December 31, 2020), then the borrower must start making payments of principal, interest and fees on the loan, beginning on the date that is "not earlier than the date that is 10 months after last day of such covered period" (unless the lender agrees to a longer deferment).

- **Eligibility for the deferral of payroll taxes.** The CARES Act permits employers to defer the payment of payroll taxes for the portion of the 2020 calendar year beginning with the date of enactment of the CARES Act. (The payment is deferred to December 31, 2021 for 50% of the taxes and to December 31, 2022 for the other 50%.) Prior to enactment of the Flexibility Act, a PPP borrower could not obtain both forgiveness of a PPP loan and the payroll tax deferral permitted under the CARES Act (and so would have to decide which of the two would be more beneficial and forego the other). The Flexibility Act provides that an employer whose PPP loan is forgiven is now eligible for the CARES Act payroll tax deferral as well.

Open Issues

- **Operational issues.** It is unclear how, for the approximately 4.5 million PPP loans issued prior to June 5, 2020, lenders will notify the borrowers of, and will process, the changes mandated by the Flexibility Act. Borrowers should keep in mind that not all lenders have used the same form of documentation for PPP loans. In addition, many lenders expressly incorporated in their loan agreements the original terms as set forth in the CARES Act, and these agreements will not reflect the new terms promulgated under the Flexibility Act. Thus, these agreements may need to be amended to reflect the retroactive changes made by the Flexibility Act (as well as any changes agreed by the lender and the borrower as permitted by the Flexibility Act). A borrower with an existing PPP loan should review the terms of the loan documents and be proactive in requesting that the lender make appropriate amendments.

- **"Covered period."** First, as discussed above, the forgiveness amount will be reduced based on a reduction in the average FTEs over the "covered period" of the loan and the Flexibility Act has extended the covered period. It is not clear how the forgiveness amount will be reduced if a borrower who has laid off employees but still has proceeds to be used now lays off additional employees during the expanded 24-week covered period. Second, as discussed above, the Flexibility Act permits existing borrowers to elect to retain the 8-week "covered period" that commences from the date of disbursement of the loan. Presumably (although it is not expressly stated), the current guidance remains in effect which permits borrowers with biweekly or more frequent pay periods to elect to begin the covered period on the first pay period commencing after the date of disbursement of the loan.

- **Safe harbors for calculating the forgiveness amount.** As discussed, the Flexibility Act permits existing PPP borrowers to elect to retain the original 8-week "covered period" for the calculation of FTEs to determine the forgiveness amount. However, it is not clear whether borrowers who elect to retain the 8-week covered period can also continue to use June 30, 2020 as the date for determination of whether the new safe harbors apply or they must use the new December 31, 2020 date. If the December 31 date applies in all cases, this may delay when applications for forgiveness based on the safe harbors can be submitted.

- **Timing for forgiveness.** The CARES Act interim final rule issued April 3, 2020 states that the PPP lender must make a determination on forgiveness within 60 days of receiving the borrower's application for forgiveness. It is not clear, however, whether a PPP loan is thereby officially forgiven, or whether additional steps (such as approval by the SBA) are required and the loan is officially forgiven only at the time the SBA remits the forgiven amount to the lender. In addition, the government has announced that all PPP loans over $2 million are subject to audit at the time forgiveness is requested--and it is unclear how that process will work and whether the audit will have to be concluded before the loan is forgiven.

- **Maturity date.** As noted, all new PPP loans, to the extent not forgiven, must have a term of at least 5 years. The CARES Act establishes a maximum interest rate of 4% for PPP loans; and the SBA's PPP regulations set a rate of 1% for all PPP loans. It remains to be seen whether, absent a change to permit higher interest rates, lenders will be willing to originate new loans with a 5-year maturity or to lengthen the maturity of existing loans.

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