Client Alert

June 2020

SBA Releases First Interim Final Rule After Passage of the Paycheck Protection Program Flexibility Act/PPPLF Conflict Issues Created

The Small Business Administration ("SBA") released the first interim final rule[1] ("IFR") in response to various significant changes created by the Paycheck Protection Program ("PPP") Flexibility Act of 2020 ("Flexibility Act"). The IFR is focused on revising the initial interim final rule posted on April 2, 2020, by changing key provisions, including the loan maturity, deferral of loan payments, and forgiveness provisions, to conform to the PPP Flexibility Act. Several of these amendments are retroactive to the date of enactment of the CARES Act, making the interpretation and implementation of these changes burdensome on lenders.

Summary of IFR

The Flexibility Act amends the CARES Act that created the PPP and specifically amends provisions related to loan terms and loan forgiveness. The following summarizes the various key changes.

Covered Period

The Flexibility Act amended the definition of "covered period" for the PPP by extending the end date from June 30, 2020, to December 31, 2020. This definition of "covered period" governs loan use, eligibility, and related requirements—it does not alter the meaning of "covered period" with respect to loan forgiveness, which is covered by a different provision of the Flexibility Act. Based on this statutory change to the definition of "covered period" in the CARES Act, the IFR creates a corresponding extension of the covered period in the initial interim final rule to December 31, 2020.

Maturity Date

The Flexibility Act provides that the five year maturity period starts on the date that the SBA remits loan forgiveness to the lender or that it starts ten months after the last day of the forgiveness covered period if the Borrower did not file for forgiveness. However, the SBA has modified the maturity date for loans made on or after June 5, 2020. The IFR provides that the maturity date is five years from the date that the SBA assigns a loan number to the PPP loan.

For loans made before June 5, 2020, the loan term is still two years. The IFR clarifies that borrowers and lenders may mutually agree to extend the maturity of such loans to five years—lenders are not required to extend loans made prior to June 5, 2020. To justify the five year maturity start date, the SBA states in the IFR that it "determined that the date the SBA assigns a loan number to the PPP loan provides an efficient, transparent, and auditable means of determining when a PPP loan is ***"made"*** that provides certainty to lenders" (emphasis added). As discussed more below, this change in determining when the loan term starts creates some issues with respect to pledging PPP loans to the Federal Reserve's PPP Liquidity Facility.

[1] Interim Final Rule on Revisions to the April 2, 2020, Interim Final Rule

Loan Forgiveness Period

The period when borrowers must expend PPP loan funds in order to be eligible for forgiveness is extended from 8-weeks to 24-weeks, but borrowers whose loan was made before June 5, 2020 may elect to apply the original 8-week forgiveness period. The “loan forgiveness covered period” begins on the date the PPP loan funds are disbursed.

Deferral Period

The IFR also changed the deferral period on PPP loans in light of the extension created by the Flexibility Act. If the forgiveness application is submitted within 10 months after the end of the loan forgiveness covered period, the borrower does not have to make any payments of principal or interest before the date on which the SBA remits the loan forgiveness amount on the loan to the lender or notifies the lender that no forgiveness is allowed. If the forgiveness application is not submitted within 10 months after the end of the covered period, payments of principal and interest begin after that period ends (e.g., if the 24-week forgiveness period ends on 12/10/2020 and the borrower does not submit a loan forgiveness application by 10/10/2021, then the borrower must begin making payments on or after October 10, 2021). Interest continues to accrue during the deferment period.

Lenders are required to notify borrowers of remittance by the SBA of the loan forgiveness amount or that the SBA has determined no forgiveness is allowed. At that time, lenders must also inform the borrower when the first payment is due.

This new deferral period calculation leaves both the borrower and lender in the dark in terms of when it will end if the borrower chooses to seek forgiveness, which is the driving feature of this program. Both parties will have to wait until the loan forgiveness application is completed by the borrower, reviewed by the lender, and ultimately approved or denied by the SBA before the deferral period ends. It is unclear how long the SBA will take to process each forgiveness application. It is possible the SBA will provide clarity in the future to provide greater certainty for all parties.

Loan Forgiveness & New Safe Harbor

The Flexibility Act reduced the amount of proceeds that must be used for eligible payroll expenses from 75% to 60%. While the Flexibility Act had the unintended consequence of eliminating the sliding scale of forgiveness for borrowers that did not meet the 60% threshold, the IFR clarifies that the sliding scale does still apply. The SBA, in consultation with the Treasury, determined that the 60% in the PPP Flexibility Act should be interpreted as “a proportional limit on non-payroll costs as a share of the borrower’s loan forgiveness amount, rather than a threshold for receiving any loan forgiveness.”

The IFR creates a new safe harbor for borrowers who are unable to rehire previously employed individuals or similarly qualified employees. In these situations, the borrower would not have its loan forgiveness amount reduced based on the reduction in full-time equivalent employees. The SBA stated that interpreting the Flexibility Act’s 60% requirement as a threshold would be in direct conflict with the flexibility provided by this new safe harbor.

The SBA provided the following example in the IFR to explain how loans may be forgiven in whole or in part using the sliding scale:

> If a borrower received a $100,000 PPP loan, and during the covered period spends $54,000 (54%) of its loan on payroll costs, the maximum amount of loan forgiveness the borrower may receive is $90,000 (with $54,000 in payroll costs constituting 60% of the forgiveness amount and the additional $36,000 in non-payroll costs constituting 40% of the forgiveness amount).

The SBA will issue revisions to the IFRs on loan forgiveness and loan review procedure as well as additional guidance on advance purchase of PPP loans, which will include any effect the amendments have on the loan forgiveness requirements.

Use of PPP Loan Proceeds

The IFR reiterates that proceeds of a PPP loan can be used for the following items:

- 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 prepayments or principal payments),
- Rent payments;
- Utility Payments;
- Interest payments on any other debt obligations incurred before February 15, 2020; and/or
- Refinancing an SBA Economic Injury Disaster Loan made between January 31, 2020 and April 3, 2020.

The IFR also clarifies that borrowers can receive both an EIDL loan and PPP loan. If the EIDL loan was not used for payroll costs, it does not affect a borrower's eligibility for a PPP loan. If the EILD loan was used for payroll costs, the PPP loan must be used to refinance the EIDL loan. The amount of any EIDL refinanced in the PPP loan will be included for purposes of determining the percentage of use of proceeds for payroll costs. Proceeds from any advance up to $10,000 on an EIDL loan will be deducted from the loan forgiveness amount of a PPP loan.

For purposes of loan forgiveness, the borrower will have to document the proceeds used for payroll costs in order to determine the amount of forgiveness.

Borrower Certifications

The IFR revises the borrower certifications to provide that "not more than 40% of loan proceeds may be used for non-payroll costs" and "not more than 40% of the forgiven amount may be used for non-payroll costs." It also adds an additional requirement that was recently revealed in the forgiveness application and forgiveness rules requiring a borrower to certify that they will provide lenders with documentation to verify the number of full-time equivalent employees on payroll as well as the dollar amounts of payroll costs, and documentation for forgivable non-payroll expenses, including covered mortgage interest, rent payments, and utilities.

Other Updates

The SBA also released updated application forms for borrowers and lenders to use for loans made on or after June 5, 2020. In addition to the expected changes to the borrower application form to account for the new forgiveness period and payroll expense percentage, the SBA revised the borrower felony certification requiring applicants to certify that they have not "been placed on pretrial diversion." The new borrower application form also clarifies that the application form should not be sent to lenders directly by mail.

Additional revisions to the SBA's interim final rules on loan forgiveness and loan review procedures are forthcoming. In light of the extended forgiveness period, the SBA also stated that it will be issuing updated guidance on advance purchases of PPP loans, which will include any effect the Flexibility Act's amendments made to the loan forgiveness requirements.

The Federal Reserve released new FAQs to accommodate the changes made by the Flexibility Act. The maturity date of an extension of credit under the PPP Liquidity Facility will equal the maturity date of the PPP loan pledged to secure the extension of credit. Accordingly, PPP Liquidity Facility advances may be five years when secured by a pledge of PPP loans with a 5-year maturity. The Federal Reserve will release additional information for lenders that agree to extend the 2-year term of pledged loans to a 5-year term.[2]

Tying the term start date to the date that the SBA issues the PPP loan number creates certain problems with respect to pledging the loans to the PPP Liquidity Facility. For example, if ten borrowers receive SBA numbers on June 12, 2020 and the loans have the same 5-year maturity date of June 12, 2025, those loans could very well be funded by a lender on different dates based upon the time it takes the borrowers to execute their loan documentation. If the lender funds and pledges five of these loans to the PPP Liquidity Facility, and the other five borrowers come back ten days later to execute their documents and receive funding at that time, the lender will be precluded from pledging those additional five loans. This presents a significant problem for banks participating in the PPP Liquidity Facility—the SBA and the Federal Reserve will have to address this issue in subsequent FAQs and, potentially, in future interim final rules.

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[2] This information will be posted on the Federal Reserve's PPP Liquidity Facility website when ready.