

SBA Provides Additional Guidance on PPP Loan Forgiveness Process and Loan Reviews

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May 29, 2020

Further Changes Possible as Congress Considers Legislation to Relax Program Restrictions

On May 22, 2020, the Small Business Administration (SBA) and the Department of the Treasury issued two interim final rules (IFRs) providing further clarity on the CARES Act Paycheck Protection Program (PPP). The [Interim Final Rule on Loan Forgiveness \(“Loan Forgiveness IFR”\)](#) follows the May 15 release of a [loan forgiveness application form](#) and associated instructions. Taken together, the two offer some new insights on the loan forgiveness process, including instructions for completing the application and formulas for determining whether loan forgiveness reduction safe harbors are met and calculating forgiveness reduction amounts, as well as some new terms borrowers might find favorable. In a separate [Interim Final Rule on SBA Loan Review Procedures and Related Borrower and Lender Responsibilities \(“Loan Review IFR”\)](#), SBA elaborates on its process for reviewing PPP loan and loan forgiveness applications to ensure their compliance with the Program’s requirements and, additionally, provides further detail on loan forgiveness decisions.

We also note current congressional efforts to modify the PPP through the Paycheck Protection Flexibility Act, which passed the House by a vote of 417-1 on May 28. Among other changes, the bill would: allow for forgiveness for expenses for up to 24 weeks (tripling the current eight week period) or through December 31, 2020, whichever comes first; reduce from 75 to 60 percent the portion of loan proceeds that must go toward payroll costs; extend the repayment period to five years (from two years); provide expanded forgiveness for businesses unable to rehire due to the continuing pandemic; allow access to payroll tax deferral for PPP loan recipients; increase the deferral period for unforgiven loan funds from six to ten months; and extend the deadline to apply for a loan to the end of the calendar year. There appears to be bipartisan support for program modifications in the Senate, as well. If PPP reform legislation is enacted in the days ahead, further guidance from the SBA will be needed to complete the loan forgiveness application.

Loan Forgiveness IFR

Below are some highlights from the new loan forgiveness application and the Loan Forgiveness IFR:

Alternative Payroll Covered Period: The guidance offers an alternative eight-week period for borrowers with biweekly (or more frequent) payroll. Instead of the eight-week period commencing on the *disbursement date* of the PPP loan, a borrower may choose instead to calculate payroll costs based on the eight-week period commencing on the *first day of the first pay period following the*

disbursement date of the PPP loan. This is intended to ease some of the administrative burden for borrowers with loan disbursement dates in the middle of a pay period.

Costs Either Paid or Incurred: The guidance clarifies that payroll costs and nonpayroll costs may be either paid *or* incurred during the eight-week covered period (or the alternative payroll covered period). Costs are eligible for forgiveness so long as they are either (i) paid during the eight-week period or (ii) incurred during the eight-week period and paid on or before the next regular payroll date (for payroll costs) or on or before the next regular billing date (for nonpayroll costs).

Hazard Pay and Bonuses: The Loan Forgiveness IFR confirms that hazard pay and bonuses paid to employees during the eight-week covered period (or the alternative payroll covered period) qualify as “payroll costs”, making them eligible for forgiveness as long as the employee’s total compensation (including the hazard pay and bonus) does not exceed \$100,000 on an annualized basis.

Leasing Payments for Personal Property: The application provides guidance on the term “covered rent obligations.” The CARES Act defined the term as “...rent obligated under a leasing agreement...” It was unclear whether this meant only a real property lease or whether it also included equipment leases and other personal property leases. The application supports the broader interpretation and defines covered rent obligations as “business rent or lease payments pursuant to lease agreements for real or personal property...”

Forgiveness Reductions Based on Employee Levels: The CARES Act provided for a reduction to the loan forgiveness amount if a borrower failed to maintain a certain number of full-time equivalent (FTE) employees. If the average number of FTE employees during the eight-week covered period was less than during the reference period chosen by the borrower, the amount eligible for forgiveness will be reduced by the same percentage reduction in FTE employees. The reference period may be either (i) February 15, 2019 through June 30, 2019, (ii) January 1, 2020 through February 29, 2020, or (iii) in the case of a seasonal employer, either of these two periods or a consecutive 12-week period between May 1, 2019 and September 15, 2019.

- The Loan Forgiveness IFR confirms that an FTE employee is an employee that works 40 or more hours per week. Both the application and the IFR offer two methods for calculating FTE employees, each of which is done on an employee-by-employee basis, and involves assigning a number no greater than 1.0 to each employee of a borrower during the eight-week covered period (or alternative payroll covered period). However, the IFR differs from the application in that the second method (as described below) is only available to those employees who are paid for less than 40 hours per week and requires a borrower to apply the same method to all part-time employees.
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 - The first method requires a borrower to determine the *average* number of hours an employee was *paid* per week during the eight-week period, then divide by 40 and round up to the nearest tenth (but capped at 1.0 as noted above).
 - The second method is intended to be simpler, and requires a borrower to determine the number of hours an employee *worked* during each week of the eight-week period, and either assign the employee 1.0 if he or she worked 40 or more hours each week, or 0.5 if he or she worked less than 40 hours each week. As noted above, according to the Loan Forgiveness IFR, this method is only available for those employees who are paid for less

than 40 hours per week. Employees who are paid for 40 or more hours per week are to be calculated based on the first method.

- Unlike the application, the Loan Forgiveness IFR requires a borrower to use the same method for calculating FTE with respect to each of its part-time employees. A borrower will want to run the calculations under each method to determine which method, as a whole, is more favorable.
- The guidance also offers a new exception to the reduction in loan forgiveness for failing to maintain a certain number of FTE employees:
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 - A borrower's loan forgiveness amount will not be reduced if an employee of the borrower was fired for cause, voluntarily resigned, or voluntarily requested and received a reduction of hours, during the covered period (or the alternative payroll covered period), and the position was not filled by a new employee. A borrower must maintain records evidencing any such event.
 - A borrower's loan forgiveness amount will also not be reduced if the borrower makes a good-faith written offer to rehire an employee during the covered period (or the alternative payroll covered period), for the same salary or wages and number of hours as prior to the separation or reduction in hours, and the offer is rejected by the employee, and the position is not filled by a new employee; provided the borrower has maintained records documenting the offer and rejection, and has informed the applicable state unemployment insurance office of the rejected offer within 30 days of the employee's rejection of the offer. In the Loan Forgiveness IFR, SBA promises to provide further information on how to report rejected offers to state unemployment insurance offices.

Forgiveness Reduction Based on Reduction in Salary/Wages: The CARES Act also provided for a reduction to the loan forgiveness amount if a borrower reduced salary and wages by more than 25 percent during the eight-week covered period. The application contains formulas for determining (i) whether an employee's pay was reduced by more than 25 percent, (ii) whether a borrower meets the salary/wage reduction safe harbor, and (iii) if applicable, the amount of reduction to a borrower's loan forgiveness amount due to a reduction in salary/wages in excess of 25 percent.

- The salary/wage reduction formulas are only for those employees of a borrower with an annual salary of \$100,000 or less. Based on the application, and consistent with the CARES Act, a borrower's loan forgiveness amount will not be reduced due to a reduction in pay of those employees with an annual salary in excess of \$100,000.
- The salary/wage calculations are on an employee-by-employee basis, and require a borrower to determine each employee's "average annual salary or hourly wage" (i) during the eight-week covered period (or the alternative payroll covered period) and (ii) during the period of January 1, 2020 and March 31, 2020. However, neither the worksheet nor the Loan Forgiveness IFR offer any guidance on the calculation of "average annual salary or hourly wages"; notably, this strays from the CARES Act, which referred to an employee's "total salary and wages" for purposes of determining a reduction.
- Satisfaction of the salary/wage reduction safe harbor is also determined on an employee-by-

employee basis, which means a borrower could benefit from the safe harbor even if it only restored salary/wages for some and not all employees by June 30, 2020. A borrower's loan forgiveness amount will not be reduced with respect to any employees for which a borrower meets the safe harbor. Note, the formula for the safe harbor clarifies that salary/wages must be restored to 100 percent of the employee's salary/wages as of February 15, 2020 (and not some lesser percentage).

- The amount of reduction to a borrower's loan forgiveness amount is also determined on an employee-by-employee basis, and based on the guidance, the reduction will not be a dollar per dollar reduction, but instead based on the reduction of the employee's salary/wages in excess of 25 percent. The application and the Loan Forgiveness IFR, however, offer different guidance as to how to calculate this amount.
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 - The application offers a specific formula for calculating the reduction: the amount of reduction equals the applicable employee's (1) average annual salary or hourly wage during January 1, 2020 and March 31, 2020, (2) multiplied by 75 percent, (3) minus average annual salary or hourly wage during the eight-week covered period (or alternative payroll covered period), (4) multiplied by eight, (5) divided by 52. As above, this formula is based on "average annual salary or hourly wages."
 - The Loan Forgiveness IFR offers an example calculation, but interestingly does not use the formula from the application in the example. In the IFR, SBA appears to use a different method for calculating the reduction, and though it is possible to deduce a formula from the example, it is not specifically laid out as in the application. Had it been, it would look something like as follows: the amount of reduction equals the applicable employee's (1) weekly salary between January 1, 2020 and March 31, 2020 (they state "reference period" but that appears to be an oversight), (2) multiplied by 25 percent, (3) minus the weekly salary during the eight-week covered period (or the alternative payroll covered period), (4) multiplied by eight. Unlike the application, this calculation is based on "weekly salary," which also is not defined under the CARES Act or the issued guidance.
 - The calculation in the Loan Forgiveness IFR on its face seems simpler, but the use of "weekly pay" raises more questions and could potentially result in a different reduction amount than the method in the application, particularly if the employee is not paid the same amount each week (e.g. due to a bonus payment or hazard pay for some but not all weeks).

Application of the Forgiveness Reductions: The Loan Forgiveness IFR acknowledges a possible overlap between the wage/salary reduction and the FTE reduction to the loan forgiveness amount that could result in a borrower being doubly penalized. SBA concluded this was not the intent of the CARES Act and therefore the salary/wage reduction will apply only to the portion of the decline in the employee's salary and wages that is not attributable to the FTE reduction.

Maintenance of Supporting Documents for Six Years: The guidance also instructs **each** borrower to maintain all records relating to its PPP loan for six years following the date the loan is forgiven or paid in full, and to give authorized SBA representatives access if requested.

Loan Review IFR

In its May 22 Interim Final Rule on SBA Loan Review Procedures and Related Borrower and Lender Responsibilities, SBA provides detailed instructions for lenders with respect to their review of PPP loan forgiveness applications, as well as what information must be submitted to SBA with a lender's forgiveness decision. Please note that a detailed description of the documentation a borrower must submit to its lender is laid out in the loan forgiveness application and a borrower cannot receive forgiveness without submitting all documentation to the lender.

Specifically, in reviewing a loan forgiveness application, the Loan Review IFR directs lenders to: (1) confirm receipt of the borrower's certifications in the loan forgiveness application form; (2) confirm receipt of the documentation the borrower must submit to aid in verifying payroll and nonpayroll costs; (3) confirm the borrower's calculations on the loan forgiveness application; and (4) confirm that the borrower's calculation determining whether at least 75 percent of the potential forgiveness amount was used for payroll costs. While lenders are expected to perform a good faith review in a reasonable amount of time, "[p]roviding an accurate calculation of the loan forgiveness amount is the responsibility of the borrower, and the borrower attests to the accuracy of its reported information and calculations on the Loan Forgiveness Application."

Within 60 days of receiving a completed loan forgiveness application from a borrower, the lender must issue a decision to SBA – i.e., an approval / partial approval; a denial; or, if directed by SBA, a denial without prejudice due to pending SBA review (allowing a borrower to later request reconsideration, if determined to be eligible). If an application is denied, a borrower may request within 30 days that SBA review the lender's decision.

For qualifying borrowers, SBA will remit the appropriate forgiveness amount – plus interest and net of any SBA Economic Injury Disaster Loan (EIDL) Emergency Advance Amount – to the lender not later than 90 days after receiving the lender's decision. SBA will use the 90 day period to review loan and loan forgiveness documentation to ensure applicable requirements have been satisfied and to prevent fraud or misuse of PPP funds.

Loan Review Process

The Loan Review IFR also provides further detail on the agency's process for reviewing PPP loan applications and loan forgiveness applications to ensure their compliance with the Program's requirements as well as congressional intent, "including the CARES Act's central purpose of keeping workers paid and employed." SBA has said it may review any PPP loan, of any size, at any time – including up to six years after the loan is forgiven or paid in full (see six-year recordkeeping requirement highlighted above).

Specifically, SBA may review borrower certifications and representations regarding: eligibility; loan amounts and use of loan proceeds; and loan forgiveness amounts. If SBA elects to undertake a review, the agency will notify the lender in writing and within 5 business days of receipt, the lender must (1) notify the borrower in writing and (2) provide SBA with electronic copies of relevant documents. A lender may not approve any application for loan forgiveness while a review is underway. During the review, a borrower will have the opportunity to provide additional information, either through its lender or directly to SBA. If a borrower fails to respond to an inquiry, SBA may determine the borrower was ineligible.

In previously-issued guidance, SBA established a "safe harbor" for borrowers with loans under \$2 million, deeming such borrowers to "have made the required certification concerning the necessity of the loan request in good faith." Notwithstanding this guidance, SBA may review any loan for any reason, at its discretion. For instance, SBA may still review questions of borrower eligibility (for

instance under the size standard) or a borrower's forgiveness calculations.

If SBA determines that a borrower is ineligible for the PPP loan or for the loan amount or the loan forgiveness amount claimed, it will direct the lender to deny the loan forgiveness application, in whole or in part, as appropriate. SBA may seek repayment of the outstanding PPP loan balance or pursue other available remedies. In the Loan Review IFR, SBA also reiterates that the CARES Act provision limiting the agency's recourse against individual shareholders, members, or partners of a PPP borrower for nonpayment only applies "if the borrower is an eligible recipient of the loan." SBA intends to issue a separate interim final rule regarding an appeals process for borrowers.

Finally, the IFR creates an interesting incentive (and potentially a dilemma) for lenders reviewing their borrowers' forgiveness applications. A lender is not eligible for a processing fee if SBA deems a borrower ineligible. Additionally, SBA may claw back processing fees if a borrower is found to be ineligible after its loan was disbursed.

Kelley Drye will continue to monitor Paycheck Protection Program developments and will provide updates in the event of further guidance or Congressional actions to modify the program.