
LEGAL UPDATES AND NEWS

The SBA's Paycheck Protection Program Loan Forgiveness Guidance

On May 23, 2020, the U.S. Small Business Administration ("SBA") issued two interim final rules (the "Interim Final Rules") related to the forgiveness of loans originated under the SBA's Paycheck Protection Program (the "PPP") established by the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"). The CARES Act allows loan forgiveness to PPP borrowers of the full principal amount of qualifying PPP loans and requires the SBA to issue guidance on the loan forgiveness requirements and procedures. The first Interim Final Rule provides the requirements for loan forgiveness, which includes instructions for properly completing the PPP Loan Forgiveness Application for borrowers. The second Interim Final Rule describes the SBA's procedures for reviewing PPP loan and forgiveness applications.

Below is a summary of key provisions from both sets of rules, which are effective immediately. Yesterday, the House of Representatives passed a bipartisan bill that would change key PPP loan forgiveness provisions, including reducing the payroll cost threshold from 75% to 60% and expanding the period borrowers have to use their PPP funds from eight weeks to six months. The Senate has proposed a similar bill, but it has not yet passed. Based on the foregoing, it is very likely the Interim Final Rules will be further modified. Luse Gorman is closely monitoring these developments and will provide updates as appropriate.

First Interim Final Rule - Requirements for PPP Loan Forgiveness

1. Loan Forgiveness Process.

The entire principal amount of the borrower's PPP loan, including accrued interest, is eligible to be reduced by the loan forgiveness amount. The loan forgiveness amount is equal to the sum of all payroll costs and qualifying non-payroll costs paid or incurred by the borrower during an eight-week covered period, as described below. Qualifying nonpayroll costs, which cannot exceed 25% of the loan forgiveness amount, include: (1) interest payments on mortgage obligations incurred before February 15, 2020 (but not mortgage prepayments or principal payments); (2) rent obligations under a lease agreement in force before February 15, 2020; and (3) business utility payments for services beginning before February 15, 2020.

The process to obtain loan forgiveness is: (1) the borrower must complete and submit the PPP Loan Forgiveness Application (SBA Form 3508 or lender equivalent) to its lender; (2) the lender must review the application within 60 days of its receipt; and (3) upon approval of the application, the lender must then request payment from the SBA, after which the SBA has 90 days to remit to the lender the loan forgiveness amount, plus any interest accrued through the date of payment. If, however, the SBA determines during its review that the borrower was ineligible for a PPP loan, the loan will not be eligible for forgiveness.

The lender is responsible for notifying the borrower of the forgiveness amount as notified by the SBA. If all or a portion of the loan forgiveness request is denied, the remaining balance due on the PPP loan must be repaid by the borrower on or before the two-year maturity date of the loan.

2. Payroll Costs Eligible for Loan Forgiveness.

Borrowers are permitted to determine their payroll costs during the eight weeks following the disbursement of the borrower's PPP loan or, alternatively, during the eight weeks starting with the first day of the first payroll cycle after the disbursement date (each the "payroll covered period"). Payroll costs are considered paid on the day that paychecks are distributed or the borrower originates an ACH transaction. Payroll costs

incurred during the borrower's last pay period of the payroll covered period are eligible for forgiveness if paid on or before the next payroll date thereafter.

Salary, wages or commissions paid to furloughed employees, including bonuses and hazard pay, are eligible payroll costs (subject to the \$100,000 annual cash limit). Further, the amount of eligible payroll costs for "owner-employees" or self-employed individuals is limited to the lesser of: (1) \$15,385 the eight-week prorated amount of the \$100,000 limit); or (2) 8/52 (or approximately 15.38%) of 2019 compensation earned across all businesses.

3. Qualifying Non-Payroll Costs Eligible for Loan Forgiveness.

Qualifying non-payroll costs must either be paid during the eight-week period beginning after the PPP loan is disbursed to the borrower (the "non-payroll covered period") or incurred during the non-payroll covered period and paid on or before the next regular billing date, even if the billing date is after the non-payroll covered period.

4. Reductions to the Loan Forgiveness Amount.

The amount of loan forgiveness will be reduced if there is either a reduction of full-time equivalent ("FTE") employees (the "Employee Reduction Penalty") or salary or wages (the "Wage Reduction Penalty") during the payroll coverage period.

Employee Reduction Penalty. To calculate the Employee Reduction Penalty, the borrower must first select a "reference period," which can either be: (1) February 15, 2019 through June 30, 2019; (2) January 1, 2020 through February 29, 2020; or (3) in the case of a seasonal employer, either of the two preceding methods or a consecutive 12-week period between May 1, 2019 and September 15, 2019. The borrower must then determine the average number of FTE employees for both the payroll covered period and the selected reference period in accordance with the methodology below. If the average number of FTE employees during the payroll covered period is less than the reference period, the total eligible expense available for loan forgiveness is reduced proportionally by the percentage reduction in FTE employees.

In determining the number of FTEs, a borrower must consider both its full-time employees and part-time employees based on the average number of hours paid for each employee per week divided by 40, but without regard to any hours worked by an employee during any week in excess of 40 hours. For example, an employee who was paid 48 hours per week on average would be assigned an FTE score of 1.0 (and not 1.2). For part-time employees, borrowers are provided two methods in determining their full-time equivalency: (1) calculate the actual average number of hours the employee was paid per week relative to 40 hours (e.g., an employee that is paid for 10 hours per week on average would be assigned an FTE score of 0.25); or (2) assign each part-time employee an FTE score of 0.5, regardless of actual hours employed. One of these two methods must be applied to all part-time employees.

Wage Reduction Penalty. To calculate the Wage Reduction Penalty, the borrower must first consider the salary and wages paid to each employee during the payroll covered period relative to those paid to the same employee between January 1, 2020 and March 31, 2020 (the "wage reference period"). If the employee's salary or wages are reduced during the payroll covered period from their level during the wage reference period, the borrower must reduce the loan forgiveness amount by the total dollar amount of salary or wage reductions that are in excess of 25%. This calculation must be performed on a per-employee basis and applies to each new employee in 2020 and each existing employee who was paid less than the annualized equivalent of \$100,000 in any pay period in 2019. To avoid a double penalty, the Wage Reduction Penalty applies only to the portion of the reduction in employee salary and wages that is not attributable to an FTE reduction. In other words, the borrower will not be penalized twice for reducing both the hours and wages for the same employee.

Exemptions. The Employee Reduction Penalty and Wage Reduction Penalty can be avoided if by June 30, 2020, the borrower restores reductions made to the number of FTE employees or the level of employee salaries and wages. Moreover, the loan forgiveness amount would not be reduced for an employee who the borrower offered to rehire or restore reduced hours, but the employee declined the offer, provided certain

requirements are met; most significantly that the borrower informed the applicable state unemployment insurance office of the employee's rejection of the offer within 30 days thereafter. Lastly, if an employee is fired for cause, voluntarily resigns or voluntarily requests a schedule reduction during the payroll covered period, the borrower may assign the employee an FTE score based on his or her full-time equivalency level prior to such event when calculating the Employee Reduction Penalty.

Second Interim Final Rule – SBA's PPP Loan Review Procedures

1. SBA Reviews of Individual PPP Loans.

The second Interim Final Rule clarifies that the SBA may review any PPP loan it deems appropriate at any time, including reviewing PPP loans under \$2.0 million that are subject to the borrower necessity certification safe harbor established by the SBA. The scope of such a review could include borrower eligibility, the PPP loan amounts and use of proceeds and the loan forgiveness amount being claimed.

To assist in the SBA's review, the borrower must retain PPP documentation in its files for six years after the date the loan is forgiven or repaid in full and permit authorized representatives of the SBA to access such files upon request. Lenders must also comply with applicable SBA requirements for record retention. The SBA may direct the lender to deny the PPP Loan Forgiveness Application in whole or in part if the borrower is ineligible for the loan amount or loan forgiveness amount claimed and may also seek repayment of the outstanding PPP loan balance or pursue other available remedies.

A borrower may appeal the SBA's determination that the borrower is ineligible for a PPP loan, the loan amount or the loan forgiveness amount claimed. The SBA intends to issue a separate interim final rule addressing this process.

2. Loan Forgiveness Process for Lenders.

Scope of Lender Review. For each PPP Loan Forgiveness Application, the lender must: (1) confirm receipt of borrower certifications contained in the application; (2) receive documentation to aid in verifying payroll and qualified non-payroll costs; and (3) confirm the borrower's loan forgiveness calculations. While providing an accurate calculation of the loan forgiveness amount is the responsibility of borrower, lenders are expected to perform a good-faith review, in a reasonable time, of the borrower's calculation and supporting documentation. The scope of this review should be commensurate with the level of supporting documentation received from the borrower. For example, if payroll costs are not documented based on a payroll report from recognized third-party payroll processor, a more extensive review would be appropriate.

Timeline for the Lender's Decision on a PPP Loan Forgiveness Application. As described above, the lender must issue a decision to the SBA on the borrower's loan forgiveness not later than 60 days after receipt of the completed PPP Loan Forgiveness Application. This decision may take the form of: an approval (in whole or in part); denial; or a denial without prejudice due to a pending SBA review of the PPP loan for which forgiveness is sought. When the lender issues its decision to the SBA, it must provide certain information to the SBA, such as confirmation that the information provided by the lender to the SBA accurately reflects the lender's records for the loan, and that the scope of the lender's review was in compliance with the applicable guidance.

If the lender determines that the borrower is entitled to loan forgiveness, the lender must request payment from the SBA at the time the lender issues its decision to the SBA. The SBA will have 90 days to remit to the lender the loan forgiveness amount, plus any interest accrued through the date of payment. If, however, the lender denies the borrower's application, the lender must notify the borrower that it has issued a decision to the SBA denying the application and, within 30 days thereafter, the borrower may request the SBA to review the lender's decision.

As noted above, the SBA may review any PPP loan of any size at any time in its discretion. If the SBA undertakes such a review, the SBA will notify the lender in writing, and the lender must then notify the borrower in writing of such review and transmit certain documents related to the PPP loan to the SBA, in each case, within five business days.

Lender Fees. If the SBA determines that a borrower was ineligible for a PPP loan, the lender is not eligible for a processing fee. Further, processing fees paid by the SBA to the lender must be repaid to the SBA if, within one year after the PPP loan was disbursed, the SBA determines that a borrower was ineligible for a PPP loan or the lender has not fulfilled its obligations required by SBA rules. The SBA's determination of borrower ineligibility will have no effect on the SBA's guarantee of the PPP loan so long as the lender has fulfilled its required obligations.

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