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Revised Information on the PPP:

Important Details in Interim Final Rule for PPP Released on April 2 by SBA

The CARES Act, released on March 27, allocated $349 billion to provide loans to small businesses generally with less than 500 employees. This funding will be provided through three SBA related programs, the new Paycheck Protection Program (PPP), the SBA's existing Economic Injury Disaster Loan (EIDL) Program that has been expanded to cover the COVID-19 disaster, and payment relief for existing and new SBA 7(a), 504 and microloans. On April 2, the SBA released an Interim Final Rule (IFR) on the PPP that provided important details on the program. There have been so many changes to the rules and requirements that we have prepared a summary along with a comparison with the existing SBA 7(a) program for your ease of reference.

The PPP is distinctly different from existing SBA loan programs. A summary of the PPP's updated rules and requirements is shown below (please see Appendix A for more details):

- *Availability:* April 3, 2020 to the earlier of June 30, 2020 or when no more available funds.
- *Guarantee:* 100% guarantee of principal and interest by the SBA. No collateral required. 0% risk weighted asset.
- *Rate:* 1% per year.
- *Originator/Lender:* Fee payable by the SBA of 5% for loans not more than $350,000; 3% for loans greater than $350,000 but less than $2 million; and 1% for loans of $2 million or more.
- *Agent Fees Paid by Lender/Originator:* Maximum of 1% for loans of not more than $350,000; .50% for loans of more than $350,000 and less than $2 million, .25% for loans of $2 million or more.
- *Maturity:* 2 year stated final maturity. Payments are deferred for the initial 6 months but interest will be accrued.
- *Loan Forgiveness:* 100% of the loan amount will be forgiven subject to: (i) 25% limitation on non-payroll expense and (ii) 25% or less decline in employment at the borrower (see more detail below on mechanics).
- *Eligible Lenders:* All existing SBA certified lenders have delegated authority. In addition, the following may apply to the SBA to make PPP loans: all insured depositories, federally insured credit unions, any Farm Credit System institution subject to BSA requirements, and any depository or non-depository financing provider that has originated, maintained or serviced at least $50 million in business loans or other commercial finance receivables or services during a recent 12 month period (subject to a formal compliance program and meeting BSA requirements).

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- *Eligible Borrowers:* Small businesses with 500 or fewer employees in operation on February 15, 2020, and whose principal place of business is in the U.S as well as certain franchises and businesses that operate in the hospitality or food delivery industry. Certain tax-exempt organizations and tribal business concerns are also included. Self-employed, independent contractors, or sole proprietorships are also permitted borrowers subject to required documentation.

- *Excluded Borrowers:* Businesses engaged in any illegal activity, household worker employers, a business with an owner of 20% or more in jail or subject to criminal charges or convicted of a felony in last 5 years. In addition, traditionally ineligible borrowers under the SBA's Standard Operating Procedures (SOP) 50 10,Subpart B, Charter 2 other than non-profits, such as lending entities, life insurance companies and gambling businesses will continue to be ineligible under the PPP.

- *Permitted Loan Amount: Lesser* of $10 million or 2.5x average monthly included payroll. The included payroll is based on the 12-month average of aggregate compensation, excluding any compensation in excess of $100,000. (Any EIDL loan made between January 31, 2020 and April 3, 2020 would be added to the total less any EIDL COVID-19 loan.)

- *Secondary Market: A PPP loan may be sold on the secondary market at a premium or discount to par-after the loan is fully disbursed. There is no fee payable to the SBA for any guarantee sold into the secondary market. More details to follow on this program.*

- *Reimbursement of Loan Timing by SBA:* Loans must be outstanding for a minimum of 7 weeks after which time the lender/originator can apply to the SBA to purchase the expected forgiveness amount of the loan. The SBA must purchase this amount within 15 days after a complete report that demonstrates the expected forgiveness amount. Note that the SBA is not required to purchase 100% of the loan if the borrower has failed to meet the purpose requirements as discussed below.

- *Loan Underwriting:* Lenders are not required to independently verify the information submitted by borrowers but may rely on borrower certifications contained in the PPP application form, receipt of information from the borrower on employees and payroll, and following applicable BSA requirements.

Paycheck Protection Program Mechanics

As illustrated in Step 1, to determine the eligible loan amount the applicant must first determine payroll costs. The eligible loan amount is the lesser of $10 million or 2.5x the borrower's average monthly payroll costs.

Step 1	Average Payroll	$125.0	(a)
Calculation of	Less: Excluded Payroll	$25.0	(b)
Included Payroll	Average Included Payroll	$100.0	
Step 2	Factor (x)	2.5	
Calculation of	Loan Amount	$250.0	(c)
Loan Amount			
	Starting Non-payroll	$50.0	20%
	Starting Payroll (8 weeks)	$200.0	80%
	Total Loan Amount	$250.0	100%
Step 3	Permitted Payroll	187.50	75%
Calculation of Max	Permitted Non-payroll	62.50	25%
Permitted non-payroll	Loan Amount	250.00	100%

[a] Included in payroll costs for employers equal (i) the sum of any payments for salary, wages, commission or similar compensation, (ii) payment of cash tips or equivalent, (iii) payment for vacation, parental, family medical or sick leave, (iv) allowance for dismissal or separation and (v) payment required for group health benefits and payments.

(b) Excluded payroll costs for employers include (i) compensation for any employee with an annual salary in excess of $100K as pro-rated from the 2/15 – 6/30 period, (ii) payroll taxes, railroad retirement taxes and income taxes, (iii) any compensation to employees with principal residence outside the U.S. and (iv) qualified sick leave under Sections 7001 or 7003 under the Families First Coronavirus Response Act.

(c) For non-seasonal employees, the maximum loan amount equals 2.5 x the average total monthly payroll costs incurred during the year prior to the loan date. For non-seasonal employees not in operation in 2019, use January or February of 2020. For seasonal employees, use average monthly payroll for 12-week period beginning February 15 or March 1 and ending on June 30, 2020.

To help small businesses weather the COVID-19 pandemic and retain employees, the Paycheck Protection Program provides a strong incentive to avoid layoffs by forgiving borrowing amounts for up to eight weeks of eligible payroll. However, the amount that can be forgiven will be reduced if the business reduces more than 25% of its employees or 25% of the total salaries during the eight-week period after loan origination until June 30.

Small business employees may find that the state and federal unemployment insurance benefits (which were also enhanced under the CARES Act) offer employees more compensation than their current salaries. For example, in New Jersey, the unemployment benefits of 60% of wages per week along with the CARES Act supplemental unemployment benefit of $600 per week represents an hourly equivalent of almost $24 per hour for a worker that would otherwise be earning $15 per hour. This higher level of compensation may present a challenge to business owners to retain staff as declines in payroll will negatively impact the loan forgiveness amount. Small business owners should be aware of the impact of payroll reductions and the related increase in non-payroll expense on the amount of loan forgiveness they receive.

Step 4 in the chart below illustrates the impact of declines in payroll. As shown in column (d), as staffing declines by 20% to 32 employees while keeping non-payroll constant at $50,000, the loan forgiveness amount would decline to $210. As long as the job losses are less than 25% and the non-payroll amount stays below 25% of total loan forgiveness, the small business owner can increase the non-payroll reimbursement to $53.3 for total reimbursement of $213.3. But this amount is only 85% of the original loan amount and the small business owner would be required to repay the $36.7 or 15% difference over the next 2 years to the lending bank or ultimately the SBA.

						(d)				
	Starting Employees	40								
	Ending Employees	40	38	36	34	32	31	30	29	
Step 4	**Percentage Decline in Staff**		5%	10%	15%	20%	23%	25%	28%	
	Ending Employee Ratio	100%	95%	90%	85%	80%	78%	75%	73%	
Impact of Job Losses	**Payroll**	$200.0	$190.0	$180.0	$170.0	$160.0	$155.0	$150.0	$145.0	
on Loan Forgiveness	**Non-payroll Constant**	$50.0	$50.0	$50.0	$50.0	$50.0	$50.0	$50.0	$50.0	
Amount	**Total Loan Amount**	$250.0	$240.0	$230.0	$220.0	$210.0	$205.0	$200.0	$195.0	
	Non-payroll Cannot Exceed 25%	20%	21%	22%	23%	24%	24%	25%	26%	(e)
Step 5	Loan Forgiveness Amount	$200.0	$190.0	$180.0	$170.0	$160.0	$155.0	$150.0	$145.0	
Impact of 25% Limit	Non-payroll (+/-) to 25% Max	$50.0	$63.3	$60.0	$56.7	$53.3	$51.7	$50.0	$48.3	
on non-payroll	Lesser of $250 or 25% Max	$250.0	$250.0	$240.0	$226.7	$213.3	$206.7	$200.0	$193.3	
	Non-payroll/Total Forgiveness Amt.	*20%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	*25%*	
	% Total Loan Forgiven	100%	100%	96%	91%	85%	83%	80%	77%	

Step 5 highlights the impact of reaching the 25% cap on non-payroll. Row (e) shows the change in percentage of non-payroll to total payroll. Once the 25% cap is breached in the last column, the small business owner can no longer have the full amount of non-payroll cost reimbursed and the total reimbursement declines to $193.3. This amount is only 77% of the original loan amount and the owner would be required to pay back 33% of the original loan over the next 2 years.

In addition to the PPP, the CARES Act also provides additional funding for the existing Economic Injury Disaster Loan (EIDL) Program to cover the COVID-19 disaster. Small business owners may apply for EIDL loans of up to $2 million at 4% with forgivable emergency loans of $10,000 available for funding within 3 days of application. Unlike the expanded category of potential borrowers under the PPP, EID loans are only available to traditionally eligible small business concerns.

Finally, for small businesses with an existing SBA-guaranteed loan, the CARES Act provides relief for up to 6 months of payments for SBA 7(a), 504, and microloans. The SBA will pay principal, interest and fees on these loans for 6 months beginning at the next payment date. Loans already on deferment will receive 6 months of payment from the SBA after the deferral period. The SBA will also encourage lenders to provide deferments and will allow lenders for up to one year to extend the maturity of SBA loans in deferment beyond the current terms.

Since the PPP was launched, the average loan size has been about $300,000. With roughly $350 billion in small business funding availability and an assumed average loan size of $300,000, only about 1.17 million small businesses would be able to access this funding. The SBA estimates that there are about 30 million businesses with under 500 employees in the U.S. This means the PPP will reach about 3.8% of the sector, assuming the average loan size holds. As such, it is reasonable to expect that this first tranche of the PPP will be the first of potentially many tranches to be allocated to support small business.

The PPP's targeted size of $349 billion represents over 10x the SBA's historical annual origination of approximately $30 billion. For participating banks to fund such a large volume of new loans in a short period of time would be a major stress for liquidity. To address that concern, the Federal Reserve announced late yesterday that it would provide a new liquidity facility to provide term borrowing for such loans. More details are expected to follow this week.

The fluid nature of the PPP rules and requirements, along with the evolving funding from the Federal Reserve, highlight the importance of the small business lending component to the overall COVID-19 recovery plans. Stay tuned for what will likely be more changes to the program as it is implemented.

APPENDIX A

Summary Comparison of SBA 7(a) and PPP Loans

	7(a)	**PPP**
Maximum Loan Amount:	$5m	$10m
Term:	Typically 25 years, but may be up to 30 years	2 years
Interest Rate:	Negotiated up to: 6.00% + 0-200bp spread for loans < $250,000 and 5.00% for loans ≥ $250,000	1.00%[1]
Origination Fee Paid to Lender to the SBA:	None	5% for loans ≤$350,000 3% for loans $350,000 - $2m 1% for loans ≥$2m
Servicing Fee Paid to Lender:	1.00%	None[2]
SBA Guarantee:	85% for loans ≤ $150k; 75% for loans > $150k	100%
Forgiveness Amount:	N/A	*Up to* 100% if: (i) at least 75% used for approved payroll expenses by June 30th; and (ii) employee; and compensation levels maintained
Deferral Period:	N/A	6 months Interest accrues during this period but no payment is required[3]
SBA Payment of Principal & Interest to Lender:	*COVID-19 CHANGE:* SBA will automatically pay the principal, interest, and fees of current 7(a), 504, and microloans for a period of six months. SBA will also automatically pay the principal, interest, and fees of new 7(a), 504, and microloans issued prior to September 27, 2020.	Pursuant to SBA Guarantee & SBA Loan Purchase Only
Borrower Repayment Terms:	Monthly, amortized principal and interest over term of loan	Monthly, amortized principal and interest over 18 months from the end of the 6 month deferral period to maturity
Guarantee Fee Paid to SBA:	Initial; Ongoing; and Secondary market sale	None

Secondary Market Sales[4]:	Guaranteed & Unguaranteed portions may be sold; Sales of whole loans packaged into pooled securities by pool assemblers permitted.	After fully disbursed; At a discount or premium; and Without payment of a guaranty fee to the SBA
SBA Loan Purchase:	Only to extent guaranteed portion packaged by a pool assembler and sold as a guaranteed pool, then the SBA purchases the guaranteed portion of the loan out of the pool. If the guaranteed portion not sold into a pool, then the SBA pays out on the guarantee similar to an insurance claim – the lender is responsible for workouts/recoveries and the SBA will make them whole, net of what they recover	At Lender request No earlier than end of 7 weeks into covered period Amount = Expected Forgiveness Amount. *Note, this may not equal the entire guaranteed amount if borrower has not met payroll and employee retention/compensation requirements.* SBA has + 15 days from receipt of all documentation to make payment
Collateral:	Loans $\leq$ $350,000: at least first lien on assets financed with loan proceeds and all fixed assets including real estate. RE collateral not required when the equity is less than 25% of the fair market value and can be limited to the loan amount. Loans > $350,000: maximum extent possible up to the loan amount. If business fixed assets do not "fully secure" the loan, may include trading assets (using 10% of current book value for the calculation), and must take available equity in the personal real estate (residential and investment) of the principals.	None No personal guarantees
Borrower Creditworthiness:	SBA Lending Criteria 120.150 SBA 120.101 Credit Elsewhere Test	120.150 N/A Eg., ATR (ability to repay) analysis NOT required Credit Available Elsewhere Test NOT required

Borrower Eligibility:	For-profit “small business” concerns	Expanded to include all businesses with < 500 employees, certain food delivery businesses with more than 500 employees, and non-profits. Affiliation standards are waived for small businesses: 1. In certain hotel and food services industries; 2. Franchises in the SBA’s Franchise Directory; and 3. Receiving financial assistance from small business investment companies licensed by the SBA Historically *in*eligible businesses, such as lending institutions, life insurance companies, gambling businesses) are NOT eligible.
Lender Eligibility:	SBA Approved Lenders Only	*Automatically Eligible:* (i) depository institutions; (ii) farm credit system institution with BSA program meeting depository institution standards; (iii) certain other financing providers that originate, maintain, and services business loans or other commercial financial receivables and participation interests if have formalized compliance program meeting BSA requirements. *Ineligible lenders:* (i) designated Troubled Condition by their primary federal regulator or (ii) subject to formal enforcement action regarding unsafe or unsound lending practices
Required Forms:	SBA Form 1919 and SBA Form 1920	*Electronic Submissions:* (i) SBA Form 2483 Paycheck Protection Program Application Form – include payroll documentation. (ii) SBA Form 2484 Paycheck Protection Program Lender’s Application for 7(a) Loan Guaranty electronically Must also maintain the forms and supporting documentation in lender files.

[1] Note, that the CARES Act set the maximum interest rate at 4.00%. Pursuant to the SBA’s Interim Final Rule, the maximum interest rate was lowered to 1.00% but the SBA could revisit before the rule is finalized in 30 days.

[2] If the lender sells the loan and then services it, they will need to back out a servicing fee.

[3] The CARES Act provided for deferrals of up to 12 months. The SBA’s Interim Final Rule limited this to 6 months.

[4] Additional guidance regarding advance purchase sales to the secondary market is expected from the SBA.

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