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COVID-19 RESOURCE CENTER

Summary of the Paycheck Protection Program Flexibility Act Analysis

On May 28, 2020, the U.S. House of Representatives passed the Paycheck Protection Program Flexibility Act (H.R. 7010) (Flexibility Act) and on June 3, 2020, the U.S. Senate voted to pass the Act, without changes. It is expected that President Trump will sign the Act into law in the very near future. The Act is intended to liberalize aspects of the Paycheck Protection Program (PPP), as well as certain employment tax provisions, enacted as part of the CARES Act.

The following is a preliminary analysis of the Flexibility Act.

1. PPP "Covered Period" Extension for Purposes of Loan Applications and $100k Comp Limitation

- *Existing Provision:* Under the PPP, the "Covered Period" is the time period during which an applicant may apply for, and a lender may issue, a PPP loan. There are also limitations regarding what loan proceeds can be used for during the Covered Period. Under existing rules, the "Covered Period" is defined as running from February 15, 2020 to **June 30, 2020**.

- *Flexibility Act Revision:* The "Covered Period" is defined as running from February 15, 2020 to **December 31, 2020**.

- *Groom Comment: PPP loans generally can only be made during the Covered Period. Thus, the new provision would effectively extend the time period during which borrowers may apply for, and lenders may issue loans.*

2. PPP "Covered Period" Extension for Purposes of Determining the Forgiveness Amount

- *Existing Provision:* The term "Covered Period" is also used for purposes of determining the loan forgiveness amount of a PPP loan, but it has a different definition in this context. It is defined in the statute as **the eight-week period beginning on the date the loan was originated**. (Through regulation Treasury/SBA has provided for use of a slightly different eight-week period for borrowers with respect to determining eligible “payroll costs” that can be measured based on payroll cycles.)

- *Flexibility Act Revision:* The Flexibility Act defines the “Covered Period” for purposes of loan forgiveness as **the period beginning on the date the loan was originated and ending on the earlier of: (a) the date that is 24 weeks after the date the loan was originated; or (b) December 31, 2020.** However, a borrower that received a loan before the Flexibility Act was enacted can elect to have the prior rule apply (i.e., covered period ends eight weeks after the date the loan was originated).

- *Groom Comment: This provision would effectively extend the period of time during which a borrower can expend costs that would be eligible for forgiveness. The FTE reduction quotient is based on average FTEs employed during this Covered Period, so the Flexibility Act’s provision would presumably give the borrower more time to get its FTE count up and improve its quotient. However, the hourly wage/salary reduction factor is also based on any such reduction during the Covered Period, so the borrower would have to maintain wages/salary for a longer period.*

3. FTE Reduction Safe Harbor Expansion

- *Existing Provision:* The loan amount that is forgivable under the PPP can be reduced if the borrower fails to maintain their full-time employee population after receiving the loan. However, the existing PPP provides a certain safe harbor (i.e., “FTE Reduction Safe Harbor”), which if met by a borrower, allows the borrower to avoid a reduction in the forgivable amount that would otherwise result from a reduction in employee headcount relative to a pre-pandemic reference period. The existing “FTE Reduction Safe Harbor” applies if (1) the borrower’s total FTE in the pay period inclusive of February 15, 2020 was GREATER THAN the borrower’s total average FTE between February 15, 2020 and April 26, 2020 and (2) the borrower’s total FTE **as of June 30, 2020** was GREATER THAN OR EQUAL TO the borrower’s total FTE in the pay period inclusive of February 15, 2020.

- *Flexibility Act Revision:* The “FTE Reduction Safe Harbor” applies if (1) the borrower’s total FTE in the pay period inclusive of February 15, 2020 was GREATER THAN the borrower’s total average FTE between February 15, 2020 and April 26, 2020 and (2) the borrower’s total FTE **as of December 31, 2020** was GREATER THAN OR EQUAL TO the borrower’s total FTE in the pay period inclusive of February 15, 2020.

- *Groom Comment: This change would give the borrower more time to increase its FTE count (if reduced between February 15, 2020 and April 26, 2020) until the end of 2020 (rather than June 30, 2020) in order to satisfy the safe harbor and avoid the potential reduction to the loan forgiveness amount.*

4. Salary/Hourly Wage Reduction Safe Harbor Expansion

- *Existing Provision:* The loan amount that is forgivable under the PPP can be reduced if the borrower fails to maintain salaries and wages for certain employees after receiving the loan. However, the existing rules provide another safe harbor (i.e., "Salary/Hourly Wage Reduction Safe Harbor") that if satisfied will allow the borrower to avoid a reduction to the forgiveness amount that would otherwise occur because of a reduction in employee pay relative to pre-pandemic levels. This safe harbor is met if (1) the employee's annual salary/hourly wage as of February 15, 2020 was GREATER THAN the same employee's average annual salary/hourly wage between February 15, 2020 and April 26, 2020 and (2) The employee's annual salary/hourly wage as of February 15, 2020 was LESS THAN OR EQUAL TO the same employee's average annual salary/hourly wage **as of June 30, 2020**.

- *Flexibility Act Revision:* The "Salary/Hourly Wage Reduction Safe Harbor" would apply to a given employee if (1) the employee's annual salary/hourly wage as of February 15, 2020 was GREATER THAN the same employee's average annual salary/hourly wage between February 15, 2020 and April 26, 2020 and (2) The employee's annual salary/hourly wage as of February 15, 2020 was LESS THAN OR EQUAL TO the same employee's average annual salary/hourly wage **as of December 31**, **2020**.

- *Groom Comment: This change would give the borrower more time to restore reduced salary/wages (if reduced between February 15, 2020 and April 26, 2020) to pre-pandemic levels to satisfy the safe harbor and avoid the potential reduction to the loan forgiveness amount.*

5. Reduction in 75% Payroll Cost Requirement to 60%

- *Existing Provision*: There was no statutory requirement in the CARES Act that a certain percentage of forgivable be expended on eligible "payroll costs." However, Treasury/SBA, as part of administrative rulemaking, issued regulations (as well as related form instructions) **(1) requiring that at least 75% of the loan proceeds be used on eligible payroll costs, and (2) limiting the forgiveness amount to an amount comprised of at least 75% of eligible payroll costs.**

- *Flexibility Act Revision:* In order to receive loan forgiveness, a borrower **"shall use" at least 60 percent of the covered loan amount for payroll costs**, and may use up to 40 percent of such amount for any payment of interest on any covered mortgage obligation (which shall not include any prepayment of or payment of principal on a covered mortgage obligation), any payment on any covered rent obligation, or any covered utility payment.

- *Groom Comment: While the reduction from the 75% threshold to 60% is certainly welcomed, this language could be read to suggest that any borrower that fails to meet the 60% "use" threshold will not be eligible for <u>any</u> loan forgiveness. As noted above, Treasury had adopted a more lenient rule that would allow borrowers under the 75% threshold to still qualify for forgiveness (albeit at an amount reduced to meet the 75% threshold). We understand that House and Senate leaders are aware of this issue and it is very possible that it will be addressed in subsequent legislation later this summer.*

6. New FTE Reduction Factor Exception

- *Existing Provision:* As noted above, a borrower's forgiveness amount may be subject to reduction it reduces its average full-time employee headcount (i.e., "FTE reduction"). The existing statute does not provide for any other exceptions to the FTE reduction other than the safe harbor discussed above; **however, Treasury/SBA did use its existing administrative authority to issue certain exceptions to the FTE reduction (such as where an employer makes a qualifying offer of employment and the offer is declined, or where the employee is fired for cause, voluntarily resigns, or voluntarily requests to reduce his/her hours)**.

- *Flexibility Act Revision:* The FTE reduction will not apply if the borrower, in good faith: (a) is able to document (1) **inability to rehire individuals** who were employees of the borrower on February 15, 2020 and (2) **inability to hire similarly qualified employees for unfilled positions** on or before December 31, 2020; or, (b) is **able to document an inability to return to the same level of business activity as such business was operating at before February 15, 2020**, due to compliance with requirements or guidance issued by HHS, CDC, or OSHA during the period between March 1, 2020 and December 31, 2020 which relates to certain COVID-19 issues (specifically, sanitation, social distancing, or worker or customer safety requirements).

- *Groom Comment: This new provision is very similar to the relief that Treasury/SBA came up with by regulation. Note, however, that it does not apply to employees who were fired for cause, voluntarily resigned, or voluntarily requested and received a reduction in hours (which Treasury also exempted). It will be interesting to see if Treasury retains its existing administrative exceptions to FTE reduction or feels compelled to pull back on the exceptions to align with this new statutory provision.*

7. Extension of PPP loan maturity period

- *Existing Provision:* The CARES Act provided that a covered PPP loan that has a balance after forgiveness would have a maximum maturity of 10 years from the date on which the borrower applies for loan forgiveness. However, Treasury/SBA then issued a regulatory rule providing that **PPP loans would have only a two-year loan period/maturity date**.

- *Flexibility Act Revision:* A covered loan that has a balance after forgiveness will **have a minimum maturity of 5 years** and a maximum maturity of 10 years from the date on which the borrower applies for loan forgiveness. This is effective for loans made after the enactment of Flexibility Act.

- *Groom Comment: This provision appears intended to effectively override the Treasury/SBA's imposition of a two-year loan period. As noted above, it is not entirely clear how this provision would apply to existing loans; however, we expect that Treasury and/or lenders may seek to reform the terms of existing loans to extend the maturity date to reflect the Flexibility Act's provision. The Flexibility Act suggests that lenders and borrowers could mutually agree to modify loans made prior to the enactment date to conform with this change.*

8. Extension of Loan Deferral Period

- *Existing Provision:* Under the statutory language of the CARES Act, lenders must allow for a deferral of loan payments (and related interest and fees) for not less than six months, and not more than a year. However, Treasury/SBA issued guidance providing that the that **deferral would apply for a fixed six month period following the date of disbursement of the loan** (a blanket rule to apply to all PPP loans, notwithstanding the language in the CARES Act).

- *Flexibility Act Revision:* **Lenders will have to allow for deferral until the date on which the amount of loan *forgiveness* is remitted to the lender**. If the borrower does not apply for forgiveness within 10 months after the close of the "loan forgiveness" covered period (see above), payments of principal, interest, and fees on the loan must begin no earlier than that date (i.e., 10 months after the last day of such covered period).

- *Groom Comment: The proposed change would provide additional time for the deferment of principal, interest and fees, which is good news for borrowers.*

9. Expansion of CARES Act Employment Tax Deferral Provision

- *Prior Provision:* Employers can generally defer the deposit and payment of the employer's share of Social Security taxes (not Medicare taxes) under the CARES Act. The deferral applies to deposits and payments required between March 27, 2020 through December 31, 2020. **However, if an employer has a PPP loan forgiven, then deposits and payments due after that date are no longer eligible for deferral.**

- *Flexibility Act Revision:* **Even if an employer applies for and receives forgiveness on some or all of its PPP loan, the employer will still be eligible for this tax deferral program.**

- *Groom Comment: This is welcome news for borrowers that intend to seek loan forgiveness.*