CARES Act:
What You Need to Know Now

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Today's Topics

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- $350 Billion Paycheck Protection Program (PPP)
- Programs to Expand Lending to Small and Mid-Size Businesses in Conjunction with Federal Reserve
- Commercial and Real Estate Finance Implications
- Expansion of Unemployment Insurance Relief
- Tax Relief

Paycheck Protection Program

Paycheck Protection Program

- A core component of the CARES Act is the provision of approximately $350 billion to guarantee loans to small businesses.
- The program, called the Paycheck Protection Program, or PPP, is an expanded SBA loan program.
- The loans will be made by banks, credit unions, and other lenders and are fully guaranteed by the SBA.

Businesses Eligible for PPP Loans with ≤ 500 Employees

- During the "covered period" ending June 30, 2020, any business concern, nonprofit organization, veterans organization, or Tribal business that:
  - was in business on February 15, 2020;
  - employs not more than 500 employees (or, if applicable, employs not more than the size standard in number of employees established by the SBA for the industry in which the entity operates)
    - including individuals employed on a part-time or other basis,
    - as well as, <u>we believe based upon existing SBA regs</u>, employees obtained from a temporary employee agency, professional employee organization or leasing concern.
- Part-time and temporary employees are counted the same as full-time employees.

Businesses Eligible for PPP Loans with ≤ 500 Employees

- Sole proprietors, independent contractors, and self-employed individuals, such as "gig economy" workers.
- Two caveats to be discussed:
  - SBA affiliation rules for commonly controlled companies
  - Special exemption for certain businesses

Employees of Commonly Controlled Companies Generally Combined for the 500-Employee Test

- The SBA has complex affiliation rules that generally require businesses under common control or otherwise affiliated to aggregate their number of employees for purposes of determining whether the business satisfies the size standard in number of employees established by the SBA for the industry in which the entity operates.

Special Exemption for Certain Businesses, Including Hotels, Restaurants and Franchise Operations

- For eligible borrowers in the food services and accommodation sectors with a NAICS code beginning with 72, the 500-employee limit is applied to each physical location and not the company. As a result, a restaurant or hotelier with 1,000 employees and 10 locations would be eligible for PPP loans at each location that has less than 500 employees.
- In addition, the CARES Act waives the application of the affiliation rules with respect to eligibility for a PPP loan for:
  - eligible borrowers in the food services and accommodation sectors with not more than 500 employees; and
  - any entity operating as a franchise that is assigned a franchise identifier code by the SBA (in other words, a franchisee does not have to aggregate all other individuals employed by the franchisor or other franchisees)
- The affiliation rules are not waived for any other entities seeking a PPP loan.

Other Eligible Businesses Based Upon SBA Criteria if Greater Than 500 Employees

- SBA rules differentiate by revenue or number of employees, depending upon industry. For PPP, eligibility is based solely on number of employees.
- "Small Business Concern" under SBA regulations is an eligible borrower.
- Also eligible is an entity with not more than the number of employees established by the SBA for the industry in which the entity operates.
  - "cookie and cracker manufacturing" concerns may have up to 1,000 employees
  - "electric power distribution" concerns may have up to 1,000 employees

What Kind of Credit Profile Does a Prospective Borrower Need to Borrow?

- The main underwriting standards for eligibility will be significantly relaxed compared to SBA loan programs already in effect when Congress approved the CARES Act.
- Existing SBA loan programs require lenders to:
  - determine repayment ability;
  - require a personal guarantee and collateral; and
  - require the borrower to certify it cannot obtain credit elsewhere.
- PPP loans will not be subject to the same requirements.

What Kind of Credit Profile Does a Prospective Borrower Need to Borrow?

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- Instead, the main underwriting standards for eligibility for PPP loans will be proof that the business was operational on February 15, 2020 and had employees for whom the business paid salaries and payroll taxes (or a paid independent contractor).
- In addition, the CARES Act requires eligible PPP borrowers to make a good faith certification:
  - that the loan is necessary due to the uncertainty of current economic conditions caused by the global COVID-19 pandemic to support the borrower's ongoing operations;
  - acknowledging that the funds will be used to retain workers and maintain payroll or make mortgage, lease and utility payments; and
  - that the borrower does not have an application pending for a loan under another SBA program for the same use and has not received such a loan.

How Much Money Can an Eligible Borrower Apply For?

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- The maximum PPP loan is equivalent to 250% of the employer's average monthly payroll costs during the one-year period before the loan is made or $10 million, whichever is less.
- With respect to employees, payroll costs are broadly defined to include:
  - salaries, wages, commissions or similar compensation
  - cash tips or their equivalent
  - severance
  - group health care benefits, including insurance premiums
  - covered leave
  - retirement benefits
  - other expenses, including payments of state or local taxes assessed on employee compensation

How Much Money Can an Eligible Borrower Apply For?

- With respect to sole proprietors or independent contractors, payroll costs are defined to include their net income from a business up to $100,000 (pro-rated for the relevant period).
- There are certain exclusions from the definition of payroll costs, including:
  - the compensation of any individual employee in excess of an annual salary of $100,000 (pro-rated for the relevant period)
  - certain federal payroll taxes and income tax withholdings on wages
  - any compensation of an employee whose principal place of residence is outside of the United States
  - qualified sick or family leave wages for which a credit is available under the Families First Coronavirus Response Act

For What Purposes Can an Eligible Borrower Use the Loan Proceeds?

- The CARES Act specifies the allowable uses of the proceeds of a PPP loan include:
  - payroll costs
  - costs related to the continuation of group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums
  - employee salaries, commissions, or similar compensation
  - payments of interest on any mortgage obligation (which may not include any prepayment or payment of principal)
  - rent, including rent under a lease
  - utilities
  - interest on any other debt obligations that were incurred prior to February 15, 2020 (which may not include any prepayment or payment of principal)

Some or All of a PPP Loan May Be Forgiven

- Most important but also most complex PPP provision.
- A PPP borrower would be eligible for loan forgiveness up to the amount spent by the borrower:
  - on specified expenses
  - during the eight-week period after the loan is originated
  - but not more than the amount of the PPP loan
- Forgiveness is subject to potential adjustments to be discussed shortly.
- CARES Act specifically provides that the borrower will not incur adverse tax consequences as a result of the forgiveness of PPP debt.

Specified Expenses Are Considered in Calculating Forgiveness of PPP Loans

- Payroll costs (as discussed previously).
- Any payment under a lease obligation in effect before February 15, 2020 (not limited to RE leases).
- Any utility payment.
- Any payment of interest on any covered mortgage obligation which includes loans secured by personal property (but does not include any prepayment of or payment of principal on a covered mortgage obligation).

Calculating Adjustments to Forgiveness Amount

- This is a bit complicated.
- Start with the amount of specified expenses during the eight weeks after the PPP loan is disbursed.
- Then, there are potentially two negative adjustments:
  - one negative adjustment relates to employee headcount (FTEs)
  - the other relates to compensation adjustments for those who never received pay in 2019 that annualized at more than $100,000
- Important: To the extent the FTE reduction or compensation reduction occurs between February 15, 2020 and April 26, 2020 (inclusive), the adjustment to the loan forgiveness amount can be preempted by eliminating the FTE reduction or compensation adjustment, as applicable, on or before June 30, 2020.

Calculation of Forgiveness Adjustment Based Upon FTE Reduction

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- The maximum amount that otherwise could be forgiven will be reduced by a percentage based upon a reduction in FTEs relative to a baseline number.
- For the baseline number, borrower may choose the lower of:
  - average number of FTEs per month employed by borrower during period beginning on February 15, 2019 and ending on June 30, 2019; or
  - the average number of FTEs employed by borrower during period beginning on January 1, 2020 and ending on February 29, 2020

Calculation of Forgiveness Adjustment Based Upon FTE Reduction

- The baseline number will be the denominator; the numerator will be the average FTEs employed by borrower during the eight-week covered period.
- Example:
  - assume PPP loan of $5 million
  - assume borrower’s specified expenses during eight-week period are $4 million
  - assume borrower’s FTEs during eight-week period is 80% of the baseline FTEs
- Maximum amount of PPP loan that may be forgiven would be $3.2 million – or 80% of $4 million – assuming no additional reduction due to a reduction in compensation and no “cure” on or before June 30 for FTE reductions occurring prior to April 26, 2020.

Adjustment Based Upon Reduction in Compensation for Those Employees Who Earned ≤ $100,000 in 2019

- An additional reduction in forgiveness amount to the extent borrower reduces by >25% the compensation paid during the eight-week period to any employee whose annualized compensation in any 2019 pay period did not exceed $100,000.
- Forgiveness amount would be reduced dollar-for-dollar by total amount of compensation reduction during eight-week period that exceeds 25% of total salary or wages for any employee described in the immediately preceding sentence.

Procedure for Applying for PPP Loan Forgiveness

- Borrower would apply for forgiveness to the lender that makes the PPP loan.
- The CARES Act requires lender to make a decision on loan forgiveness within 60 days after lender receives a complete application for loan forgiveness.

What Steps Can a Prospective Borrower Take to Best Position the Borrower to Obtain a PPP Loan?

- Contact your current bank or credit union ASAP.
  - Be patient. During the next several days, your lender may not know much more about PPP than you do.
- The CARES Act authorizes the SBA to guarantee up to $349 billion, including loans under existing SBA lending programs.
- We assume a lender will fund a PPP loan only if it first confirms SBA will guarantee it.
  - We assume SBA will confirm guarantees on a first-come, first-served basis.
- Once outstanding SBA guarantees hit $349 billion, a small business not already approved for a PPP loan will not be able to obtain funding unless Congress expands the program.
  - At this time, it is not certain that Congress will expand the PPP or other SBA programs.

What Steps Can a Prospective Borrower Take to Best Position the Borrower to Obtain a PPP Loan?

- We recommend that potential PPP borrowers their existing banks ASAP to confirm that the bank is planning to offer PPP loans.
  - We understand some banks are planning to give priority to existing customers and will likely make PPP loans to a business that is not an existing customer only if that borrower’s current bank is not participating in the PPP.
  - If a prospective borrower’s existing bank will not be participating in the PPP, we recommend that the prospective borrower next contact a bank in the area that is an SBA preferred lender.

What Steps Can a Prospective Borrower Take to Best Position the Borrower to Obtain a PPP Loan?

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- We recommend that a prospective PPP borrower have the following documents ready:
  - Schedule of employees, confirming that it does not have more than 500 employees
    - Or, if applicable, that it does not have more than the size standard in number of employees established by the SBA for the industry in which the entity operates.
  - Analysis of average monthly “payroll costs” for the past 12 months, showing the amounts included and excluded from the definition of payroll costs.
    - Use 12-month period April 1, 2019 to March 31, 2020 as a starting point but be prepared to update analysis to cover 12-month period prior to origination of PPP loan.
    - Payroll costs are defined broadly to include wages, salaries, retirement contributions, health care benefits, covered leave, and other expenses.

What Steps Can a Prospective Borrower Take to Best Position the Borrower to Obtain a PPP Loan?

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Continued from previous slide

- Worksheet demonstrating that requested PPP loan does not exceed maximum loan limit for which the prospective borrower is eligible.
  - Maximum PPP loan is equivalent to 250% of employer’s average monthly payroll costs during one-year period before the loan is made or $10 million, whichever is less.
- P&L for 2019, but only if available.
  - If a prospective borrower does not have its 2019 P&L readily available, it should not delay contacting its bank until the P&L is prepared.
- Modified version of SBA Form 1919 that SBA is expected to publish shortly.

What If a Prospective Borrower Cannot Obtain a PPP Loan? What Other Options Are Available?

- There are multiple types of loans available through the SBA or SBA preferred lenders, including economic injury disaster loans (EIDL) and emergency grants.
- The SBA's EIDL program is accepting applications from prospective borrowers located in Massachusetts.
- EIDLs are made directly by the SBA.
- Small businesses, private nonprofit organizations of any size, small agricultural cooperatives, and small aquaculture enterprises that have been financially impacted as a direct result of the global COVID-19 pandemic since January 31, 2020 may qualify for EIDLs of up to $2 million to help meet financial obligations and operating expenses which could have been met had the disaster not occurred.

What If a Prospective Borrower Cannot Obtain a PPP Loan? What Other Options Are Available?

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- The interest rate is 3.75% for small businesses and 2.75% for private nonprofit organizations. The SBA offers EIDLs with long-term repayments, up to a maximum of 30 years.
- The CARES Act establishes an emergency grant to allow an eligible borrower who has applied for an EIDL to request an advance on that loan, of not more than $10,000, which the SBA must distribute within three days.
- If the application for an EIDL is denied, the CARES Act provides that recipients are not required to repay emergency advance funds.
- Emergency advance funds can be used for payroll costs, increased material costs, rent or mortgage payments, or for repaying obligations that cannot be met due to revenue losses.

What If a Prospective Borrower Cannot Obtain a PPP Loan? What Other Options Are Available?

- The CARES Act provides a limitation on a borrower from receiving a PPP loan and an EIDL for the same purpose.
- It does allow an eligible borrower who has an EIDL unrelated to the global COVID-19 pandemic to apply for a PPP loan, with an option to refinance that loan into the PPP loan.
- The emergency EIDL grant award of up to $10,000 would be subtracted from any amount otherwise forgiven under the PPP.
- A prospective borrower may not have applications pending concurrently for both an EIDL and a PPP loan.

Programs to Expand Lending to Small and Mid-Size Businesses in Conjunction with Federal Reserve

Programs to Expand Lending to Small and Mid-size Businesses in Connection with the Federal Reserve

- Overview of Section 4003 of CARES Act.
- U. S. Treasury and Federal Reserve Board Section 13(3) Programs and Facilities.
- Main Street Lending Program
  - Small and Mid-size Business loan and liquidity program
- Mid-sized Business Program
  - 500 to **10,000 employees**
  - Certifications (restrictions), including:
    - funds will be used to retain at least 90 percent of recipient's workforce, at full compensation and benefits, until September 30, 2020
    - recipient intends to restore not less than 90 percent of its workforce as of February 1, 2020, and to restore all compensation and benefits to the workers of the recipient no later than 4 months after the termination date of the COVID-19 public health emergency declared on January 31, 2020
- No dividends or buybacks while loan is outstanding.

Commercial and Real Estate Finance Implications

Expansion of Unemployment Insurance Relief

Relief for Workers Affected by Coronavirus Act

- Pandemic Unemployment Benefits available to individuals out of work due to nearly any reason attributable to pandemic.
  - CARES Act allocates $250 billion for unemployment benefits
  - Includes self-employed, those seeking part-time employment, with insufficient work history, or otherwise wouldn’t qualify for benefits
- Extends regular weekly benefits for up to 39 weeks between January 27, 2020 and December 31, 2020.
  - MA benefits are usually about 50% of average weekly wage
- Workers eligible for additional $600 weekly benefit payable until July 31, 2020.

Tax Relief

Payroll Tax Relief

I. **Retention <u>Refundable</u> Payroll Tax Credit on 50% of Qualified EmployeeWages**

- Applies if:
  - A company's operations were fully or partially suspended, or
  - A company's gross receipts declined more than 50% when compared to the same quarter of 2019
- Limited to the first $10k of wages paid, including health benefits
- If more than 100 employees: only wages paid to employees when they are not providing services for COVID-19 related purposes

II. **Payroll Tax Deferral**

- Delay in Payment of Employer Share of Payroll <u>and</u> Self-Employment Taxes (6.2%) during 2020
- Amounts must be paid back:
  - 1/2 by December 31, 2021
  - 1/2 by December 31, 2022

Business Tax Relief – TCJA Reversals

Modification of Limitations on the Use of NOLs

- Restores the ability temporarily for businesses to carry back net operating losses to prior years
- The TCJA previously eliminated this ability as a way to pay for tax cuts
- Businesses may carryback NOLs incurred in 2018-2020 for 5 years, and may fully offset income in the carryback years

Increase of the Limitation on Deductibility of Business Interest Expense

- The Act amends the federal interest deduction limitation by increasing the interest expense deduction limitation from 30% to 50% of business adjusted taxable income, plus any interest income for taxable years beginning in 2019 and 2020.
- For 2020, taxpayers may substitute their adjusted taxable income for their 2019 tax year for their adjusted taxable income for their 2020 tax.

Tax Relief for Individuals/ Benefits

Payments of Student Loans by Employers (in 2020)

- Income exclusion for employees for payment by employer
- Up to the $5,250 employer provided educational assistance cap

Relaxation of Rules for Qualified Retirement Plans (in 2020)

- Relief from required minimum distribution rules
- Relief on 10% early withdrawal penalty for corona-related purposes
    - Taxation on withdrawals spread out over 3 years
    - Recontributions allowed without regard to contribution limits
- Increased flexibility for loans from plans

Increase in Benefits for Charitable Contributions

- A new $300 above-the-line deduction for taxpayers who do not itemize
- Maximum threshold for contributions to public charities has risen from 50% of AGI to 60% of AGI

QUESTIONS?

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