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PAYCHECK PROTECTION PROGRAM FLEXIBILITY ACT

June 5, 2020

Today the Paycheck Protection Program Flexibility Act of 2020 (the "**Flexibility Act**") was signed into law. The Flexibility Act makes significant changes to the Paycheck Protection Program ("**PPP**") and impacts both new and existing PPP loans. Although these changes are generally positive for most borrowers, the Flexibility Act does impose some new requirements and appears to create some new uncertainties and unintended consequences.

Below is a summary of the key changes to the PPP included in the Flexibility Act. If you have any questions, please contact us.

1. **The cap on non-payroll costs has been increased to 40%, with a catch**. A borrower will be able to have its PPP loan forgiven if it spends at least 60% of its PPP loan on eligible payroll costs and no more than 40% on eligible non-payroll costs. Since the prior PPP rules capped non-payroll costs at 25%, this will benefit borrowers with higher non-payroll costs. However, all borrowers should be aware that the 60% threshold for payroll costs now applies to the *entire* PPP loan amount (not just the portion of the loan amount for which forgiveness is requested). In other words, if less than 60% of the PPP loan is spent on payroll costs, there is no forgiveness for any portion of the PPP loan. Although this change applies retroactively to all existing PPP loans, it is unclear how it will be applied in practice to borrowers who are already far along in their 8 week covered period or who voluntarily repaid a portion of their PPP loan (for example, after applying the liquidity/access to capital test).

2. **The covered period is extended to 24 weeks**. Borrowers now have a longer time frame in which to spend their PPP loans. The Flexibility Act extends the "covered period" from 8 weeks after the loan proceeds were received to the earlier of (a) 24 weeks after the loan proceeds were received, or (b) December 31, 2020. This extended covered period applies to all new loans. **Importantly, existing borrowers have the option to continue to use the original 8 week covered period to measure their loan forgiveness or use the new 24 week covered period.** If a borrower does elect to use the 24 week covered period, the borrower will need to maintain the requisite full-time equivalent employee ("**FTEs**") and wage levels for the remaining 16 weeks not funded by the PPP loan proceeds, or else face a significant reduction in loan forgiveness based on its failure to maintain the requisite level of FTEs and wages.

3. **The deadline to restore FTEs and wages is extended from June 30, 2020 to December 31, 2020**. Borrowers now have until December 31, 2020 (instead of June 30, 2020) to restore any reduction in their FTEs that occurred between February 15, 2020 and April 26, 2020 in order to avoid having a reduction in their loan forgiveness amounts based on FTEs. Borrowers also now have until December 31, 2020 to restore wages for continuing employees to at least 75% of what they were as of February 15, 2020 to avoid having a reduction in their loan forgiveness amounts based on wages. This new deadline applies even if a borrower elects to continue to use the 8 week covered period instead of utilizing the 24 week covered period to calculate payroll costs. The impact of this change should be evaluated by any borrower that might need to use this

alternative method to calculate the loan forgiveness reduction based on the level of FTEs. The Flexibility Act did not address the existing uncertainty as to whether a borrower is required to maintain its restored level of FTEs and wages for any specific period of time prior to the deadline.

4. **There is a new safe harbor for borrowers who are unable to restore their FTE levels**. A borrower's loan forgiveness amount will not be reduced due to a reduction in its FTEs if the borrower can document that (a) it was unable to rehire individuals who were employed as of February 15, 2020, and (b) it was unable to hire similarly qualified employees to fill any unfilled positions on or before December 31, 2020. As of the date of this Client Alert there is no guidance regarding the documentation a borrower will need to produce in order to verify the inability to hire, or rehire, employees. Further, it is not clear whether this new safe harbor is intended to supplement or replace the safe harbor reflected in the Small Business Administration's ("**SBA**") Loan Forgiveness Application (the "**Application**") for employees who reject a written offer of employment during the covered period.

5. **There is also a new safe harbor for borrowers that are unable to return to the same level of business activity due to the coronavirus**. A borrower's loan forgiveness amount will not be affected due to a reduction in FTEs if the borrower can document that it was unable to return to the same level of business activity at which it was operating before February 15, 2020 due to having to comply with requirements or guidance relating to sanitation, social distancing or any other worker or customer safety requirement related to the Coronavirus, that was established by the Secretary of Health and Human Services, the Center for Disease Control and Prevention, or the Occupational Safety and Health Administration. However, it does not appear that this safe harbor is available if business activity was reduced solely due to compliance with state restrictions or guidelines or governmental orders, which in some states may be more restrictive than the federal guidelines.

6. **The deferral period for the repayment of unforgiven loans has been significantly extended**. A borrower is not required to begin making payments on the unforgiven portion of its PPP loan until the date on which the forgiveness amount is remitted to the PPP lender by the SBA. Since (a) the covered period can now be as long as up to 24 weeks for a borrower to spend PPP proceeds, (b) a borrower can wait up to 10 months after the covered period ends before applying for loan forgiveness, (c) a PPP lender can take up to 60 days after receipt of a borrower's application to make a decision about the amount of loan forgiveness, and (d) the SBA can take up to 90 days to remit the amount of loan forgiveness to a PPP lender after that decision is made, it could take as long as 20 months before a PPP borrower will need to begin repaying the balance of the loan after forgiveness was applied. This extended deferral period should be very beneficial to borrowers, especially considering that PPP loans have a 1% annual interest rate. If a borrower does not apply for loan forgiveness, repayment of its PPP loan will commence 10 months after the end of the covered period.

7. **The maturity date for new PPP loans is extended to 5 years**. The maturity date for loans made after the date the Flexibility Act was enacted will be 5 years. Although the Flexibility Act does not change the 2 year maturity date for existing PPP loans, the lender and the borrower may agree to extend the maturity date of an existing PPP loan.

8. **Borrowers can now take full advantage of the employer payroll tax deferral**. The Coronavirus Aid, Relief, and Economic Security Act (the "**CARES Act**") allows businesses to defer the deposit and payment of the employer's portion of Social Security taxes and certain railroad retirement taxes, and 50% of the Social Security tax on net earnings from self-employment income, incurred between March 27, 2020 and January 1, 2021. Specifically, a

business can defer paying 50% of such taxes until December 31, 2021 and the remaining 50% until December 31, 2022. Under the CARES Act and prior SBA guidance, this deferral was not available to a borrower once it was notified that its loan was forgiven. The Flexibility Act removed this restriction and now a PPP borrower can take full advantage of the deferral even if its PPP loan is forgiven. Since this deferral is effectively a loan at a 0% interest rate for at least 30 months, borrowers who have not already taken advantage of this deferral should consider doing so.

While the Flexibility Act addresses some of the many questions surrounding the details of the PPP, it also gives rise to some new uncertainties. We expect that the Treasury Department will revise its Application in light of the Flexibility Act and it may, through an updated Application or through further FAQs or rulemaking address some of the open questions (and, if past is prologue, alter existing expectations as to how loan forgiveness will work). All participants in the PPP should remain alert for an updated Application and further guidance.

Notwithstanding the possibility that the existing Application may be updated, we remind all borrowers to take the time to calculate their projected forgiveness in detail by following the instructions in the existing Application. The changes effected by the Flexibility Act, notably the option to use the original 8 week covered period or to extend to 24 weeks, and the change in the measuring date for the safe harbor in restoring a borrower's workforce, each could have a significant impact on how a borrower should use its loan proceeds and maximize loan forgiveness. **We recommend that each PPP borrower do pro forma projections of loan forgiveness now.** Those projections should be as of the end of the 8 week period as well as of the end of the 24 week period. Based on our conversations with PPP borrowers, it appears that many have not yet done an initial projection of loan forgiveness and many of those that have done their projections were surprised to learn that their initial understanding of the loan forgiveness amount was inaccurate due to their failure to fully understand the nuances of the loan forgiveness rules as implemented by the Application.