Updates
April 29, 2020

# The CARES Act: Key Loan and Grant Programs for Nonprofit Organizations

**Update:**

**Certification That Funds Are "Necessary"**

Following recent press and new guidance from the Small Business Administration (SBA), many nonprofit organizations are carefully considering whether borrowing funds under the Paycheck Protection Program (PPP loans) is "necessary" for their organization, a critical component of the loan application. This applies both to previous applicants and those planning to apply following the over $300 billion in newly-appropriated funds for PPP loans under the most recent federal legislation.

Certain nonprofit organizations are clearly experiencing extreme economic uncertainty and funding issues, and have had no issues comfortably certifying to their lender and the SBA in their PPP loan application that "economic uncertainty makes [the PPP] loan request necessary to support the ongoing operations of the Applicant." But for those organizations with larger endowments or other access to material liquidity, this standard remains amorphous.

The SBA has since released additional guidance regarding the "necessary" certification, aimed mostly at large public companies and private companies with adequate sources of liquidity. That guidance emphasizes the importance of carefully considering and documenting how the organization reached its conclusion that the PPP loan was necessary to support ongoing operations. *See* SBA FAQ Questions 31 and 37, published April 23, 2020, and April 28, 2020.

This new guidance has not made the certification rules any laxer, and if anything, it further discourages large, well-funded businesses from borrowing funds. The guidance, for example, gives borrowers the opportunity to return funds by May 7, 2020, and be deemed to have made the "necessary" certification in good faith (i.e., no further scrutiny from the SBA if the funds are returned during this grace period, including by organizations who may be questioning their prior certifications). The guidance also reminds borrowers that they should be prepared to demonstrate to the SBA, upon request, that their certification took into account current business activity and the organization's "ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business." On April 28, 2020, Treasury Secretary Steven Mnuchin further emphasized that PPP loans were intended for small businesses, not companies with access to other capital. Mnuchin stated that all loans greater than $2 million for government relief programs for small businesses, such as the PPP loans, would be audited to ensure borrowers complied with the "necessity" requirements.

Nonprofit organizations may still have a wide degree of latitude to make the certification given the current unpredictability. For example, will daily life and/or the economy return to "normal" in 2 months, 6 months, 18 months? Even for those entities that currently have material cash on hand, PPP loan proceeds may still be "necessary" to keep the organization running at capacity without creating a financial cliff in the near future. Moreover, other organizations may not easily be able to access their endowments under their governing documents. But the recent SBA guidance and risk of audit certainly emphasizes the need for all nonprofit organizations to exercise caution and care when applying for PPP loans, and ensuring they document their thought process to the extent possible. This is especially true given that the organization may need to prove the funds were "necessary" before the extent of the economic toll is really known.

Finally, media organizations like the *Wall Street Journal* have publicly disclosed their Freedom of Information Act (FOIA) requests made to the U.S. government for further information about PPP loan borrowers' identity and loan details. The SBA has so far rejected these requests to focus its resources on other tasks, but the SBA has also indicated that it will turn its efforts to providing loan-specific data to the public in the future.

**Calculating FTE Employees**

The SBA also issued additional guidance on calculating employees status for purposes of PPP loan eligibility and forgiveness. *See* SBA FAQ Question 36, published April 26, 2020. For determining loan *eligibility*, "employees" include "individuals employed on a full-time, part-time, or other basis," without adjustment for those working less than full time. The SBA published a simple example: "[I]f a borrower has 200 full-time employees and 50 part-time employees each working 10 hours per week, the borrower has a total of 250 employees." For determining loan *forgiveness*, the borrower can use the classic definition of "full-time equivalent employees" (FTEs). Under the prior example, rather than 250 employees, the FTE equivalent would be 212.5 (or 200 full time + 50 working at 25% hours).

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The recently-enacted Coronavirus Aid, Relief, and Economic Security (CARES) Act expands nonprofits' access to critical federal loan and grant programs as part of its approximately $2 trillion aid package addressing the COVID-19 economic fallout. The Small Business Administration (SBA) will run multiple programs that broaden access to loans—some of which are partially forgivable—and provide emergency cash grants. While these programs also serve for-profit businesses, this update focuses on nonprofits and provides a high-level summary of the following programs:

- Paycheck Protection Program loans (PPP loans) to support smaller-size 501(c)(3) charitable organizations or 501(c)(19) veterans' organizations in making payroll and other essential payments during the COVID-19 crisis
- Economic injury disaster loans (EIDLs) up to $2 million, and emergency cash grants up to $10,000 for private nonprofit organizations
- Mid-size organization loans and guarantees as part of the industry stabilization fund program, available to private nonprofit organizations with between 500-10,000 employees

Nonprofits may qualify for one or more of these loan and grant programs, each of which will likely face significant immediate demand. Perkins Coie can help answer questions about your eligibility, as well as advising on navigating these complex programs to address your organization's immediate cashflow needs (for example, the CARES Act contemplates the emergency cash grants being made within three days of application).

# PPP Loans

PPP loans expand the SBA's current 7(a) loan and guarantee program through the following changes:

- Simpler borrower eligibility criteria
- Increased maximum dollar amount of 7(a) loans
- Broader permissible uses of loan proceeds
- Waiver or reduction of SBA fees
- Partial loan forgiveness and repayment deferral for 6-12 month

PPP loans are made by approved SBA-certified lenders (e.g., eligible banks), and will be available through June 30, 2020. The federal government also will guarantee 100% of PPP loans made by SBA-certified lenders through June 30, 2020. The following sections discuss the key aspects of PPP loans and certain practical measures for nonprofits to consider, and incorporate additional guidance provided by the SBA in its interim final rule regarding implementation of the PPP.

**Eligibility:** PPP loans are available to 501(c)(3) nonprofit organizations or 501(c)(19) veterans' organizations with not more than 500 employees (which includes individuals employed on a full-time, part-time, or other basis). The SBA has clarified that faith-based organizations that are otherwise eligible to receive loans are eligible regardless of whether they provide secular social services. Certain federal nondiscrimination requirements apply while the organization has an outstanding obligation to the government. The SBA has clarified that for faith-based organizations that receive loan proceeds, these requirements apply to goods, services, or accommodations offered generally to the public (e.g., a restaurant or thrift store), but that it is not the federal government's intent to limit most other activities or impose substantial burdens on faith-based loan recipients. PPP loans do not test creditworthiness or repayment ability. Instead, qualifying nonprofits must have been in operation on February 15, 2020, and have employees for whom the nonprofit paid salaries and payroll taxes. Eligible borrowers must certify that (1) the uncertainty of current economic conditions makes the loan request necessary to support its ongoing operations, (2) the funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments, and (3) they are not receiving duplicative funds for the same uses under another SBA program.

**Maximum Loan Amount, Interest, and Term:** The maximum dollar amount of the loan is the lesser of (1) 250% of the average monthly payroll costs incurred during the one-year period before the loan is made and (2) $10 million. If the nonprofit employs seasonal workers, it can opt to use the average monthly payroll costs for the 12-week period beginning February 15, 2019, or the period from March 1, 2019, through June 30, 2019. Payroll costs include salary, wages, sick leave (unless otherwise addressed by separate paid-leave tax credits), health benefits, pension benefits, and state taxes. Payroll costs exclude payments to independent contractors and the items described below.

For any amounts not forgiven (see "Loan Forgiveness," below), the SBA announced the interest rate for PPP loans will be 1% and the term will be 2 years (with a maximum 4% interest rate and a maximum maturity of 10 years provided by the CARES Act). The SBA will provide a 100% guarantee for any remaining balance on the loan after forgiveness.

**Use of Proceeds:** Eligible nonprofits may use the loan proceeds for the following:

1. Payroll costs (including compensation, salary, wages, and commissions)
2. Costs related to group healthcare benefits including healthcare premiums, retirement benefits, and payment of state or local employment tax
3. Paid sick, medical, vacation, parental, or family leave
4. Allowance for dismissal or separation
5. Interest on mortgage (but not prepayments or payments on principal)

6. Rent and utilities
7. Interest on any prior debt existing before February 15, 2020

The average monthly payroll costs exclude, and PPP loan proceeds cannot be used to pay, compensation over $100,000 (as prorated for the covered period), certain taxes, compensation of employees whose principal place of residence is outside the US, or qualified sick and family leave, if addressed by tax credits in other recently-enacted relief legislation (i.e., the Families First Coronavirus Response Act). Borrowers who use PPP loans for unauthorized purposes will be required by the SBA to repay those amounts, and if borrowers *knowingly* used PPP loans for unauthorized purposes, they may be subject to additional liability such as fraud charges.

**Collateral and Fees:** PPP loans have no loan fees and no prepayment fees. They also do not require collateral or personal guarantees. The SBA will establish application fee caps for lenders who charge application fees.

**Loan Forgiveness:** The loan forgiveness features of PPP loans are a critical consideration for nonprofits. Borrowers will be eligible for loan forgiveness equal to the amount they spend during the eight-week period after the loan origination date on the following:

1. Payroll costs
2. Mortgage interest payments (on mortgages incurred prior to February 15, 2020)
3. Rent payments (on leases in force prior to February 15, 2020)
4. Utility payments (for services that began prior to February 15, 2020)

Loan forgiveness would not apply to proceeds used to pay vendors or existing debt obligations. For the PPP loan to be forgiven, non-payroll costs may not make up more than 25% of the loan forgiveness amount, and at least 75% of PPP loan proceeds must be used for payroll costs. Borrowers will be required to provide documentation verifying how proceeds are used. In addition, while the CARES Act provides for forgiveness of all or a portion of the principal amount loaned under the PPP loans, the SBA interim final rules indicate that interest accrued on a PPP Loan may also be subject to forgiveness, subject to the limitations set forth in the CARES Act and elsewhere in the interim final rule. The interim final rule notes that additional guidance will be issued by the SBA regarding loan forgiveness.

The amount forgiven will also be reduced proportionally by any reduction in employees compared to the prior year, and certain pay reductions of employees beyond 25% of their prior year compensation. To encourage employers to rehire any employees who have already been laid off due to the COVID-19 crisis, borrowers that rehire workers previously laid off will not be penalized for having a reduced payroll at the beginning of the period. There will also be reductions if a PPP loan is used to pay employee salaries in excess of $100,000 on an annualized basis. Any PPP loan amounts not forgiven will be carried forward as an ongoing loan under the rate and terms listed above.

**Other Practical Considerations for PPP Loans**

**Applying for PPP Loans:** Applications will be accepted on a first-come, first-served basis, and eligible borrowers will receive only one PPP Loan. Accordingly, the SBA encourages borrowers to apply for the maximum amount. The SBA has provided additional guidance on documentation to be used to establish eligibility for a PPP Loan, including payroll processor records, payroll tax filings, Form 1099-MISC for independent contractors, or records of income and expenses from a sole proprietorship. In the absence of such documentation, lenders may rely on other supporting documentation, such as bank records, that are sufficient to demonstrate the qualifying payroll amount.

**Finding a Certified 7(a) Lender for PPP Loans:** As stated above, 7(a) loans, including PPP loans, are provided by SBA-certified lenders including many major banks. Nonprofits should start by contacting their existing bank to confirm whether it is an SBA-certified lender. If a nonprofit's existing bank is not SBA-certified, we recommend contacting other local community banks for PPP application assistance. A third option is the SBA's website that matches lenders to potential borrowers. SBA-certified lenders will undoubtedly be inundated by loan applications, and the CARES Act provides for a fast track approval process to become an SBA-certified lender. But the ability of new lenders to be certified quickly to provide these loans is speculative.

- **Navigating SBA-Lender's Approval Process:** The CARES Act delegates authority to certified SBA lenders to make and approve PPP loans based only on whether an eligible borrower (1) was in operation on February 15, 2020, and (2) had employees for whom the borrower paid salaries and payroll taxes. This eliminates the typical criteria of creditworthiness and repayment ability. However, there are hundreds of pages of regulations regarding borrower qualifications for an SBA guaranteed loan, and every bank has its own underwriting criteria. Under current law, the paperwork required to obtain a 7(a) loan is voluminous and the process is extremely lengthy. As the intent of the act is to put money in the hands of small businesses quickly, one would expect that these standards would be modified but there is no guidance as to what those changes (if any) may be.
- **Timing:** Although the CARES Act seeks to fast track new SBA lenders and set standards to incentivize lenders to act quickly, governmental agencies are constrained by staffing and funding issues to move that quickly. Nonprofits should expect that receipt of funds or application approval may be delayed due to the expected volume of applications from other organizations and businesses.

# Economic Injury Disaster Loan and Grant Program

The CARES Act expands the SBA's existing Economic Injury Disaster Loan (EIDL) program, which provides loans and grants to eligible entities including private nonprofit organizations (other than certain religious or political organizations).

- **Loans:** The EIDL program provides loans of up to $2 million to eligible entities that suffer substantial injury as a result of the COVID-19 pandemic. Interest rates for EIDLs are low, and there are no upfront charges or prepayment penalties. Personal guaranties for loans over $200,000 are waived from January 31, 2020, through December 31, 2020, however, the SBA may require the applicant to pledge collateral for loans greater than $25,000. The SBA, however, will not decline a loan if the applicant lacks collateral so long as the SBA can be reasonably sure that the loan can be repaid. The size and term of the loans (up to 30 years) are determined on a case-by-case basis.
- **Emergency Grants:** In addition, private nonprofit organizations may apply for EIDL emergency grants of up to $10,000, which the SBA intends to disburse in as few as three days after receiving a qualified application. Unlike the loans, these grants do not have to be repaid. EIDL emergency grants may be used for numerous purposes, described below.

The following sections discuss the key aspects of loans and grants under the EIDL program, as well as certain practical measures, for private nonprofits organizations to consider.

**Eligibility:** All private nonprofit organizations that have been in operation since January 31, 2020, and that have suffered substantial economic injury from COVID-19, are eligible for loans and grants under the EIDL program. Private nonprofit organizations include tax-exempt organizations under 501(c), (d), and (e) of the Internal

Revenue Code and nonprofits under state law. The SBA has clarified that faith-based organizations that are otherwise eligible to receive loans are eligible regardless of whether they provide secular social services. Certain federal nondiscrimination requirements apply while the organization has an outstanding obligation to the government. The SBA has clarified that for faith-based organizations that receive loan proceeds, these requirements apply to goods, services, or accommodations offered generally to the public (e.g., a restaurant or thrift store), but that it is not the federal government's intent to limit most other activities or impose substantial burdens on faith-based loan recipients. Certain eligibility requirements are waived from now until December 31, 2020, including, for example, that organizations be in operation for a year and show they could not obtain funds from elsewhere. The CARES Act also waives the requirement of a personal guarantee on loans of up to $200,000.

Eligible entities are no longer required to submit tax returns to the SBA to prove their ability to repay the loans. Instead, the SBA will assess the ability of an eligible entity to repay the loan solely through the applicant's credit score, or "alternative appropriate methods to determine an applicant's ability to repay."

Private nonprofit organizations that are primarily engaged in political or lobbying activities, however, are not eligible under the EIDL program.

**Maximum Loan Amount, Interest, Term, and Use of Funds:** Although specific terms and amounts are determined on a case-by-case basis, the maximum loan amount an eligible entity may receive is $2 million and the maximum term is 30 years. The interest rate for all loans to private nonprofit organizations is 2.75% (for-profits have a rate of 3.75%). Proceeds of EIDLs must be used for working capital purposes necessary to carry on the organization's business, which may include the payment of fixed debts, payroll, accounts payable, sick leave, and other obligations that cannot be met because of COVID-19's impact. EIDL proceeds, however, cannot be used to refinance indebtedness incurred prior to the disaster event, to make payments on other loans owed to a federal agency, to pay tax penalties or government fines, repair physical damages, or pay dividends to owners (except for reasonable payments directly related to their performance of services for the company). Failure to properly apply the EIDL proceeds may result in fines, or even criminal prosecution. Private nonprofit organizations should also make sure that any use of EIDL proceeds does not result in the organization losing its tax-exempt status.

**Maximum Grant Proceeds and Use of Funds:** The maximum amount receivable under an EIDL emergency grant is $10,000, which does not need to be repaid. The emergency grants may be used for the following purposes:

1. Providing paid sick leave to employees unable to work due to COVID-19
2. Maintaining payroll to retain employees during business disruptions or substantial slowdowns
3. Meeting increased costs to obtain materials due to interrupted supply chains
4. Rent or mortgage payments
5. Repayment of obligations which cannot be met due to revenue loss

### Other Practical Considerations for EIDL Program Loans and Grants

**Tax-Exempt Status:** Although the definition of "nonprofit organizations" in the CARES Act related to the PPP loans only includes those organizations that are exempt under 501(c)(3), the list of private nonprofit organizations eligible for EIDL program loans and grants is comprehensive, and includes entities such as civic leagues, clubs, and religious organizations. In addition, nonprofit corporations or entities that receive funds as part of a fiscal sponsorship relationship, but which are not themselves 501(c), (d), or (e) exempt, may still be eligible entities but at the increased interest rate of 3.75% applicable to other business entities.

**Timing:** The CARES Act states that, upon request, an eligible entity may receive an EIDL emergency grant within three days of receipt of its application. Due to estimated demand and staffing limitations, it is unclear at this time whether this expedited timeline will be consistently met. EIDL grants and expanded loan eligibility are only available until December 31, 2020. Applications should be submitted as early as possible to ensure receipt of funds.

Existing SBA Loans and EIDL Program Loans: If a business has a COVID-19-related loan under the EIDL program, it has the option to refinance the EIDL loan under the PPP or reduce the amount of its PPP loan that can be forgiven by the amount of the EIDL loan.

**Applications:** To submit an application, follow the application instructions at the Economic Injury Disaster Loan Assistance website.

Industry Stabilization Fund Loans and Guarantees

Nonprofits employing between 500 and 10,000 people may be eligible for certain midsize business loans as part of the industry stabilization fund established by the CARES Act. The loans will generally carry a maximum interest rate of 2%, and will not accrue interest or require repayment for the first six months. Nonprofits that take out these midsize business loans must retain or rehire at least 90% of their staff (at full compensation).



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