The Real Estate Roundtable

8-Point Plan to Reform the Payroll Protection Program

Small Business Loans Under the CARES Act

April 8, 2020

PAYROLL PROTECTION PROGRAM
8-POINT REFORM PLAN[1]

1. Expressly Waive SBA's Business "Ineligibility" Rule Governing its "Regular" Loan Programs, to Give Real Estate and Other Industries Clarity on Their PPP Eligibility.

2. LLPs and LLCs as Duly Formed and Recognized Under State Law Should be Their Own Entity Eligible for PPP Loans.

3. Congress Waived the SBA "Affiliation Rules" Only for Restaurants and Hotels. It Should Not Pick Industry "Winners and Losers," and Should Waive the Affiliation Rules for *All* Industries.

4. Loan Amounts Should be Calculated Relative to Business "Operating Expenses" — Not Only "Payroll Expenses."

5. SBA and Treasury Should Not Restrict PPP Loans and Forgiven Amounts with a "One Size Fits All" Rule that Limits Coverage for Rent and Other Business Expenses.

6. Property Owners Should Have Flexibility to Work with Their 3rd-Party Management Companies in Counting Workers for the "500-Employee" Threshold.

7. Businesses Should Have Flexibility to Not Count Part-Time Employees in the "500 Cap" – Because if the Cap is Exceeded None of Its Employees Get Payroll Protection.

8. Multifamily Building Owners Should be Eligible for PPP Loans to Help Cover Mortgage Principal — During the *CARES* Act Period that Tenants Are Protected from Evictions.

[1] This document is based on The Real Estate Roundtable's on-going review of the *CARES* Act and interpretive rules and guidance. It is subject to change.

4/8/2020

PPP PRIORITY #1:

EXPRESSLY WAIVE SBA'S BUSINESS "INELIGIBILITY" RULE GOVERNING ITS "REGULAR" LOAN PROGRAMS, TO GIVE REAL ESTATE AND OTHER INDUSTRIES CLARITY ON THEIR PPP ELIGIBILITY

Summary:

- In the *CARES* Act, Congress said that ***"any"*** business concern meeting certain small business size standards is eligible for a PPP loan.[2]

- Guidance from the U.S. Treasury released on April 6 affirms the *CARES* Act's broad coverage for the kinds of businesses that are PPP eligible. Q&A #3 in the Treasury guidance states:
  - "***Question:*** Does my business have to qualify as a small business concern (as defined in section 3 of the Small Business Act, 15 U.S.C. 632) in order to participate in the PPP?"
  - "***Answer:*** No. In addition to small business concerns, a business is eligible for a PPP loan if the business has 500 or fewer employees whose principal place of residence is in the United States, or the business meets the SBA employee-based size standards for the industry in which it operates (if applicable)."[3]

- SBA's "Interim Final Rule" that took effect on April 2 somewhat muddies the waters. While Treasury states that its April 6 Q&A guidance can be relied upon to reflect the view that "any" business concern (with 500 employees or less) is PPP eligible,[4] the SBA's own April 2 rule offers an interpretation regarding PPP non-eligibility
  - "Businesses that are ***not eligible*** for PPP loans are identified in 13 C.F.R. § 120.110."[5]
  - In turn, this existing SBA regulation (§ 120.110) lists a number of business types that are ***not*** eligible for SBA loans under its "regular" program, including:

    "(c) Passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds (except Eligible Passive Companies under § 120.111)"[6]

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[2] Section 36(D) [p. 14, line 9]

[3] Available at: https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequenty-Asked-Questions.pdf

[4] The Treasury Q&A also states (at page 1): "Borrowers and lenders may rely on the guidance provided in this document as SBA's interpretation of the CARES Act and of the Paycheck Protection Program Interim Final Rule ('PPP Interim Final Rule')."

[5] Interim Final Rule, pp. 7-8, available at https://www.sba.gov/sites/default/files/2020-04/PPP--IFRN%20FINAL_0.pdf

[6] 13 C.F.R. § 120.111 – regarding *Eligible* Passive Companies – states: "An Eligible Passive Company must use loan proceeds only to acquire or lease, and/or improve or renovate, real or personal property (including eligible refinancing), that it leases to one or more Operating Companies for conducting the Operating Company's business, or to finance a change of ownership between the existing owners of the Eligible Passive Company."

- SBA's April 2 rule implementing the PPP also cross references and would attempt to incorporate an agency interpretive manual used for its "regular" loan program. SBA's "Standard Operating Procedure Manual 50-10 5(K)" indicates an interpretation under the "regular" loan program that real estate businesses are ineligible for ordinary Section 7(a) loans. [7]

➢ To further complicate matters, both the *CARES* Act and the Treasury Q&A state "typical" small businesses that meet size thresholds for "regular" SBA loans can qualify for PPP loans (in addition to "500-employee" businesses). [8]
  - These existing rules indeed ***include*** "Real Estate Rental and Leasing" concerns as "regular" program-eligible, assuming they meet small business size standards based on an annual gross receipts threshold (not an employee level threshold).[9]

➢ In short: For Real Estate Development and Leasing businesses to receive clarity on whether they can qualify for PPP loans, they need to consult a guidance from Treasury, a manual from SBA, and four separate SBA rules – all to ascertain whether they are within the term "***any*** business concern" as Congress broadly stated in the *CARES* Act.

Solutions:

➢ **Regulatory:** SBA should clearly effectuate Congress's intent and plainly state that a business that develops or leases residential or commercial real estate is eligible for the PPP as "any" concern that employees 500 employees or fewer.

  - SBA should expressly state in a subsequent regulation or guidance that the rule at 13 C.F.R. § 120.110 does ***not*** apply to legal business operations – including real estate development and leasing.
  - SBA should also state in a subsequent regulation or guidance that its Standard Operating Procedure Manual 50-10 5(K) does ***not*** preclude legal businesses from receiving PPP loans – including real estate development and leasing.

➢ **Legislative:** If SBA does not so clarify, Congress should amend the *CARES* Act by waiving the ineligibility provisions at 13 C.F.R. § 120.110 and in SOP Manual 50-10 5(K) for legitimate business concerns, including real estate development and leasing.

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[7] Sections III.A.3(b)-(g) of the manual. The Interim Final Rule (top of p. 8) refers to Standard Operating procedure (SOP) 50-10 5(K), "Lender and Development Company Loan Programs" (effective April 1, 2019), available at: https://www.sba.gov/sites/default/files/2019-02/SOP%2050%2010%205%28K%29%20FINAL%202.15.19%20SECURED%20copy%20paste.pdf

[8] Section 36(D) [p. 14, lines 8-9] ("… ***in addition to*** small business concerns, ***any*** business concern …). See also *supra*, note 2.

[9] 13 C.F.R. § 121.201. Sector 53: Lessors of Residential Buildings (Subsector 53110); Nonresidential Buildings, except Miniwarehouses (Subsector 531120); Miniwarehouses and Self-Storage Units (Subsector 531130); Other real Estate property (531190). Annual gross receipts not to exceed $30 million, except for leasing to the Federal Government, where the annual receipts threshold is not to exceed $41.5 million.

PPP PRIORITY #2:

LLPs and LLCs as Duly Formed and Recognized Under State Law Should Be Their Own Entity Eligible for PPP Loans

Issue:

- In the *CARES* Act, Congress said that "any business concern" meeting small business sizing criteria is eligible for a PPP loan.
- State law – not Federal law – establishes the rules and regulations for business concerns to legally form as corporations, partnerships, or other ventures.
- The *CARES* Act and implementing SBA/Treasury rules should respect these business formation structures as duly recognized and created by State laws.
- In existing regulations governing the "regular" SBA program,[10] SBA indeed defers to these State-level business formation laws. It recognizes that a "business concern" may be in the legal form of a partnership, limited liability company, corporation, joint venture, association, trust or cooperative.
- SBA and/or Congress should make clear that this regulation applies to the PPP program.
- Any individual LLP, LLC, or other entity legally formed under State partnership, corporation, or similar laws should be eligible for its ***own*** PPP loan as a "business concern" (assuming the entity has 500 employees or less or meets regular SBA program size standards).

Solutions:

- **Regulatory:** SBA should expressly state in a subsequent regulation that its existing "business concern" definition at 13 C.F.R. § 121.105(b) applies to the PPP program – and that each legally-formed entity as recognized by State law is eligible for its own loan.

- **Legislative:** If SBA does not so clarify, Congress should undertake this clarification by amending the *CARES* Act. It should codify the "business concern" rule at 13 C.F.R. § 121.105(b) and state that each legally-formed LLP, LLC, etc., is eligible for its own individual PPP loan.

[10] 13 C.F.R. § 121.105(b)

PPP PRIORITY #3:

CONGRESS WAIVED THE SBA "AFFILIATION RULES" ONLY FOR RESTAURANTS AND HOTELS. IT SHOULD NOT PICK INDUSTRY "WINNERS AND LOSERS," AND SHOULD WAIVE THE AFFILIATION RULES FOR ALL INDUSTRIES

Issue:

- A business qualifies for a PPP loan if it meets existing program "small" size standards or if it employs less than 500 employees.[11]
- A key question for a business to determine if it falls under the 500-employee cap arises in the context of "affiliated businesses."
  - Should employees be added up and counted across all affiliates?
  - Or should employees only be counted "per affiliate" or "per physical location" of the business?
  - If a business must aggregate employees across all individual locations, it could exceed the 500-employee cap and thus become PPP ineligible.
- There is no simple answer to these affiliation questions.
  - SBA has adopted a byzantine "affiliation rule"[12] that sets forth a number of fact-specific, subjective criteria to determine when one concern is an "affiliate" of the other.
  - The affiliation rule raises so many difficult questions that SBA created a separate "Compliance Guide"[13] to try and explain it.
- In the *CARES* Act, Congress recognized the complexity of the affiliation rule.
  - It waived the rule – ***but only for hotels, restaurants, bars,*** and similar businesses covered by "NAICS Code 72" and franchise locations.[14]
  - The practical effect of this waiver means that more hotels and restaurants will receive PPP loans. They can "disaggregate" employees across all affiliated locations and have a better chance of falling under the 500 employee cap.

Waiving the affiliation rule for "NAICS Code 72" hotels and restaurants is a great start. But it does not go far enough.

- Health care and senior living facilities (NAICS Code 62) must aggregate employees across locations. This means fewer payroll loans to help doctors, nurses, caretakers, and other support staff on the front lines of the public health emergency.
- Retail locations (NAICS Code 45) must aggregate across locations. This means workers stocking shelves in supermarkets, and sales associates employed by all of the stores that have been shuttered, get less payroll protection.

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[11] Section 36(D)(i) [p. 14 lines 8-9, 17]

[12] 13 C.F.R. § 121.103

[13] See https://www.sba.gov/sites/default/files/affiliation_ver_03.pdf

[14] Section 36(D)(iv)(I),(II) [p. 16, lines 8-24]. Franchise locations assigned a code on SBA's Franchise Directory also benefit from the affiliation rule waiver.

- Warehousing (NAICS Code 49) must aggregate across locations. Workers enabling our supply chain should not have to worry about their next paycheck and their employers should have full opportunities to obtain PPP loans.
- Owners and lessors of commercial and residential properties (NAICS Code 53) – that must keep buildings safe, healthy and operable for residents and tenants during the pandemic even though rental revenue stream are drying up – should receive full and fair access to access to PPP loans.
- Workers at tourist attractions, museums, and theaters (NAICS Code 71) merit payroll protections to the same extent as hotel and restaurant employees at businesses within the next sequential industry code (NAICS Code 72).
- Congress should not pick and choose industry "winners and losers" in waiving the affiliation rules.
- It should waive the affiliation rules temporarily for all industry sectors, so all workers can benefit.

Solution:

- Congress should be neutral on the categories of businesses that seek PPP loans. The ***type*** of business should not matter; it should only matter that the business is ***"small."***
- Congress should reform the *CARES* Act and waive the affiliation rule at 13 C.F.R. § 121.103 for ***all*** industry sectors during the PPP "covered period."

PPP PRIORITY #4:

LOAN AMOUNTS SHOULD BE CALCULATED RELATIVE TO BUSINESS "OPERATING EXPENSES" — NOT ONLY "PAYROLL EXPENSES"

Issue:

- The maximum amount of a PPP loan is $10 million or 2.5 times payroll — whichever is less.[15]
- The allowable uses of the loan are to pay costs for payroll, and related health care and other benefits – but also to help pay mortgage interest, rent, utility bills, and interest on other debt obligations.[16]
- The formula to calculate the loan amount should reflect ***all*** of the loan uses that Congress allowed— not only just for payroll expenses.
- 2.5 times payroll is too limited.

Solution:

- Congress should reform the *CARES* Act to fully reflect the availability of loan proceeds for all "allowable uses."
- Congress should amend the *CARES* Act to state that the loan amount formula should be 2.5 times a business's "operating expenses" or $10 million, whichever is less.

[15] Section 36(E) [starting at p. 17, line 23]
[16] Section 36(F) [starting at p. 20, line 3]

PPP PRIORITY #5:

SBA AND TREASURY SHOULD NOT RESTRICT PPP LOANS AND FORGIVEN AMOUNTS WITH A "ONE SIZE FITS ALL" RULE THAT LIMITS COVERAGE FOR RENT AND OTHER BUSINESS EXPENSES

Issue:

- In the *CARES* Act, Congress said that a business can use PPP loans to help cover payroll, employee health and other benefits, rent payments, mortgage interest, utility bills, and other debt obligations.[17]
- Moreover, the Federal government will forgive eight weeks of these costs.[18] The "forgiveness" allowance basically converts the eight week portion of the loan to a grant.
- However, in the Interim Final Rule that SBA released on April 2, it divined a requirement that no more than 25% of PPP loan amounts, or forgiveness amounts, can be used for non-payroll items.[19]
- A U.S. Treasury "fact sheet" similarly states: "Due to likely high subscription, it is anticipated that not more than 25% of the forgiven amount may be for non-payroll costs."[20]
- The "No More Than 25% for Non-Payroll" standard has no basis in the *CARES* Act.
- Businesses should be left to decide how they best want to use PPP loans – as long as proceeds are devoted to statutory "allowable uses."
  - Other state and federal resources may help cover salary, wages, and health benefits.
  - A small business might need the PPP loan to pay rent or other operating expenses, and help the business avoid mortgage default. Employees will suffer if the buildings in which they reside or work are foreclosed upon by a lender.

Solutions:

- **Regulatory:** In subsequent rulings or guidance, SBA and Treasury should explicitly withdraw the standard that no more than 25% of PPP loan proceeds or forgiven amounts can be used for mortgage interest, rent or other allowable non-payroll uses.

- **Legislative:** If SBA and Treasury do not withdraw the "25% Rule" on their own accord, Congress should expressly rescind it in subsequent COVID-19 response legislation.

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[17] Section 36(F) [p. 20 starting at line 1]

[18] Section 1106(a)(3) (8-week "covered period) [p. 41, line 24]; §§ 1106(b), (c) (forgiveness of payroll, mortgage interest, rent, and utility during "covered period" treated as "canceled indebtedness") [p. 43 starting at line 3].

[19] SBA Interim Final Rule, pp. 14, 18.

[20] See https://home.treasury.gov/system/files/136/PPP--Fact-Sheet.pdf

PPP PRIORITY #6:

PROPERTY OWNERS SHOULD HAVE FLEXIBILITY TO WORK WITH THEIR 3RD-PARTY MANAGEMENT COMPANIES IN COUNTING EMPLOYEES FOR THE "500" THRESHOLD

Issue:

- Frequently in the real estate business, a building owner will hire a third-party management company to handle tasks like hiring employees (such as building maintenance and security staff), administering payroll, collecting rent, and paying utilities.
- Retaining an experienced third-party property manager gives the building owner more free time to develop its core business rather than deal with day-to-day tenant and building operational issues.
- In terms of counting employees for the "500" threshold to get a PPP loan:
  - Are the employees counted by the property owner who ultimately bears the economic cost of payroll?
  - Or are they counted by the third-party management company who hired the workers and who issues their payroll?
- Policy makers should provide flexibility here. It should leave the decision to the property owner and the third-party property manager to resolve.
- The decision to count employees should fall under ***either*** the property owner ***or*** the third-party property manager, as may best suit a given situation.

Solutions:

- **Regulatory:**
  - SBA should expressly state in a subsequent regulation that businesses and third-party management companies have flexibility in counting employees related to their respective operations.
  - As long as the property owner and third party manager make a good faith certification that they do not "double dip" and count the same employees, SBA should give them leeway on this question when the apply for PPP loans.

- **Legislative:** If SBA does not so clarify, Congress should undertake this clarification by amending the *CARES* Act and expressly allowing flexibility on PPP "employee count" matters for property owners and third-party managers.

PPP PRIORITY #7:

BUSINESSES SHOULD HAVE FLEXIBILITY TO NOT COUNT PART-TIME EMPLOYEES IN THE "500 CAP" – BECAUSE IF THE CAP IS EXCEEDED NONE OF ITS EMPLOYEES GET PAYROLL PROTECTION.

Issue:

- The *CARES* Act defines "employee" for purposes of the 500-level criterion as a term that "includes individuals employed on a full-time, part-time, or other basis."[21]
- The text does ***not*** state "*shall* include … part-time" employees.
- Small businesses in key sectors like hotels, restaurants, tourism, and construction rely heavily on seasonal, on-call labor and could rapidly exceed the 500-employee cap if the part-time segments of their workforce must be counted.
- The intent of the *CARES* Act is furthered by reaching as many small business concerns as possible and covering as much payroll and other allowable costs as possible, to benefit workers.
- Latitude should be given to only include full-time employees within the "500" count.
- ***All*** employees at a business concern – including full-time workers -- could suffer and lose the *CARES* Act's payroll protections if part-time workers must be counted for the "500 cap" and the employer exceeds the threshold.

Solutions:

- **Regulatory:** SBA and Treasury should expressly state in a subsequent regulation and/or guidance that businesses applying for PPP loans have the flexibility to ***only*** count full-time workers with regard to the 500-employee cap.

- **Legislative:** If the agencies do not so clarify, Congress should make this point plain by amending the *CARES* Act accordingly.

[21] Subsection 36(D)(v) [p. 17, lines 6-14]

PPP PRIORITY #8:

MULTIFAMILY BUILDING OWNERS SHOULD BE ELIGIBLE FOR PPP LOANS TO HELP COVER MORTGAGE PRINCIPAL — DURING THE PERIOD THAT TENANTS ARE PROTECTED FROM EVICTIONS

Issue:

- The *CARES* Act gives provides broad protections for residential tenants from eviction.[22]
- There is no requirement that a residential tenant must show loss of a job or income to get anti-eviction protection.
  - The tenant anti-eviction protections are in place until the end of 2020 or POTUS's termination of the national disaster declaration (whichever comes first).
  - The tenant anti-eviction protections apply to any building financed by a federal mortgage, or a mortgage purchased or securitized by Fannie Mae or Freddie Mac.[23]
  - For the 120-day period after enactment of the *CARES Act*, a residential landlord cannot initiate eviction against a tenant or re-possess the property for non-payment of rent.
  - Furthermore, a notice to evict from the residential landlord cannot be issued until 30 days after the 120-day eviction moratorium expires … and then the tenant is not required to vacate until 30-days after the eviction notice.[24]

- In contrast: The multifamily building owner gets only limited protections for "forbearance" relief from mortgage payments to its lender.[25]
  - The multifamily owner must "document financial hardship"[26] to get limited forbearance protection – unlike a tenant, who is protected from eviction and can forego rent payments even if (s)he can afford to pay.
  - A multifamily borrower with a Federally-backed mortgage may submit an oral or written request to the loan servicer, affirming financial hardship due to the COVID-19 pandemic.
  - The servicer shall provide forbearance up to 30 days – and the borrower can request "up to" two additional 30-day periods of forbearance.[27]
  - Any extension request made by the borrower must be at least 15 days prior to the end of the first 30-day forbearance period.

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[22] *CARES* Act § 4024(b) [p. 578, line 1].
[23] §§ 4024(a)(2)(B), (4) [p. 575, line 6; p. 576, line 4; p. 577, 7 line 3]
[24] § 4024 (c) [p. 578, lines 11-18]
[25] § 4023 [p. 570, line 17]
[26] § 4023(c)(1)(A) [p. 571, line 12]
[27] §§ 4023(c)(1)(B), (C) [p. 571, lines 13-17]

- The duration of tenant anti-eviction protections can be more than double the amount of time that a multifamily owner might obtain forbearance on mortgage payments.
  - The multifamily owner will be "exposed" to pay mortgage for a period of time when rents are not incoming from the tenant.
  - Even if the tenant can afford to pay rent – but does not – it is protected from eviction for six months ***plus*** the eviction notice period.
- PPP loans should be available to assist multifamily building owners during this "exposed period."
- Tenants economically impacted by the COVID-19 crisis certainly warrant protection from eviction.
- However, there should be symmetrical protections given to landlords for forbearance on paying a mortgage while rents are not incoming to service the debt.

Solution:

- Congress should allow residential landlords to receive PPP loans to cover mortgage principal, interest, and taxes for a limited emergency period.
- The residential landlord should be eligible for PPP loans in amounts that cover non-payment of rents, that are legally due from a tenant, during the ***CARES*** Act non-eviction period.