ECONOMIC INNOVATION GROUP

Understanding the Paycheck Protection Program
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A Lifeline for Small Businesses Included in the Phase III COVID-19 Relief Bill

What is the Paycheck Protection Program?

Title 1 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act is the *Keeping American Workers Paid and Employed Act*, which provides relief for small businesses and their employees who are adversely affected by the outbreak of COVID-19. The cornerstone provision is the "**Paycheck Protection Program**," an emergency lending facility, administered by the Small Business Administration (SBA) under its 7(a) lending program, to provide small business loans on favorable terms to borrowers impacted by the current state of economic uncertainty. At $349 billion in new lending capacity, it accounts for the vast majority of the small business assistance provided in the Phase III legislation, and is one of the most important — if somewhat overlooked — aspects of the Congressional response to the pandemic thus far.

Congress intended the Paycheck Protection Program to accomplish two fundamental goals: 1) help small businesses cover their near-term operating expenses during the worst of the crisis, and 2) provide a strong incentive for employers to retain their employees. In short, <u>it is intended as a partial revenue replacement program to allow deeply affected businesses to hibernate through a period of severe disruption without making drastic changes to their footprint</u>.

How does it work?

The program generally targets businesses, nonprofits, Tribal businesses, and veteran's organizations with 500 employees or less as eligible for federally insured, partially forgivable loans that can be used to cover short-term operating expenses during the economic crisis. The maximum loan size is equivalent to 250 percent of the employer's average monthly payroll costs (e.g., roughly 10 weeks of payroll expenses) or $10 million, whichever is less. Payroll costs are defined broadly to include wages, salaries, retirement contributions, healthcare benefits, covered leave, and other expenses.

The program includes a number of generous features for borrowers, including six months to one year of deferred repayment, fee waivers, and streamlined application requirements. <u>Most importantly, borrowers are eligible for loan forgiveness equivalent to the sum spent on covered expenses during the eight-week period after the loan is originated.</u> Those covered expenses include the bulk of a typical business's fixed operating costs: payroll, rent, utilities, and mortgage interest obligations. The forgivable nature of these loans in effect turns them into grants, meaning that qualifying businesses will not see a significant increase in their debt burdens. But to qualify for forgiveness, employers must maintain their pre-crisis level of full time equivalent employees, or else face a reduction in forgiveness proportional to the reduction in headcount. Since many businesses have already been forced to make staffing reductions in response to vanishing customers and lost revenues, the legislation includes a clause that allows them to qualify for loan forgiveness if they have re-hired back to pre-crisis levels by June 30, 2020.

Congress made the terms generous and the barriers to entry low in an effort to ensure resources would be made available as quickly as possible to needy businesses. Borrowers do not need to demonstrate actual economic harm in order to qualify. Instead, they simply need to make a series of good faith certifications, principally that current economic conditions necessitate the loan to support ongoing business operations, and that the funds will be used to maintain payroll and address other covered expenses. While this streamlined approach will certainly make it easier for vulnerable businesses to receive support on an expedited basis, it may also lead some otherwise healthy businesses to take advantage of the program at the expense of those whose survival depends upon it.

Why is this needed?

The U.S. small business sector is facing an unprecedented crisis as a result of the pandemic. Already, a wave of businesses have closed their doors, helping fuel a record number of new unemployment claims. Many others have seen their revenues dry up, making it impossible to keep up with basic operating costs for much longer. These businesses need immediate access to capital that can replace their lost revenue and help them weather the crisis until normal operations can resume. The more small businesses that survive the crisis, the stronger the recovery we can expect once it is over.

Will it be enough?

Probably not. Economists Michael Strain of the American Enterprise Institute and Glenn Hubbard of Columbia Business School estimate the cost of replacing lost revenue for affected firms for three months to be $1.2 trillion. The initial $349 billion in new lending will no doubt help many businesses survive a short-term crisis, but mass closures have already begun, and many more will follow if Congress is slow to extend additional lending capacity. Indeed, the amount currently allocated may not even be enough to meet demand during a short-term crisis; it will almost certainly not be adequate for helping small businesses survive the plausible scenario of a protracted crisis followed by a slow return to normal.

What happens next?

The Paycheck Protection Program is a critically-needed lifeline for American small businesses. However, Congress should immediately begin preparing for an extension of the program so that new lending is made available before the current resources are exhausted. Congress should also consider complementary approaches to providing small business relief in the weeks ahead, such as the one outlined in a recent post, "[How to Rescue Main Street from Coronavirus Before It's Too Late]."

Below we've outlined the key elements of the program as well as an industry breakdown of firms with fewer than 500 employees.

Paycheck Protection Program Overview	
Covered Loan Period	• Retroactive to February 15, 2020, through June 30, 2020
Eligible Businesses	• Small businesses, nonprofits, Tribal business concerns, and veteran's organizations that: • Have less than 500 employees or the applicable size standard for the industry as provided by SBA, or • Are sole proprietors, self-employed individuals, or independent contractors • Were in business on Feb. 15, 2020
Maximum Loan Amount	• The lesser of: • 2.5X average monthly payroll costs during the 1-year period* before the date on which the loan is made, or • $10 million • *For new businesses, the measurement period would be Jan. 1 to Feb. 29, 2020* • The legislation also temporarily increases the maximum amount for an SBA Express loan from $350,000 to $1 million through December 31, 2020
Guarantees	• Increases the government guarantee of 7(a) loans to 100 percent through December 31, 2020
Allowable Uses	• Payroll costs • Health care benefits (including paid sick or medical leave, and insurance premiums) • Mortgage interest obligations • Rent obligations • Utility payments • Interest on other debt obligations incurred previous to Feb. 15, 2020
Eligible Lenders	• SBA and the Department of the Treasury are granted authority to determine additional lenders to administer the Payment Protection Program loans
Maturity Schedule	• Maximum 10-year maturity after application for loan forgiveness
Interest Rate	• Not to exceed 4 percent during the covered period
Payment Deferral	• Not less than 6 months and not more than 1 year (including payment of principal, interest, and fees)
Terms of Loan Forgiveness (Sec. 1106)	• Loan recipients will be eligible for loan forgiveness for an 8-week period after the loan's origination date in the amount equal to the sum of the following costs incurred during that period: • Payroll costs (compensation above $100,000 excluded) • Payment of interest on mortgage obligation • Rent obligations • Utility payments • The amount forgiven cannot exceed the amount borrowed. • Loan forgiveness will be proportionally reduced if the average number of employees is reduced during the covered period as compared to the same period in 2019. The amount of loan forgiveness will be reduced by the amount of any reduction in total employee salary or wages during the covered period that is in excess of 25 percent of the total salary or wages. • Payroll documentation and documentation of expenses are required to receive forgiveness, to ensure the forgiveness was used to retain employees and pay expenses. • Borrowers that rehire laid off workers by June 30 won't be penalized for having a smaller workforce at the beginning of the period. • Borrowers with tipped workers may receive loan forgiveness for the additional wages paid to those employees. • Lenders have 60 days to issue a decision on the application. • The canceled loan amount will not count towards gross income for tax purposes
Waivers	• Borrower and lender fees are waived • Prepayment fees are waived
Borrower Requirements	• Good faith certification that the loan is necessary because of economic uncertainty caused by COVID-19 and will be applied to maintain payroll and make required payments. • Borrower must also certify that they are not receiving this assistance and duplicative funds for the same uses from another SBA program. • No collateral or personal guarantee are required.
Nonbinding Guidance	• Lenders should prioritize small businesses, entities in underserved and rural markets, veterans and members of the military community, small business concerns owned by socially and economically disadvantaged individuals, women, and businesses in operation for less than 2 years.
Lender Reimbursements	• Lenders will be reimbursed at the following rates based on the balance of the financing outstanding at the time of loan disbursement: • 5 percent for loans up to $350,000 • 3 percent for loans between $350,000 and $2,000,000 • 1 percent for loans above $2,000,000
Appropriated Amounts for Program	• $349 billion

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U.S. Small Business Share of Firms and Employment by Industry

NAICS Code	NAICS Description	Total Number of Firms	Total Number of Small Firms (<500 employees)	Small Firms as % of Total	Total Employment	Total Employment at Small Firms (<500 employees)	Small Firm Employment as % of Total
--	Total	5,996,900	5,976,761	99.7%	128,591,812	60,556,081	47.1%
11	Agriculture, Forestry, Fishing and Hunting	22,641	22,535	99.5%	164,046	136,591	83.3%
21	Mining, Quarrying, and Oil and Gas Extraction	19,080	18,720	98.1%	578,098	244,367	42.3%
22	Utilities	5,957	5,752	96.6%	644,703	111,747	17.3%
23	Construction	701,477	700,393	99.8%	6,533,061	5,373,702	82.3%
31-33	Manufacturing	248,039	244,098	98.4%	11,721,785	5,039,772	43.0%
42	Wholesale Trade	298,127	294,909	98.9%	6,115,476	3,413,157	55.8%
44-45	Retail Trade	647,927	645,685	99.7%	15,705,808	5,526,296	35.2%
48-49	Transportation and Warehousing	185,028	182,688	98.7%	4,866,282	1,685,388	34.6%
51	Information	79,662	78,430	98.5%	3,507,966	984,379	28.1%
52	Finance and Insurance	238,408	236,657	99.3%	6,408,168	1,909,993	29.8%
53	Real Estate and Rental and Leasing	309,369	308,106	99.6%	2,148,006	1,451,546	67.6%
54	Professional, Scientific, and Technical Services	811,320	807,932	99.6%	8,905,549	5,190,980	58.3%
55	Management of Companies and Enterprises	26,956	19,134	71.0%	3,462,498	423,295	12.2%
56	Administrative and Support and Waste Management and Remediation	347,829	343,791	98.8%	11,897,056	3,754,463	31.6%
61	Educational Services	93,500	92,148	98.6%	3,688,541	1,645,962	44.6%
62	Health Care and Social Assistance	655,069	650,689	99.3%	20,241,438	8,984,159	44.4%
71	Arts, Entertainment, and Recreation	130,107	129,287	99.4%	2,368,928	1,428,531	60.3%
72	Accommodation and Food Services	539,886	537,443	99.5%	14,088,211	8,542,661	60.6%
81	Other Services (except Public Administration)	696,668	695,268	99.8%	5,534,978	4,697,878	84.9%

Source: Census Bureau's Statistics of U.S. Businesses 2017