CARES Act Saves 100,000 Nonprofits

By Charles Schultz, Crescendo Interactive President

On March 27, 2020, Congress and the President enacted the Coronavirus Aid, Relief, and Economic Security Act (CARES Act, H. R. 748). The $2 trillion CARES Act provides massive relief for individuals, businesses, medical centers and nonprofits. The “Paycheck Protection Program Loans” (PPP Loans) are potentially able to save over 100,000 nonprofits from closing their doors.

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Nonprofits at Risk

This is a challenging time for all Americans. Millions are under lockdown orders to reduce the risk of community spread of the virus. Over 3.2 million Americans filed unemployment claims the week of March 15 to 21 (over four times the previous weekly record). With restaurants, hotels, airlines, cruise ships and thousands of other businesses reducing operations or closing, there will be many more unemployed during the next months.

The National Council of Nonprofits reports that our nation has over 1.3 million nonprofits. Over half of the nonprofits have just one month of cash reserves. While the largest universities have substantial endowments, most midsized and small nonprofits do not have large reserves. Over 88% of nonprofits operate with less than $500,000 in annual gift revenue.

Fortunately, the PPP Loans will provide these nonprofits with loans to cover eight weeks of payroll, benefits, rent or mortgage interest and utilities. Best of all, qualifying nonprofits may receive up to eight weeks of loan forgiveness. In essence, the federal government will make a grant for the eight weeks of nonprofit overhead expenses. The eight week payroll and expense grants are likely to save at least 100,000 nonprofits who would otherwise close their doors.

Qualifications for a Nonprofit Loan-Grant

The U.S. Senate Committee on Small Business and Entrepreneurship published an explanation of the CARES Act with specifics applicable for nonprofits. Loans are issued under the Small Business Administration (SBA) Sec. 7(a) program. Sec. 501(c)(3) organizations generally qualify if they have 500 or fewer employees (full and part time, not full time equivalents) and had paid employees on Feb. 15, 2020. Sec. 1102(a)(2)(D)(v).

Some nonprofits with multiple related organizations may be subject to the SBA affiliation standards under 13 C.F.R. § 121.103. If a parent nonprofit controls a subsidiary, the SBA may aggregate the employees of both entities. Sec. 1102(a)(2)(D)(iii).

The nonprofit "shall make a good faith certification—(I) that the uncertainty of current economic conditions makes necessary the loan request to support the ongoing operations of the eligible recipient; (II) acknowledging that funds will be used to retain workers and maintain payroll or make mortgage payments, lease payments, and utility payments; (III) that the eligible recipient does not have an application pending for a loan under this subsection for the same purpose and duplicative of amounts applied for or received under a covered loan; and (IV) during the period beginning on February 15, 2020 and ending on December 31, 2020, that the eligible recipient has not received amounts under this subsection for the same purpose and duplicative of amounts applied for or received under a covered loan." Sec. 1102(a)(2)(G)(i).

While there will be some level of subjective judgment on the "necessary" standard, a nonprofit with substantial endowment or reserves is not likely to qualify for an SBA Sec. 7(a) loan. The intent of the PPP Loans is to assist nonprofits who need funds to avoid employee layoffs.

PPP Loan Terms

For most nonprofits in existence on Feb. 15, 2019, the loan amount is a maximum of "2.5 times the average total monthly payments by the applicant for payroll costs incurred during the 1-year period before the date on which the loan is made," with a maximum loan value of $10,000,000. PPP Loans are nonrecourse and there is no personal guarantee and no collateral. Sec.

1102(a)(2)(F)(v) and (J). The nonprofit does not need to show it was unable to obtain credit from another lender. Sec. 1102(a)(2)(I).

The intention of the loan is to cover payroll and approved expenses for an eight week period between Feb. 15, 2020 and June 30, 2020. While the authorized loan purposes include rent, lease and utility payments, the loan formula is based only on payroll.

Loan payments will be deferred from six to twelve months. Sec. 1102(a)(2)(M)(iii). The interest rate may not exceed 4%. Sec. 1102(a)(2)(L). The nonprofit will not pay a fee to the lender. Sec. 1102(a)(2)(H). The SBA will pay the lender a 5% fee for loans up to $350,000, a 3% fee for loans up to $2 million and a 1% fee for loans over $2 million. Sec. 1102(a)(2)(P)(i). A qualified nonprofit is “presumed to have been adversely impacted by COVID-19.” Sec. 1102(a)(2)(M)(i).

Permitted Expenses Under PPP Loans

The PPP Loan may be used for “(I) payroll costs; (II) costs related to the continuation of group health care benefits during periods of paid sick, medical, or family leave, and insurance premiums; (III) employee salaries, commissions, or similar compensations; ‘(IV) payments of interest on any mortgage obligation (which shall not include any prepayment of or payment of principal on a mortgage obligation); (V) rent (including rent under a lease agreement); (VI) utilities; and (VII) interest on any other debt obligations that were incurred before the covered period.” Sec. 1102(a)(2)(F)(i). The rental agreement, lease or mortgage must have been in place by Feb. 15, 2020.

Most nonprofits will use the PPP Loan to cover salaries, medical benefits, rent or interest on a mortgage and utilities. If payroll is low and building costs are high, the 2.5 times payroll formula for the loan may not fully cover all facility costs.

Payroll costs are limited to salaries of $100,000 or less. These costs may include “(AA) salary, wage, commission, or similar compensation; (BB) payment of cash tip or equivalent; (CC) payment for vacation, parental, family, medical, or sick leave; (DD) allowance for dismissal or separation; (EE) payment required for the provisions of group health care benefits, including insurance premiums; (FF) payment of any retirement benefit; or (GG) payment of State or local tax assessed on the compensation of employees.” Sec. 1102(a)(2)(A)(viii).

PPP Loan Forgiveness Amounts

The nonprofit may qualify for forgiveness for an eight week period, starting on the date of the loan origination. Sec. 1106(a)(3). The “forgiveness amount” is the payments during the eight week period for “(1) Payroll costs, (2) Any payment of interest on any covered mortgage obligation (which shall not include any prepayment of or payment of principal on a covered mortgage obligation), (3) Any payment on any covered rent obligation, (4) Any covered utility payment.” Sec. 1106(b). The forgiven loan amount may not exceed the loan principal.

Because the nonprofit must substantiate all of these qualified expenses, it may be helpful to set up an accounting system to track them or a separate bank account for all of these payments. The loan forgiveness also includes forgiveness of interest for the eight week period.

Documentation for PPP Loan Forgiveness

The nonprofit must submit specific documentation to the lender at the end of the eight week period to qualify for loan forgiveness. Sec. 1106(f). The documentation must verify “the number of full-time equivalent employees on payroll and pay rates for the periods described in subsection (d), including—(A) payroll tax filings reported to the Internal Revenue Service; and (B) State income, payroll, and unemployment insurance filings; (2) documentation, including cancelled checks, payment receipts, transcripts of accounts, or other documents verifying payments on covered mortgage obligations, payments on covered lease obligations, and covered utility payments; (3) a certification from a representative of the eligible recipient authorized to make such certifications that—(A) the documentation presented is true and correct; and (B) the amount for which forgiveness is requested was used to retain employees, make interest payments on a covered mortgage obligation, make payments on a covered rent obligation, or make covered utility payments.” Sec. 1106(e).

Nonprofits should set up their accounting systems to ensure this documentation is available for the lender.

Employee Limitation for PPP Loan Forgiveness

The goal of the PPP Loans is to enable employers to avoid laying off employees during the eight week period. If the payroll expenses for employees earning less than $100,000 decrease by 25% or there is a reduction in the number of employees, there is a reduction in the loan forgiveness amount. Sec. 1106(d)(3). The employee count formula is generally the average number of full-time equivalent employees per month employed by the eligible recipient during the covered period divided by the average number of full-time equivalent employees per month employed by the eligible recipient during the period beginning on February 15, 2019 and ending on June 30, 2019. Sec. 1106(d)(2).

Nonprofits who have laid off employees may rehire them after the PPP Loan disbursement and will still qualify for the loan forgiveness provisions. Sec. 1106(d)(5).

When and How to Apply for a PPP Loan

Most large banks are familiar with SBA loan forms and procedures. It is best to contact your bank to discuss the application. Because there is no collateral, no personal guarantee and the SBA pays the fee to the lender within five days of the loan disbursement, the loan process should be quite rapid. With most of the nation in lockdown, Congress desires these funds be transferred to small businesses and nonprofits as quickly as possible. If the loan application process is commenced in early April, many banks should be able to close the loan and make disbursements by the third or fourth week of April.

At publication time, the SBA has posted the Economic Injury Disaster Loans application ($10,000 loan), but it has not posted the Paycheck Protection Program Nonprofit Application Form to www.sba.gov. When it is posted, this article will be updated with an explanation of the form. Treasury Secretary Steven Mnuchin has indicated a simple Paycheck Protection application process will be available in early April. Because Congress allocated $350 billion to the Paycheck Protection Program, it is potentially the largest grant program in history.

Nonprofits will be very interested in the Paycheck Protection Program.

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Enrolled CARES Act Sections 1102 and 1106 (PDF) »