The CARES Act PPP Necessity Certification for SNFs

The federal government established the Paycheck Protection Program (PPP) as part of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) to assist eligible businesses with payroll, mortgage/rent, and utility costs during the COVID-19 crisis. The PPP was rolled out quickly and, as such, is neither perfectly drafted nor conceived.

One issue of immediate importance to borrowers, including skilled nursing facilities (SNFs), is the PPP Necessity Certification. On April 23, 2020, well after many PPP loan applications were submitted by, and loan dollars were disbursed to, applicants, the Small Business Administration (SBA) issued new guidance that sought to effectively expand the requirements associated with the Necessity Certification in a manner potentially contrary to the PPP statute. Now, assuming they do not wish to challenge the new SBA guidance, borrowers must decide whether they comply with the revised Necessity Certification or return the PPP loan before May 14, 2020 in order to avoid potential false certification penalties.

This white paper provides background information on the PPP and its Necessity Certification, discusses factors that may assist SNFs in determining whether they meet the revised Necessity Certification requirements, and provides some recommendations on documenting compliance in preparation for an audit.

The information in this white paper represents our view point at the time of drafting. We cannot assure that a federal or state court, an adjudicative administrative body, any federal or state agencies, or a government contractor, would agree with the views expressed in this white paper. This document is not legal advice and should not be interpreted as legal advice. Seek out the advice of experienced healthcare counsel when needed.

May 6, 2020.

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BACKGROUND ON THE PPP & NECESSITY CERTIFICATION

In response to the COVID-19 pandemic, the federal government implemented the PPP under the CARES Act. The PPP is administered by the SBA, a federal agency with experience facilitating and regulating small-business capital and lending.

The PPP provides loans to eligible businesses who, after applying the SBA affiliation rules[1], meet one of the following standards:

- 500 or fewer employees.
- Fewer employees than (if applicable) the SBA NAICS Code limits for their industry, even if that number is higher than 500 employees.
- Meet the SBA "alternative size standard" as of March 27, 2020:
  - Maximum tangible net worth of the business is not more than $15 million; and
  - The average net income after federal income taxes (excluding any carry-over losses) of the business for the 2 full fiscal years before the loan application date is not more than $5 million.
- Have an NAICS Code beginning with 72 (Hospitality/Accommodation/Food Service/ Drinking Places), are certain franchises, or receive financial assistance from a small business investment company AND comply with additional special rules.

The PPP is intended to cover most costs associated with payroll, mortgage interest, rent, and utilities. Costs must be incurred during the eight (8) weeks immediately following the borrower's receipt of the first loan disbursement.[2]

Loan amounts will be forgiven if the borrower uses funds for permitted costs and maintains its employees and compensation levels. To obtain forgiveness, a borrower must submit a loan forgiveness application.[3]

If not forgiven, PPP loan payments are deferred for 6 months, due in 2 years, and accrue interest at a fixed rate of 1%.

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[1] SBA Affiliation Rules (last updated April 3, 2020): https://www.sba.gov/sites/default/files/2020-04/Affiliation%20rules%20overview%20%28for%20public%29%20v2.pdf.

[2] Information about the PPP is available at https://home.treasury.gov/system/files/136/PPP Borrower Information Fact Sheet.pdf.

[3] Additional detail about the loan forgiveness procedure is forthcoming.

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Any SNF that has applied, or is applying, for a PPP loan is required to make a series of certifications in good faith as of the loan application date, including a certification that "***[c]urrent economic uncertainty makes the loan necessary to support [] ongoing operations***."[4] This certification is also called the "Necessity Certification" and is important for several reasons.

New Requirements. The Necessity Certification is the subject of FAQ guidance[5] from the SBA and Department of the Treasury that effectively, and retroactively, changes the requirements for borrowers making the Necessity Certification prior to April 23, 2020. On April 23, the FAQ was updated with new information about how the Necessity Certification will be interpreted. Specifically, it requires all borrowers making the Necessity Certification in good faith to "***tak[e] into account their current business activity and their ability to access other sources of liquidity sufficient to support their ongoing operations in a manner that is not significantly detrimental to the business.***"[6] Additional guidance regarding a safe harbor permitting return of PPP loans indicates that this new "interpretation" will be applied retroactively to PPP loans issued, and loan applications submitted, prior to April 23. Moreover, new FAQ guidance indicates that, before May 14, the SBA will issue yet further guidance about how it will review the Necessity Certification.[7]

Audits Announced. The SBA has announced that it, along with the Department of the Treasury, will audit **all** PPP loans over $2 million and other PPP loans "as appropriate".[8] The guidance regarding these audits strongly suggests that their central purpose is compliance with the Necessity Certification. However, according to the guidance, audits are conducted to "ensure that PPP loans are limited to eligible borrowers in need" which could potentially involve audits broader than that required to review solely Necessity Certification.

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[4] PPP Loan Application (p. 2): https://www.sba.gov/sites/default/files/2020-04/PPP%20Borrower%20 Application%20Form.pdf.

[5] FAQ (last updated May 5, 2020): https://home.treasury.gov/system/files/136/Paycheck-Protection-Program-Frequently-Asked-Questions.pdf.

[6] FAQ #31 & #37.

[7] FAQ #43.

[8] FAQ #39.

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Time Limited Safe Harbor. Guidance provides borrowers making this certification prior to April 23, 2020 with the opportunity to repay the entire loan by May 14, 2020,[9] with no questions asked, while being deemed by SBA to have made the Necessity Certification in good faith.[10] This repayment opportunity is referred to as a "Safe Harbor". The Safe Harbor allows borrowers to repay their PPP loan before May 14 without being penalized for failure to comply with the expanded interpretation of the Necessity Certification. Penalties for making a false certification on the PPP application may include imprisonment for up to 30 years and a fine of up to $1,000,000.

In the future, we expect the agencies' authority to issue this expanded interpretation of the Necessity Certification to be challenged in court. This is especially true because the interpretation arguably contradicts the CARES Act suspension of the routine SBA loan requirement that borrowers are unable to obtain credit elsewhere. However, despite the questionable legal foundation for this interpretation, nursing facilities that have received, or applied for, PPP loans will likely want to be proactive in their response to these changes in case of an audit and to minimize the risk of paying expensive penalties or settlements in the future.

Recall that the newly interpreted Necessity Certification requires that:

> ***Current economic uncertainty makes the loan necessary to support the borrower's ongoing operations, which must include taking into account the borrower's current business activity and ability to access other sources of liquidity sufficient to support ongoing operations in a manner that is not significantly detrimental to the business.***

Given their exceptionally unique role and vulnerable position in the COVID-19 pandemic, many nursing facilities should consider retaining the PPP loan and standing by their Necessity Certification, even as expanded by the FAQ guidance. However, and as it often is, the key to compliance will be excellent documentation. The sections below discuss considerations for nursing facilities making the Necessity Certification and documentation suggestions.

COVID-19: A PERILOUS SEA CHANGE

COVID-19 has created an unstable and unprecedented economic environment for most businesses. Key employees and contractors may become ill or be unavailable due to child- or

[9] The original Safe Harbor deadline was May 7. However, the FAQ guidance issued on May 5 (#43) extended the deadline to May 14.

[10] FAQ #31 & #37.

elder-care obligations caused by the COVID-19 shutdown. Demand may decrease due to a change in customer behavior and/or government regulation and public health orders. Even if business remains steady, supply chains can deteriorate, bringing production to a standstill and/or causing prices for essential items to skyrocket.

Just the possibility of one or two of these setbacks should make a business owner nervous. However, SNFs have been caught in a perfect storm of adversity since COVID-19 arrived. They face **all** of these catastrophes on a scale magnified by their frontline role as home and healthcare provider to the frail and elderly people most affected by the virus that causes COVID-19.

Regulatory Compliance. In addition to the myriad of regulations and guidance to which SNFs are typically subject, COVID-19 adds on a complex overlay of state and federal infection prevention and other requirements that change at least weekly. Staying current with and quickly operationalizing all of these rules and best practices takes a significant amount of time and money. New information must be identified and processed, an implementation strategy must be formulated, policies and procedures must be drafted, and training and revised processes must be rolled-out to staff.

Staffing. SNFs are well-recognized as vulnerable to COVID-19 outbreaks that can sicken and even kill staff members in addition to the residents they seek to protect. This affects staffing on several levels. Most obviously, staff who become sick or who are exposed to the virus while working cannot return to work until they meet certain criteria including mandatory isolation for a set period of time that can range from one to over two weeks. Similarly, an outbreak increases workload in a SNF when isolation procedures are implemented and ill residents require additional care. Additionally, when COVID-19 strikes a SNF, staff are less likely to report to work out of fear of infecting themselves and/or their families. Furthermore, staffing decreases can become exponential as remaining staff members are stressed by constantly changing policies and procedures and the absence of familiar colleagues and workflows. Finally, even facilities that have not yet experienced an outbreak may struggle to maintain pre-COVID-19 staffing levels simply because personnel are afraid of the possibility of an outbreak. These issues are exacerbated by the state and federal limitations on visitation in SNFs that have required significant increases in staff time and resources expended in communicating with families and responsible parties.

To address these issues, managers and owners offer hazard pay, use staffing agencies, pay overtime, and incur time and money costs for additional orientation training. Since adequate staffing must be maintained to care for residents and comply with regulatory requirements, staffing can be an enormous expense.

Supply Chain. Elderly and frail residents depend upon nursing facilities to provide or arrange for most of the essential day to day items that they may require, such as food, medications, DME, linens, and personal care supplies, to only name a few. On top of these routine items, the pandemic has forced nursing facilities to join the fierce competition to obtain personal protective equipment (PPE), such as N95 respirators, facemasks, gowns, eye protection, and gloves. Adequate PPE has been notoriously difficult, if not impossible, to find as evidenced by the CDC relaxing its recommendations related to COVID-19 PPE and issuing guidance for PPE extended use and reuse. Even routine items like hand sanitizer, cleaning products, toilet paper, and certain medications are known to be scarce. SNFs are dedicating extra time and money to locate and purchase (at costs that are often inflated to reflect a surge in demand) a diverse array of supplies readily available at reasonable prices before the pandemic.

Other Costs. COVID-19 has caused SNFs to incur a variety of other unexpected costs including additional equipment to minimize the sharing of items, like glucometers and blood pressure machines, between resident and technology such as wireless internet, tablets, phones, and screens to enable residents to visit with friends and family while visitation prohibitions are in effect.

Revenue. While SNF costs associated with compliance, staff, supplies, etc. have significantly increased, reimbursement rates are largely unchanged and admissions/censuses have unexpectedly decreased due to moratoriums on elective surgeries and procedures, fear of COVID-19, infection prevention policies prohibiting visitation, admission freezes when an outbreak occurs, and stigma in the aftermath of an outbreak.

While some federal relief has been provided to facilities with Medicare residents, it is often not enough to cover the increasing gap between revenue and expenses. Furthermore, while planned, the many nursing facilities caring solely for Medicaid residents have, to date, received zero relief from the U.S. Department of Health and Human Services (which includes CMS) nor from the Ohio Department of Medicaid. In Ohio, Medicaid and its managed care organization contractors have yet to increase SNF rates or otherwise compensate providers for increased costs related to COVID-19.

Financing and Access to Capital. Given the general economic upheaval since the arrival of COVID-19, financing options and opportunities have narrowed in response to accumulating unknowns. This issue is magnified for nursing facilities due to their uphill battle to maintain operating margins. Additionally, management and executives who usually spend time securing financing and capital may be otherwise occupied by the flood of new urgent COVID-19 regulatory and operational issues. Traditional sources of business liquidity such as cutting staff or decreasing

production are not viable for SNFs that must maintain adequate staff to provide quality care to all residents and that are prohibited from discharging residents except in very limited circumstances which do not include to reduce operating costs.

RECOMMENDATIONS

The issues outlined above affect many SNFs on the frontlines of COVID-19 and are important considerations for organizations making a Necessity Certification in connection with a PPP loan. However, the facts and circumstances existent when the PPP loan application is submitted will differ for every facility.

Organizations electing to keep PPP loans, especially loans greater than $2 million, should consider taking the time now to create a PPP file to support its Necessity Certification in the event of an audit. Items that may be appropriate for the PPP file include:

- Additional policies and procedures drafted and implemented in response to COVID-19.
- CDC guidance for COVID-19 infection control and PPE use.
- Financials showing original budget and revised budget in response to COVID-19.
- Efforts to obtain PPE.
- Cost of PPE acquired and a comparison to pre-COVID-19 PPE cost and volume.
- Receipts for equipment, (*e.g.*, glucometers, BP machine, pulse oximeter) and technology (*e.g.*, tablets, wireless upgrades) purchases, and investments related to COVID-19.
- Personnel hours spent on the items above, including employee and contractor fees (such as additional accounting or legal fees incurred due to COVID-19).
- Identify viable sources of financing and capital (if any) and document why pursuing these sources instead of the PPP loan will be significantly detrimental to the business or why both funding sources are necessary. If you document the latter, be prepared to provide proof that the non-PPP funds were spent.

  Documentation may include why: (a) alternate funding sources are too time consuming for personnel who should be focused on the COVID-19 response; (b) depleting emergency cash funds puts the SNF at imminent risk of closure; (c) maxing out an available line of credit will cause a SNF to be unable to proceed with planned renovations or to incur interest charges significant enough to harm the business;

and/or (d) funds will not be disbursed quickly enough to avoid significant damage to the business.

These are just several possible examples. Whether they are sufficient to support a Necessity Certification depends upon the specific facts and circumstances of each organization, documentation provided to the government, and how the SBA and/or Department of the Treasury interpret what may be "significantly detrimental to the business".

- Documentation of anticipated revenue and expenses and plans for managing/maintaining cash or a line of credit created prior to the Necessity Certification.
- Articles about the impact of COVID-19 on SNF revenue and staffing published prior to the Necessity Certification.
- Any other documentation supporting economic uncertainty for nursing facilities, disruption to operations caused by COVID-19, and why using alternate sources of cash or financing would be significantly detrimental to the facility.

Note that documentation in existence when the Necessity Certification is made is preferred because the certification must be true at the moment the certification is made and signed. However, subsequent documentation about how actual numbers deviated significantly from what was budgeted or projected due to COVID-19 may be helpful to show that the Necessity Certification was reasonable. This is especially true in instances where the SNF has minimal documentation predating the Necessity Certification.