Paycheck Protection Program (PPP) Loans – Certifying Need and Determining Forgiveness

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Today’s Agenda

- PPP Overview
- Certification of Need
- Determining Forgiveness
- Planning Considerations

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Paycheck Protection Program Overview

The Paycheck Protection Program

- Title 1 of the Coronavirus Aid, Relief, and Economic Security Act or the CARES Act (the "Act")
- Provides for forgivable loans equal to 2.5 months of average 2019 payroll costs, with a maximum of $10 million per entity and $20 million per affiliated group
- Meant for small businesses, 501(c)(3) and 501(c)(19) organizations with 500 or fewer employees
- Loan proceeds can be used for qualified payroll costs, loan interest, rent and utilities
- Amounts not forgiven are repayable over 2-years, with interest of 1% and a 6-month payment deferral
- $660 billion authorized in 2 tranches of funding

The Paycheck Protection Program
(Continued)

- Administered by the U.S. Small Business Administration (SBA)
- Loans processed and disbursed by banks and other lenders
- Not a new program – The Act temporarily amended the existing SBA *Business Loan Program* under Section 7(a) of the Small Business Act
  - Relaxed underwriting requirements
  - Expanded eligibility
- Division A, Title I of the Act is entitled ***Keeping American Workers Paid and Employed Act***

PPP Loans to Date

	Round 1 Thru 4/16/20	Round 2 Thru 5/10/20	Total Thru 5/10/20
Total loan amount	$342,277,999,103	$188,943,588,568	$531,221,587,671
No. of loans	1,661,367	2,571,167	4,232,534
Average loan size	$206,000	$73,500	$125,500
No. lenders	4,975	5,463	

- Round 1 was fully committed in 8 days.

Certification of Need

Why the Focus Certification of Need

- The Act requires every borrower to "make a good faith certification that *the uncertainty of current economic conditions makes this loan request necessary to support the ongoing operations* of the Applicant"
- As round 1 closed, the public became aware of several perceived abuses
- April 23rd – SBA announced that public companies with substantial market value and access to capital markets probably don't have need
- April 28th – Extended this statement to include private companies with adequate sources of liquidity
    - Provided a safe harbor for borrowers to return funds by May 7th

Why the Focus Certification of Need

(Continued)

- April 29th – Announced all loans over $2 million, plus others, will be audited
- May 3rd – Extended the safe harbor date for returning loan funds to May 14th and indicated that additional guidance would be forthcoming
- Failure to comply with this requirement may result in criminal liability under the False Claims Act
- Unfortunately – Neither the Act nor the SBA define *economic uncertainty*, *necessary, ongoing operations*, or *adequate sources of liquidity*

Our Recommendations

- Prepare projections going out as long as you believe the pandemic might have an affect on your business
  - Based on facts known and uncertainty that existed at the time the PPP loan application was submitted.
  - Assume that 2019 payroll levels will be maintained for at least 8-weeks or through June 30, 2020, regardless of the volume of business
  - Consider other sources of liquidity including cash on hand, investments, reserve and quasi-endowment funds, pay reductions for highly compensated employees, elimination of bonuses, business profits suspension of dividends or distributions, available lines of credit (but be mindful of expiration dates and material adverse change clauses), owner resources
- Document the key uncertainties that existed, how you interpreted "necessary," what would be detrimental to the business, and other key considerations

Our Recommendations *(Continued)*

- Consider the possibility of partial need
  - While the PPP loan application might lead one to believe otherwise, the Act provides that the *maximum loan amount* is 2.5 times average monthly 2019 payroll costs
  - If you feel your needs are less than the maximum, consider returning some of the funds
  - For example, if you were planning on a 20% reduction in force for 6 months, but you take the PPP loan to avoid the RIF, this would equate to approximately 1.25 months of payroll, rather than a full 2.5 months. So maybe you just take half the loan amount in order to cover this cost.
- *These recommendations are not based on any statutory requirements or definitions. Following these recommendations is not a guarantee that you will avoid issues; ignoring them does not mean you have any issues.*

PPP Loan Forgiveness

Loan Forgiveness Calculation

Eligible Costs Incurred

X Employee Retention Ratio (FTEs)

Forgiveness Before XS Wage Reduction

Less: Excess Wage Reduction Amount

Less: EIDL Grant

Loan Forgiveness Amount

Caution: Some lenders and others have interpreted the Act to require payroll costs during the 8-week forgiveness period to be equal to at least 75% of the loan amount in order to be eligible for any forgiveness. This is not our interpretation, but further guidance is necessary to clarify this very important point.

Loan Forgiveness – Eligible Amount

- ***Costs incurred and payments made*** on the following during the 8-week period beginning with the date of the loan:
  - Payroll costs
  - Payments of interest on mortgage indebtedness outstanding prior to February 15, 2020
  - Payments of rent and utilities
- At least 75% must be expended on payroll costs.

Note for nonprofits and healthcare organizations: The Act does not address how loan forgiveness will be impacted by the receipt of other government funds – such as federal or state cost reimbursement grants, Medicare and Medicaid – that cover some or all payroll and other costs. It is possible that these payroll and other costs will not be eligible for forgiveness, and any such loan proceeds received in respect of these costs will need to be immediately repaid.

Loan Forgiveness – Payroll Costs

These are the same costs that were used in determining payroll costs for purposes of the PPP loan application:

- Salaries and similar compensation of employees, not to exceed $100,000 a year ($1,923 a week) for any individual employee
- Payments for vacation, parental, family, medical or sick leave
- Group health insurance for employees (employer's cost only) (<u>not</u> life, disability or other insurance)
- Retirement benefits for employees (employer's cost only)
- State and local taxes on employee wages (SUI, MTA, but <u>not</u> DBL or WC)
- Self-employment income of a sole proprietor or partner, not to exceed $15,385 for the 8-weeks

Loan Forgiveness – Other Costs

- Interest on mortgage loans on *real or personal property* that were in place prior to 2/15/20
  - Is a loan secured by personal property eligible?
  - Other loan interest for debts existing at February 15, 2020 is a permissible use of the loan, but does not count for forgiveness.
- Rent [for real and personal property] obligated under a leasing agreement in force before 2/15/20
- Utilities for services in place prior to 2/15/20 – electricity, gas, water, telephone, internet access, transportation
  - Cell phones?
  - Fuel for transportation vehicles?

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Loan Forgiveness – Cash or Accrual?

- There is no clear guidance. The Act states *costs incurred and payments made*.
  - This insinuates you cannot pre-pay expenses and that <u>payments made</u> during the 8-week forgiveness period are eligible.
- This presents some issues:
  - Companies with a semi-monthly payroll will only make 3 payments
  - Health insurance and office rent are often paid in advance
  - What about March & April rent our landlord allowed us to defer?
  - What about our 2019 profit sharing contribution that has not yet been paid?
- For now – Pay expenses in the ordinary course; business as usual.

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Calculating FTEs

- A full-time employee is one who works – or is being paid to work – a minimum of 30 hours a week
- For part-time employees – take the number of hours worked by all PT employees and divide by 30 hours a week to arrive at part-time FTEs
- You do this for each pay period in the applicable period and then take the average.
- Your *employee retention ratio* is the average FTEs in the 8-week period divided by the average FTEs in either the period:
    - February 15, 2019 to June 30 , 2019, or
    - January 1, 2020 to February 29, 2020

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Calculating FTEs *(Continued)*

- Bonus:
  - If a borrower laid off people between February 15, 2020 and April 26, 2020 and replaces or rehires them by June 30, 2020, the borrower can include these people in their FTE count as if they were employed the entire time.
    - There is no guidance on how long you have to retain the rehired workers for them to count. It seems clear, however, that you do not need to pay them their back pay for the time they were out.
  - If a borrower offered to rehire a laid-off employee and that employee rejects the offer, that employee can be excluded from the FTE count in the base period (they are already excluded from the 8-week forgiveness period).

Excess Wage Reductions

- This only applies to:
  - Employees who earned an annualized salary of <u>not more than </u>$100,000 a year in the most recent full quarter they were employed prior to the 8-week forgiveness period (general Q1-20) and
  - Whose salaries were reduced by more than 25% during the 8-week period
  - Also, if a borrower reduced a salary by more than 25% between February 15, 2020 and April 26, 2020 but restores the salary by June 30, 2020, the excess wage reduction does not apply.
- If this applies, the amount of loan forgiveness is reduced by the amount by which the salary reduction exceeds 25%

Excess Wage Reduction - Example

	For the Period*	Annualized
Salary in Q1-2020	$25,000	$100,000
Salary for 8-week forgiveness period	10,769	70,000
Reduction amount (30%)		30,000
Maximum allowable reduction (25%)		25,000
Excess reduction		5,000
For the 8-week period (5,000/52*8)	769	

* The “period” is either the most recent full quarter worked by the employee, or the 8-week forgiveness period, as is applicable.

Planning Considerations

Maximizing Forgiveness

- Reducing FTEs has the biggest negative impact on loan forgiveness
  - It is better to reduce salaries than FTEs
  - If you reduced FTEs between 2/15 and 4/26, plan to rehire them by 6/30
- Consider running and paying a short-period payroll on or just before the last day of the 8-week forgiveness period
- If non-payroll expenses will fall short of the 25% cap, make sure you are picking up all eligible interest, rent and utility costs
- Monitor new regulations as they come out in order to maximize your health insurance and retirement costs
- Consider the need to pay small *hazard pay bonuses* to front-line workers
- Don’t do anything out of the ordinary course that might be considered abusive

Keep Good Records

- Your application for loan forgiveness must include proper documentation for all eligible costs
  - Copies of payroll registers and supporting worksheets to reflect adjustments for those earning over $100,000 on an annualized basis (your payroll provider may be able to provide you with this report)
  - Copies of payroll tax returns (941's and state unemployment)
  - Support for retirement plan contributions, segregated between employee and employer
  - Support for health insurance premiums, segregated between employee and employer
  - Copies of rent and utility bills and loan statements (you may also need to submit loan and lease agreements)
- Consider opening a separate checking account

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