ProService HAWAII

EMPLOYERS GUIDE:

Strategic Use of PPP Funds

What's the best way to utilize your PPP loan funds? Strategic planning can help you find the answer.

Featuring advice from the HR experts at ProService Hawaii:

- Nelson Befitel / Chief Counsel
- Elena Martinez / Compliance and Regulatory Manager
- Michelle Stone / Associate Corporate Counsel

Released May 29, 2020

Note: At the time of this writing, new legislation on PPP loan forgiveness is being reviewed by Congress. Information in this guide is subject to change pending any new legislation and/or guidance released.

PART 1

Understanding your options

I received PPP approval and funding, now what?

The current business reality

Today, many Hawaii businesses are operating at significantly lower revenues versus February 15, 2020, and many have completely stopped operations altogether. Many are facing the reality that their operational needs have declined far below the levels forecasted when they applied for their PPP loan only a couple weeks ago.

If your business situation is similar to what we've just described, focusing solely on loan forgiveness may be a short-sighted decision. At this stage, placing all employees back on payroll (even though they are not performing any real work) while the government stay-at-home orders are still in effect may be a futile attempt to kickstart or accelerate your business.

Until now, much of the discussion around PPP has been focused on total loan forgiveness. However, it's not the only option.

The ProService Hawaii recommendation

We encourage all businesses who received PPP loan approvals to *build a strategic plan* and find a way to deploy PPP funds so that they can sustain their business longer than 8 weeks.

While loan forgiveness is an attractive feature, it's also important to note that PPP funds can be a *great short-term loan* with 1% interest, 2-year payback, and 6-months of deferred payments. PPP funds could be your business' life support in the short-term, with some funds reserved as the boost to get back on your feet when business starts to rebound.

Why strategic planning?

Ultimately, it's your decision on how to spend PPP loan funds. We're here to guide your thinking around this crucial decision, as it will have implications in the near-and long-term. In the next section, we'll show you how creating a strategic plan can help you identify when it makes sense to make the funds stretch over a longer period versus 8 weeks.

PART 2

Thinking through your business plan

Keep in mind—it's NOT all about forgiveness.

It's about surviving now, and thriving for the long-run. In this section, we'll walk you through a couple of scenarios to illustrate that while PPP loan forgiveness is very important, it shouldn't be the only consideration.

There are other critical considerations to consider.

Instead of spending funds to maximize loan forgiveness, deploy them to solve two business goals: 1) Short-term survival over the next 8 weeks, and 2) Long-term viability over the next few months and into next year.

We recommend following these steps to determine how long you can stretch your resources.

1.	Map out a monthly April-December 2020 plan. Forecast conservatively low revenue numbers through at least June. Then, forecast the following items monthly: 1. Revenue (existing and/or new sources of revenue) 2. Minimum staff required to support the products and services in #1 3. Payroll required to fund #2 4. Minimum levels of all other expenses to support #1 and/or keep your business from shutting down (utilities, rent, or mortgage interest)
2.	Allocate all your available cash sources to pay for items #2-4. This includes your PPP funding.
3.	**Answer this question:** How many months will your cash last?

Understanding Loan Forgiveness

Before we dig into the sample scenarios, it's important to understand how loan forgiveness is calculated. As of this writing, the Small Business Administration (SBA) has yet to issue final guidelines on how the forgiveness provisions will work, but the CARES Act and the SBA's Interim Final Rules provide us some guidance.

> ***Disclaimer:*** *As of 5/29/20, new legislation on PPP loan forgiveness is being reviewed by Congress. Information presented in this guide is subject to change pending any new legislation and/or guidance released.*

These 3 factors can reduce loan forgiveness:

1. **Headcount reduction:** Per the Treasury guidelines, you must match your full-time equivalent (FTE) headcount from *before the COVID period* to your FTE count *during the loan period*. There are safe harbors for employees voluntarily resigning or refusing work, or if your FTE count is restored by 6/30/2020. If your FTE count is lower during the loan period and on the safe harbor date, the forgivable amount will be proportionately reduced.

HOW TO CALCULATE YOUR AVERAGE FTE

There are **two options** for Calculating FTE during the Covered Period or Alternative Covered Period.

- **Option 1:** Use average number of hours paid per week divided by 40, capped at 1.0. For each employee, take the average number of hours paid per week, divide by 40, and round the total to the nearest tenth.
- **Option 2:** Count all employees who work 40/week or more hours as 1.0 and anyone below that at 0.5.

The borrower has their choice of Reference Period, either (i) February 15, 2019 to June 30, 2019; (ii) January 1, 2020 to February 29, 2020; or (iii) in the case of seasonal employers, either of the preceding periods or a consecutive 12-week period between May 1, 2019 and September 15, 2019.

2. **Major reduction of an employee's salary and wages:** For any employee who is paid an annual salary or wages of $100k or less, you should not reduce that employee's

wages/salary by more than 25% or your loan forgiveness amount will be further reduced. Wages/salary include commissions and tips.

3. **Overspent on non-payroll costs:** if you spend more than 25% of the PPP loan amount on non-payroll costs (i.e., rent, utilities, mortgage interests), then the dollar amount of the portion beyond 25% reduces, dollar for dollar, the amount of loan forgiveness.

How to calculate loan forgiveness:

1. Look at how much you spent on payroll over the 8-week period, and that becomes 75% of the forgivable amount.

THE LOAN PERIOD

There are **two methods** to determine the loan period.

1. The 56 days (8 calendar weeks) following the disbursement of your loan. This is called the "covered period" which starts once the PPP funds hit your account.
2. For businesses with bi-weekly or more frequent payroll, you may choose an "alternate covered" period which is the first day of the pay period immediately following the disbursement of the loan and will end on the 56th day after.

Fact: If your goal is maximum forgiveness, you must spend 100% of those funds before the end of this eight week period.

2. If your headcount is lower in the loan period or the safe harbor date of 6/30/2020 than it was from your reference period, the forgivable amount thus far will be proportionately reduced.

3. Add in what you spent on rent, utilities, and mortgage interest. This can become a maximum of 25% of the forgivable value.

LEARN MORE >> Click here to watch the PPP Loan Forgiveness webinar.

Next, let's take a look at some basic examples to show how PPP funds can be applied.

Example A: John's Company (focus on longevity)

Scenario: John's Company has 10 full-time employees (FTE) and an average payroll of $50,000/month. He was approved for $50K x 2.5 = $125,000 PPP loan. With the business slowdown, John only has productive work for 3 FTE for the next month or so, and forecasts that business will start to pick up in July. John expects to spend $10,000 on rent and utilities over the 8 week period. What can John do with his PPP loan funds?

Recommendation: In the first 8 weeks, John brought back 3 employees and spent $40,000 on payroll. Per the Treasury guidelines, if headcount is lower on June 30 than it was on February 15, the forgivable amount will be proportionately reduced.

In this scenario, John retained 30% of his FTEs by June 30. This reduces the forgivable amount by 70% Total payroll spend plus non payroll spend was $50,000. Reducing this by 70% he qualifies for $15,000 in forgiveness.

The unforgiven amount ($110,000), will become a loan with 1% interest, 2-year payback, and 6 months deferred payment. Although he did not maximize loan forgiveness, John can keep his business running <u>beyond</u> the 8 weeks and get ready for when business picks back up in July.

Note: In this scenario, John did not reduce any employees' wages by 25% or more, and did not spend more than 25% of the forgivable amount in non-payroll costs.

John's Company Spreadsheet (focus on longevity)

#FTE on Feb 15	10			
#FTE on Jun 30	3			
% Change of FTE	70%			
	← First 8 weeks →			
	MAY	**JUN**	**JUL**	**AUG**
# FTE Needed	3	3	5	6
Payroll	$20,000	$20,000	$25,000	$30,000
Rent	$4,000	$4,000	$9,000	$9,000
Utilities	$1,000	$1,000	$1,000	$1,000
Total Expenses	**$25,000**	**$25,000**	**$35,000**	**$40,000**
	PPP can cover expenses for 4 months, buying time for business to rebound			
$PPP Funds Remaining	$100,000	$75,000	$40,000	$0

$PPP Forgivable	**$15,000**
$PPP Loan	**$110,000** (1%, 2-yr term, 6-mo deferred payments)

KEY TAKEAWAY

We believe going through this exercise and following the above approach will better position you to 1) survive the next eight weeks, and 2) rebuild your business, rehire staff and gain traction quickly post-COVID. Instead of focusing on maximum loan forgiveness, for some businesses, choosing to conserve and stretch out PPP funding could position you on the leading edge of the recovery, and ahead of your competition.

When does it make sense to focus on maximizing PPP loan forgiveness?

Using PPP loans to fund short term payroll and other qualifying expenses (payroll, utilities, rent, mortgage interest) may make most sense for your business if:

- You require 100% of their employees to do business-critical work NOW and over the eight week period following loan distribution, and
- Have the financial means to pay expenses after the first eight weeks

How can I maximize 100% PPP loan forgiveness?

First, the average full time equivalent (FTE) count in the loan period or by June 30, 2020 must be equivalent to the FTE count in your selected reference period. Second, the business must also spend at least 75% of the PPP funds on payroll costs. The remaining proceeds not spent on payroll costs should be spent on the other three other approved costs: rent, utilities, and mortgage interest.

Now let's take a look at the same scenario, except with the intention of maximizing forgiveness.

Example B: John's Company (focus on loan forgiveness)

Scenario: John has 10 full-time employees and his average monthly payroll is $50,000/month. He was approved for $50K x 2.5 = $125,000 PPP loan. With the business slowdown, John only has productive work for 3 full-time employees (FTE) ($10,000/mo payroll) for the next month, and forecasts that business will start to pick up in July. John expects to spend $20,000 on rent and utilities over the 8 week period. What can John do with his PPP loan funds?

To maximize loan forgiveness: John keeps all 10 employees full-time for 8 weeks and uses the PPP funds to pay for qualified expenses (payroll, rent, mortgage interest, utilities). Because he retained 100% of his staff from the reference period, the amount of qualified expenses spent during the first 8 weeks will be forgiven. The unforgiven balance will become a loan with 1% interest, 2-year payback, and 6 months deferred payment.

Note: In this scenario, John did not reduce any employees' wages by 25% or more, and did not spend more than 25% of the forgivable amount in non-payroll costs. Otherwise, the forgivable amount would be reduced.

John's Company Spreadsheet (focus on loan forgiveness)

#FTE on Feb 15	10			
#FTE on Jun 30	10			
% Change of FTE	0%			
	← First 8 weeks →			
	MAY	**JUN**	**JUL**	**AUG**
# FTE Needed	10	10	10	10
Payroll ($5K/FTE)	$50,000	$50,000	$50,000	$50,000
Rent	$9,000	$9,000	$9,000	$9,000
Utilities	$1,000	$1,000	$1,000	$1,000
Total Expenses	**$60,000**	**$60,000**	**$60,000**	**$60,000**
	PPP can cover expenses for 2 months. John will need a plan to cover expenses from July and on.			
$PPP Funds Remaining	$65,000	$5,000	(-$55,000)	(-$115,000)
$PPP Forgivable	**$120,000**			
$PPP Loan	**$5,000** (1%, 2-yr term, 6-mo deferred payments)			

PART 3

Deciding what's right for your business

At the end of the day, there are a lot of options and factors to consider. Business owners need to be informed so they can make the best decision for their business and employees. As an HR partner, it's our responsibility to help you understand your options—so you can make the best choice for your business.

We believe business owners will be in a *better position* to survive the next eight weeks and thrive into the new year when they understand and think through the delicate balance between loan forgiveness and long-term business viability.

IN SUMMARY, WE RECOMMEND THAT YOU:

- **Use a smaller portion of your loan to pay for the next eight weeks of truly productive payroll, utilities, rent and mortgage interest.** This amount will be forgiven.
- **Conserve the balance or your PPP for the same critical expenses beyond your first eight weeks.** This will provide you the critical cash flow you will need to sustain your business into the post-COVID era. It is also a financially attractive option. This portion would become a loan at a 1.0% interest rate, with a 2-year pay back period, and a six month deferment. There is no collateral or personal guarantee attached to the loan.

We make these recommendations because the survival of our small businesses community is paramount, for the good of our employers, their employees, and our Hawaii community.

A Note for ProService Partners

We're here to help you develop your strategic business plan and identify the best way to manage your PPP funds and cash-flow for the weeks AND months ahead. Please contact us to schedule a consultation.

LEARN MORE >> Click here to watch the CEO Insights webinar on this topic.