ProService HAWAII

EMPLOYERS GUIDE:

Strategic Use of PPP Funds

Updated with new PPP Flexibility Act (PPPFA) information

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

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What's Inside?

Why this guide

Your Paycheck Protection Program (PPP) loan has been approved, congratulations! You acted swiftly to get a piece of the $349B relief for small businesses.

More importantly, now is the time to carefully consider how those funds can be best utilized. With appropriate planning and strategic thinking, PPP funds can help you survive the next eight weeks—then rebuild, re-staff, and thrive long after that.

We're here to guide you through this very important decision.

PART 1
Understanding your options

I received Paycheck Protection Program (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 and utilize the full 24 week extension, as appropriate.

While loan forgiveness is an attractive feature, it's also important to note that PPP funds can be a *great business loan* with 1% interest and 5-year payback. 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. With the new rules, businesses can use funds to rebound and still achieve forgiveness.

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.

PART 2

Thinking through your business plan

Forgiveness is flexible, time to focus on your business needs.

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 due to the PPP Flexibility Act, forgiveness is easier and you can spend time focusing on growing your business instead of worrying about forgiveness.

There are other critical plans to consider.

Instead of spending funds to maximize loan forgiveness, deploy them to solve two business goals: 1) Short-term survival over the next 24 weeks, and 2) Long-term viability past the 24 weeks 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 PPPFA and loan forgiveness

On June 5, 2020, the **Paycheck Protection Program Flexibility Act (PPPFA)** was signed into law and *significantly* changed the original loan forgiveness rules of the PPP. Before we dig into the sample scenarios, it's important to understand what changed and how loan forgiveness is calculated.

PPP program changes as a result of PPPFA:

- *Covered Period* was extended from 8 weeks to an *optional* **24 weeks**
- *Reduced payroll expenditure* requirement from 75% to **60%**
- *Increases* amount you can use for covered non-payroll items (rent/utilities) to **40%**
- *Deadline to restore payroll levels* extended from June 30, 2020 to **December 31, 2020**
- *Loan maturity* extended from 2 years to **5 years** (for loans made after 6/5/20)
- *Loan payment deferral* changed from 6 months to the date on which the SBA remits the loan forgiveness amount to the lender. If the borrower does not apply for forgiveness, payments will be deferred for **10 months**.
- Borrowers will not suffer a reduction in loan forgiveness if they are able to document that they are unable to re-hire employees from 2/15/20 and hire similarly qualified employees, or that they are unable to return to the same level of business activity as of 2/15/20 due to compliance with COVID-19 safety or government requirements.

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 40% of the PPP loan amount on non-payroll costs (i.e., rent, utilities, mortgage interests), then the dollar amount of the portion beyond 40% 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 24-week period, and that becomes 60% of the forgivable amount.

THE LOAN PERIOD

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

1. The 168 days (24 weeks) from the disbursement of your loan. This is called the "covered period" which starts once the PPP funds hit your account.

2. You may also still use an 8 week covered period from (56 days) from the date of disbursement.

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

2. If your headcount is lower in the loan period or the safe harbor date of 12/31/20 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 40% of the forgivable value.

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

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

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 enough demand for 1 FTE for the next few months, and forecasts that business will start to pick towards the end of the year for the holidays. 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 24 weeks, John chose to only bring on employees he needed to meet customer demand. He started by bringing 1 FTE in May and ramped up to 4 FTE by October. In total, he spent $65,000 on payroll during the 24 weeks. Per the Treasury guidelines, if headcount is lower on 12/31/20 than it was on 2/15/20, the forgivable amount will be proportionately reduced.

In this scenario, John reduced his FTEs by 60% as of 12/31/20, which also reduced his loan forgiveness by 60%. To calculate the new loan forgiveness amount, take the amount spent on payroll, $65,000, and reduce this by 60% due to the reduction in employees. This comes out to $26,000 and becomes 60% of the new total loan forgiveness amount. $26,000/60% = $43,333.

The unforgiven amount ($81,667), will become a loan with 1% interest, 5-year payback, and 10 months deferred payment. Although he did not maximize loan forgiveness, John can keep his business running beyond the 24 weeks and get ready for when business picks back up in 2021.

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 2/15/20	**10**
#FTE on 12/31/20	**4**
% Change of FTE	**-60%**

	First 24 weeks					
	First 8 Weeks					
	MAY	**JUN**	**JULY**	**AUG**	**SEPT**	**OCT**
# FTE needed	1	1	2	2	3	4
Payroll ($5K/FTE)	$5,000	$5,000	$10,000	$10,000	$15,000	$20,000
Rent	$9,000	$9,000	$9,000	$9,000	$9,000	$9,000
Utilities	$1,000	$1,000	$1,000	$1,000	$1,000	$1,000
Total Expenses	**$15,000**	**$15,000**	**$20,000**	**$20,000**	**$25,000**	**$30,000**
	PPP can cover expenses for 24 weeks, almost 6 months, buying time for business to rebound					
$PPP Funds remaining	$110,000	$95,000	$75,000	$55,000	$30,000	$0
PPP Maximum Forgivable Amount	$43,333					
Loan Conversion Amount	$81,667					

KEY TAKEAWAY

We believe going through this exercise and following the above approach will better position you to 1) survive the next 24 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 8-week or 24-week period following loan distribution, and
- Have the financial means to pay expenses after the first 8 or 24 weeks.

How can I maximize 100% PPP loan forgiveness?

First, the average full time equivalent (FTE) count in the loan period (first 8 weeks) or by 12/31/20 must be equivalent to the FTE count in your selected reference period. Second, the business must also spend at least 60% 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'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 enough demand for 1 FTE for the next few months, and forecasts that business will start to pick towards the end of the year for the holidays. John expects to spend $10,000 on rent and utilities over the 8 week period. What can John do with his PPP loan funds?

To maximize loan forgiveness: John brings back all employees right away 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 24 weeks will be forgiven. Anyunforgiven balance will become a loan with 1% interest and a 5-year payback.

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 2/15/20	**10**
#FTE on 12/31/20	**10**
% Change of FTE	**0%**

	First 24 weeks					
	First 8 Weeks					
	MAY	**JUN**	**JULY**	**AUG**	**SEPT**	**OCT**
# FTE needed	10	10	10	10	10	10
Payroll ($5K/FTE)	$50,000	$50,000	$50,000	$50,000	$50,000	$50,000
Rent	$9,000	$9,000	$9,000	$9,000	$9,000	$9,000
Utilities	$1,000	$1,000	$1,000	$1,000	$1,000	$1,000
Total Expenses	**$60,000**	**$60,000**	**$60,000**	**$60,000**	**$60,000**	**$60,000**
YTD Expenses	$60,000	$120,000	$180,000	$240,000	$300,000	$360,000
	PPP can cover expenses for 8 weeks. How will John cover expenses from July and on?					
$PPP Funds remaining	$65,000	$5,000	-$55,000	-$115,000	-$175,000	-$235,000
PPP Forgivable Amount	$125,000					
Loan Amount	$0					

KEY TAKEAWAY

In this scenario, you'll see that the $125,000 in PPP funds were spent in 2 months, and John maximized loan forgiveness. However, if John anticipates demand to remain low after the first two months, he'll need a plan to cover expenses after the PPP funds are depleted.

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 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:

- **Build a 6-12 month strategic plan** to help you identify the best use of PPP funds.
- **Use PPP funds to pay for the next 24 weeks of truly productive payroll, utilities, rent and mortgage interest.** This amount will be forgiven.
- **Conserve the balance or your PPP for critical expenses beyond 24 weeks.** This may be rare, since most businesses will use the funds over 24 weeks, however, this can 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 5-year repayment period. 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.