SBA PPP: MANAGING THE 8-WEEK PROCESS

PREPARING FOR LOAN FUNDING AND EXPENSE DOCUMENTATION

April 15, 2020

Disclaimer

Please know we hate the word "disclaimer" as much as you do. However, there still remains a great deal of guidance to come from the SBA. You will note in your loan documents, likely, there will be references to the language in the law and to further interpretation and guidance which is yet to come. We sincerely wish we had all the answers, but we simply do not at this point.

We do believe we understand the spirit of the law, and that is to incent employers to remain as fully employed as possible relative to the various lookbacks. With that in mind, we offer the following guidelines.

8-Week Period

Our interpretation is that the 8-week period begins the date that funding occurs from your loan (Start Date) and that only cash payments made during the 8-week period will count toward loan forgiveness. In other words, cash payments made in advance of the start date will not count, and accrued payments at the end of the 8-week period but not yet paid will not count.

In addition, any bonuses or other payments that were accrued and ultimately paid during the 8-week period should count.

From the start date forward, we recommend that you track all expenses related to compensation, rent, utilities, and payments of interest on mortgage obligations incurred before February 15, 2020.

From a high-level view, make sure that no less than 75% of the amount of loan is spent on payroll costs and not more than 25% of the loan may be used for non-payroll costs such as rent, utilities and mortgage interest. And strive to maintain the same number of employees as the lookback periods mentioned below.

Processes

It may be advisable to deposit the loan proceeds in a segregated account so that bank statements will be specific to this use.

Begin now accumulating any documents related to payroll costs, rent, utilities, and mortgage interest. These will be helpful when communicating with your lender regarding forgiveness.

Establish a separate ledger/worksheet in order to track all PPP-related cash expenses on a weekly basis.

In our payroll system, we are working on payroll reports that can easily be pulled into a worksheet to help you track your payroll-related expenses paid during the period.

In the meantime, please keep a record of applicable payroll costs from the start date.

You will want to be tracking your non payroll related costs (rent, utilities, and mortgage interest) to also load into your worksheet.

You will want to have your comparison/lookback FTE numbers as well as compensation for the appropriate time frames as a point of reference and comparison. The lookback periods are itemized below.

For employees you've laid off, to the fullest extent possible, we recommend you work now to reactivate them. For reduced hours/furloughed employees, you can simply begin payments to them. For all employees, we recommend you resume compensation commensurate to the daily/weekly average equal to at least 75% of their average levels in the first quarter of 2020.

We realize that there may be situations where there is not enough work for all employees to do. If possible, redeploying them in other capacities could be an option. In some cases, we recognize that you could be making payments to employees who will not be working, by your choice.

If employees are choosing on their own not to work where you otherwise have work for them, we do not recommend that you pay them. It may be preferable to send them a notice to report to work and interpret those who do not as having resigned and seek to replace them.

For any of these who may not have been receiving compensation or full compensation, while notice is not required, a letter or email from you would be acceptable letting them know they are expected to either report for work, if not forbidden by a "stay at home" order, or to be on call and to confirm their banking information and address is still the same.

The Act expressly excludes the following:

- Any compensation of an employee whose principal place of residence is outside of the United States;
- The compensation of an individual employee in excess of an annual salary of $100,000, prorated as necessary;
- Federal employment taxes imposed or withheld between February 15, 2020 and June 30, 2020, including the employee's and employer's share of FICA (Federal Insurance Contributions Act) and Railroad Retirement Act taxes, and income taxes required to be withheld from employees; and
- Qualified sick and family leave wages for which a credit is allowed under sections 7001 and 7003 of the Families First Coronavirus Response Act (Public Law 116–127).

Tracking Potential Deductions and Loan Forgiveness

Obviously, it is appropriate to be tracking your progress and status as you go through the 8-week process. At this point in time, it is impossible to know exactly how the lenders will be directed to assess deductions. There are simply too many discrepancies and different interpretations in the law. We are hoping for more guidance.

For the time being, and to repeat, we believe the "spirit" of the law was to incent employers to remain as close to full strength of number of employees as possible as compared to whichever lookback period you're using.

As we have more information available, we will provide that to you.

Loan Forgiveness

Loan Forgiveness Request:
During the 7th week of the 8-week covered period, you can submit a request to the lender that is servicing the loan. The request will include documents that verify the number of full-time equivalent employees and pay rates, as well as the payments on eligible mortgage, lease, and utility obligations.

You must certify that the documents are true and that you used the forgiveness amount to keep employees and make eligible mortgage interest, rent, and utility payments. The lender must make a decision on the forgiveness within 60 days.

Forgiveness Deductions:
You will owe money when your loan is due if you use the loan amount for anything other than payroll costs, mortgage interest, rent, and utilities payments over the 8 weeks after getting the loan. No more than 25% of the forgiven amount may be for non-payroll costs.

You also may owe money if you do not maintain your staff and payroll.

- Number of Staff: Your loan forgiveness will be reduced if you decrease your employee headcount.
- Level of Payroll: Your loan forgiveness will also be reduced if you decrease salaries and wages by more than 25% for any employee who made less than $100,000 annualized in 2019.
- Re-Hiring: You have until June 30, 2020 to restore your full-time employment and salary levels for any changes made between February 15, 2020 and April 26, 2020.

Note: Remember that "total salary or wages" would include overtime, tips, allowances, commissions, bonuses, shift premiums, and so on, that were paid.

Additional Questions

The SBA has indicated that further guidance will be forthcoming on a number of questions related to the forgiveness aspect of the PPP loan program and potential deductions, among other questions.

Items already clarified:

- SBA guidance from April 3 has stipulated payments to independent contractors (1099s) cannot be included in the calculation for your loan nor are they considered eligible expenses that can be forgiven.

- Indications are also that banks are not including K-1 income for purposes of calculating loan amounts. Presumably, they will also not be including non-W-2 income for purpose of calculating loan forgiveness.

- The new guidance also indicated that 75% of loan proceeds must be applied to payroll costs in order to be forgiven. Only 25% of the loan forgiveness amount can apply to be non-payroll expenses.

Items yet to be clarified:

- There is not clarification in the current wording as to whether the expenses will be based on an accrual versus a cash basis. Therefore, we are interpreting that only cash expense for all relevant items will count.

- The definition of "Full Time Equivalent Employees" (or FTE) is still something that has not been defined for purposes of the PPP.

  For the measurement of deductions for loan forgiveness, the lookback period for comparison is either:
  1) the average number of FTE per month employed by the eligible recipient during the period beginning on February 15, 2019 and ending on June 30, 2019; or
  2) the average number of FTE per month employed by the eligible recipient during the period beginning on January 1, 2020 and ending on February 29, 2020.

  What is not defined is FTE. The DOL does not define a fulltime worker and leaves that up to employers. There are also definitions for benefit programs. ACA provides a formula that takes into consideration both part-time and fulltime employees. We did find reference to the ACA FTE calculation in the Employee Retention Credit Program which is also in the CARES ACT.

  Therefore, our recommendation is the ACA and DOL definitions as regards to overtime rules for the lookback periods of either 2/15/19–6/30/19 or 1/1/20–2/29/20 and for the 8-week period. We can calculate this for you. The prudent person, we believe, would calculate it out for both periods to determine which to submit with their request for loan forgiveness.

  We believe the key will be to be consistent in the way in which you make your calculations.

- Another deduction that is referenced comes from the pay difference. There is likely more guidance to come out regarding the measurement formula for this as well. For example, the language in the law says the forgiveness "shall be reduced by the amount of any reduction in total salary or wages…of any employee…during the covered period that is in excess of 25 percent of the total salary or wages…of the employee during the most recent full quarter during which the employee was employed before the covered period…"

  This doesn't address if the employee quits and you replace them. It doesn't say you can take total compensation and work the formula from there. And it doesn't say what happens if you terminated/laid off the employee and don't rehire them so they are no longer an employee.

  One assumption is that they will be looking at "equivalent" employees filling "equivalent" positions.

  Keep in mind that "total salary or wages" would include overtime, tips, allowances, commissions, bonuses, shift premiums, and so on, that were paid.

We realize the idea of doing the math on this for each person will be time consuming, which is why we believe there will be some more guidance to provide clarity. We will be working on the lookback documentation process to help you be prepared.

If there are any unforgiven amounts that roll into a loan, the first 6 months of interest will be allowed to accrue.

Strategic Planning Thoughts

- A borrower must use the full loan amount within the 8-week covered period in order to receive full forgiveness.

- The overriding emphasis of this legislation was to provide an incentive for employers to remain at or get back to as close to full employment as possible.

- If full employment in terms of number of employees as compared to either of the lookback periods is not an objective, it will be important to keep track of the differences and be aware of the possible deductions from loan forgiveness. Managing cash will be both a strategic and a subjective process and may require some careful forecasting and analysis.

- Where it is known that certain employees will not be reactivated, it may be advisable to retain an amount of cash from the loan equal to an approximate estimate of their compensation in the first quarter of 2020 in case you want to use that to repay that portion of the loan that may not be forgiven.

- If you have some staff working and others not working, based on your decisions, you may consider paying a reduced wage for those not working, but not below 25% of their average compensation in the first quarter of 2020. You could also consider an increased wage for employees who are working.

- Now that the loan term has been reduced to 2 years, this loan may not appear as attractive as it did with a 10-year payback. Employers who have laid off more than half of their employees may want to consider whether or not they should participate.

  For example, an employer who laid off 60% of their workforce is likely to receive a 60%-plus deduction in the forgiveness for their loan. So, depending on cash flow and cash reserves, it's possible that a significant percentage of the loan will not be forgiven and will be converted to a 2-year, 1% loan with possibly limited reserves to pay off.

  We encourage you to forecast what your expenses, potential deductions and cash position will be before completing the loan process.

- To repeat: from a high-level view, make sure that no less than 75% of the amount of loan is spent on payroll costs and not more than 25% of the loan may be used for non-payroll costs such as rent, utilities and mortgage interest. And strive to maintain the same number of employees as the lookback periods mentioned above.

- Our best advice is the following:

  1) **Plan to be at as close to full strength in number of employees (FTE) as possible during the 8-week period:**
     - **Consider bringing back laid off, reduced hours and furloughed employees**

- **Consider paying all employees even if they are not able to accrue hours during this time**

2) **Maintain at least the number of FTE you had during the 2/15/19–6/30/19 or 1/1/20–2/29/20 lookback periods**
3) **Maintain as close to your monthly average of total compensation that you showed in the first quarter of 2020 (but not less than 75% of employees' previous compensation)**
4) **Make sure 75% is spent on payroll costs and no more than 25% of the total loan proceeds is spent on allowable non-payroll items (rent, utilities, and mortgage interest)**

If this all takes place, we believe your deductions should be minimal regardless of the final guidelines.

Communicating with BFG

We welcome your requests and need your questions, and we will be working hard to process them on a timely basis. We know this is critically important to you, and we want to do everything in our power to help you successfully meet all of your obligations as an employer.

We continue to have teams dedicated to different facets of issues related to COVID-19. While the SBA PPP loan process is underway, other clients are dealing with sick leave and many other issues. We want to be responsive and diligent to all the questions and issues that arise.

In communicating with us, we would like to continue to request the following:

- The single best way to communicate with us is via email. If you already know who is likely to answer your question, you can start there. Otherwise, feel welcome to contact your normal service representative, and he or she will make sure it gets where it needs to go. You may also reach out to Kim@BFGonline.com. We will respond to your requests.

- While it can be preferable and certainly more personal to talk by phone (and in normal times, that is what we want to deliver), please note that during this time, efficiency and conservation of our service time is paramount. Phone calls simply take longer. Many clients will have the same questions, and it's easier for us to respond via email with answers already scripted. An email leaves us with documentation where a phone call requires additional time for us to stop and document the discussion.

Closing

We sincerely hope and pray that each of you will receive your funding very soon. Obviously, this represents critical capital that will enable you to "cash flow" key elements of your business. And, obviously, so many of your employees will benefit from this as well.

Please know that we are here to help you with your HR functions and decision making and will do our very best to be responsive as you have needs. Thank you for allowing us to partner with you as we live through this together.

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