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Key Considerations When Determining Whether to Apply for the Paychecks Protection Program Loan

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Presented By:

Lawrence J. Maiello, Esq.

John H. Prorok, Esq.

INTRODUCTION

- You have likely already seen or heard numerous summaries of the CARE Act Paychecks Protection Program (PPP) as it relates to small businesses having 500 or less than employees.
- At MBM, we are currently strategizing with several of our clients on whether it makes sense to take advantage of the PPP Covered Loan.

- **Please see the attached COVID Disaster Loan Comparison Summary**

ljm@mbm-law.net

INTRODUCTION

- A PPP Covered Loan will provide your business with 2-½ times your average monthly payroll for the measuring period and certain essential costs, i.e., rent and utilities, as an **unsecured** loan with no personal risk. Payment will also be deferred for no less than 6 months. Loan terms are favorable (see attached COVID Disaster Loan Comparison Summary) at 4% interest and a ten (10) year term.
- **Consider the following scenarios when analyzing whether a PPP Covered Loan is a right fit for your company.**
  - Our Business Needs Cash Now, However, Business Is Down And Has Laid Off A Majority Of Its Employees.
  - Our Management team is Concerned About Not Meeting the Requirements for Loan Forgiveness and Being Obligated to Repay a Loan Our Business Doesn't Currently Need.
  - What will the Impact be of the CARE Act $600 per Week Emergency Increase in Unemployment Benefits on my ability to Rehire my Employees in order to Maximize the Benefit of the PPP Covered Loan Forgiveness?

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SCENARIO #1: Our Business Needs Cash Now, However, Business Is Down And Has Laid Off A Majority Of Its Employees.

SCENARIO #1

EXAMPLE:

- We have laid off a majority of our employees (80%) and project significantly reduced revenue over the eight (8) week Covered Period utilized for determining PPP Covered Loan forgiveness.
- **Does it make sense for our business to apply for the PPP Covered Loan?**

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SCENARIO #1

CONSIDER:

- There is a chance the extent of your Covered Loan Forgiveness may be less than your Covered Loan amount. Unless you incur Covered Payroll expenses during the 8 week Covered Period equal to the payroll costs used to determine the amount of your Covered Loan, it is likely your Covered Loan Forgiveness will be significantly reduced.
- **Bottom Line – you might have to pay back a portion of the PPP Covered Loan.**

SCENARIO #1

CONSIDER *(continued)*:

- Loan forgiveness is only one element when determining whether to apply for the PPP Covered Loan. **Access to cash, immediately, should be another**.
- Your management team must consider if cash reserves are low what sources of financing are available to the business now and in the foreseeable future that will not require the business to go through the regular lender underwriting process AND not be secured by the business owner's personal guarantee.
- Does it make sense to utilize what remains available on the business line of credit or emergency cash reserves when the PPP Covered Loan monies can be accessed without the need for standard underwriting and personal guarantees? Likely not. Your business should apply for the PPP Covered Loan.

SCENARIO #1

NEGATIVE FACTOR

- A majority of the Covered Loan benefit **will not be forgiven if you are unable rehire a significant portion of your staff and pay wages during the Covered Period.**
- In addition, the Covered Period Qualified Expenditures for Covered Loan Forgiveness will likely be reduced by Covered Loan Forgiveness reduction factors such as the full-time equivalent employee comparison and wage rate reduction calculation to the extent applicable to your business.

POSITIVE FACTOR

- Your business will have received an unsecured loan with favorable terms to assist with immediate cash needs. The unsecured PPP Covered Loan will not be based on your current credit worthiness.

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SCENARIO #2: Our Management Team is Concerned About Not Meeting the Requirements for Loan Forgiveness and Being Obligated to Repay a Loan Our Business Doesn't Currently Need.

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SCENARIO #2

EXAMPLE:

- Let's assume 2-½ times an average monthly payroll, e.g., $200,000 (See Loan Chart for calculation details) entitles ABC Co. to a $500,000 PPP Covered Loan. What factors will be considered when determining the Covered Loan Forgiveness:
- Qualified Expenditures during the 8 Week measuring period ("Covered Period"):
- The amount of the PPP Covered Loan monies spent on qualified Covered Expenditures such as **payroll, rent, utilities, and interest on debt** (See Loan Chart) beginning on the PPP Covered Loan origination date (Act. Sect. 1106(a)(3)). The Loan origination date will be the eight (8) week starting point for determining the PPP Loan Forgiveness amount.
- **Note**: Literature has varying statements as to whether flexibility exists regarding the starting date for 8-week period, however the Act specifically references the Loan Origination date as the starting debt.

SCENARIO #2

CONSIDER

- The largest expenditure during the Covered Period **will be payroll**. If you do not bring back your laid off employees, your Covered Loan Forgiveness (CLF) will be likely minimal relative to the Covered Loan amount. **The reduced employment level will significantly lower the Covered Loan amount eligible for forgiveness**. Keep in mind the Covered Loan eligible for forgiveness will be determined by your Covered Loan expenditures subject to the reduction factors based on the employment percentage comparison and wage rate reduction built into the Act (See Chart and below).

If employees accounting for approx. 50% of ABC Co.'s monthly payroll of $200,000, i.e., $100,000, return to service with selective wage reductions over the Covered Period

→ ABC Co. will incur approximately $200,000 of qualified payroll costs ($100,000 per mos. x 2) and potentially $80,000 of additional qualified covered expenses such as debt interest, rent, utilities, etc. ($40,000 per mos. x 2)

→ For a total of **$280,000** of Eligible Covered Loan Expenditures (ECLE). Note the ECLE are also subject to reduction by the Covered Loan Forgiveness Reduction Factors before the Covered Loan Forgiveness amount can be determined.

- **Note**: The Eligible Covered Loan Expenditures are also subject to reduction by the Covered Loan Forgiveness Reduction Factors before the Loan Forgiveness amount can be determined.

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SCENARIO #2

CONSIDER *(continued)*:

- Covered Loan Expenditures before Application of Reduction Factors: **$280,000** of the **$500,000** Covered Loan is eligible for forgiveness **before** the Covered Loan Reduction Factors applied;

- Full Time Employee Count Reduction Factor: Average monthly Full Time Equivalent (FTE) employee count for ABC Co. prior to COVID 19 was 50. During the Covered Period the average monthly FTE was 40 (i.e., a reduction of 10). Covered Loan Forgiveness eligibility will be **80%** (40 FTE/ 50 FTE). Note additional factors apply when determining the FTE reduction percentage such as employees rehired before June 30, 2020. In our example ABC Co. may have initially brought back 25 employees however prior to June 30, 2020 rehired another 15 resulting in a total of 40 employees.

ljm@mbm-law.net

SCENARIO #2

IMPACT:

- The ECLE that will be used for the Loan Forgiveness calculation is only $280,000 of the $500,000 Covered Loan. The FTE reduction factor causes the Loan Forgiveness to be further reduced.
- The FTE Reduction formula provides because only eighty (80%) percent FTE's are counted as being employed during the Covered Period (40 vs. 50 employees) the Eligible Covered Loan Expenditures available to be applied towards Covered Loan Forgiveness will be reduced to $224,000 e.g. $280,000 x (80%) or $224,000.

SCENARIO #2

NOTE: A variety of factors impact the Covered Loan FTE Reduction Factor

- Employees laid off between February 15 and April 26 but rehired by **June 30** not counted against business' FTE calculation.
- Takes into account part time employees and is based on monthly averages calculated using payroll period averages during the month.
- **Salary Reduction Factor:** Reductions in wage rates in excess of twenty five (25%) will reduce Covered Loan Forgiveness on a dollar ($1) for dollar ($1) basis. If ABC Co. reduced certain employee wages by 30% during the Covered Period and after taking into account the 25% salary reduction cushion wage reductions equaled $5,000 ABC Co.'s eligible Covered Loan Forgiveness will be decreased by an additional $5,000.

ljm@mbm-law.net

SCENARIO #2

NOTE *(continued)*:

- **ABC Co. $500,000 Covered Loan Forgiveness.**
  - Eligible Covered period Expenditures: $280,000
  - FTE Employee Reduction Impact to Loan Forgiveness: ($56,000) $280,000 x .80 = $224,000.
  - Salary Reduction Impact to Loan Forgiveness = $5,000
  - Forgiveness of $500,000 Covered Loan: $219,000
  - **Balance Of $500,000 Covered Loan payable by ABC Co.: $281,000**

SCENARIO #2

THINGS TO CONSIDER:

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- **If limited work is available for ABC Co., does it make sense to immediately bring back employees when the Covered Loan is originated with the goal of maximizing Eligible Covered Expenditures during the 8-Week Covered Period so as to increase the amount eligible for Covered Loan Forgiveness?**
- The CARES Act does not penalize a company under the FTE Reduction Formula if you bring back employees laid off from February 15 through April 26 prior to June 30, 2020. The lack of Covered Expenditures during the Covered Period, however, **will** significantly reduce the Covered Loan eligible for forgiveness.
- If you are able to (a) maximize the Loan Forgiveness amount and (b) generate a portion of normal revenue, the strategy of applying for the PPP Covered Loan and quickly rehiring employees may have merit. If it is unlikely revenue can be generated or that variable costs not considered Covered Expenses will negate the limited revenue generated, it may not be advisable to use the PPP Loan. The choice not to participate in the PPP Loan may be easier to make when we consider that the Loan Forgiveness process and how it will be administered is an unknown until a company actually initiates the process.

SCENARIO #3: What will the Impact be of the CARE Act $600 per Week Emergency Increase in Unemployment Benefits on my ability to Rehire my Employees in order to Maximize the Benefit of the PPP Covered Loan Forgiveness?

SCENARIO #3

- Employees making $50,000 (plus health benefits) prior to being laid off will likely make more on unemployment when taking into account the CARES Act supplemental weekly $600 benefit. Pa. UC typically provides for a weekly benefit of approximately ½ of the employees weekly pay not to exceed in most cases $580 per week. The additional $600 a week benefit remains through July 30, 2020. An individual typically entitled to $580 will receive a weekly benefit of $1180.
- **To receive maximum PPP Covered Loan Forgiveness employees will have to be called back to work. What are my options if an employee resists a call back to work?**
- ***Section 402***(a) of Pa. UC law provides, in part, that an employee shall be ineligible for compensation for any week in which his/her unemployment is due to failure, without good cause, to accept suitable work when offered to him/her by any employer. The employer must notify the Pa UC department within seven days of the offer by submitting the form, UC-1921W, online.

THANK YOU

Maiello Brungo & Maiello

424 South 27th Street, #210 Pittsburgh, PA 15203
412.242.4400 | 412.242.4377
www.mbm-law.net

Lawrence J. Maiello | ljm@mbm-law.net
John H. Prorok | jhp@mbm-law.net