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## PPP Loan Forgiveness: Further Guidance on the Math

*NOTE: You may have seen Verrill's earlier introduction to the complexities of [Paycheck Protection Program math](#). The article below provides an even deeper look into the loan forgiveness portion of that math.*

Thousands of companies have submitted applications for loans under the Paycheck Protection Program (PPP), and those funds are beginning to hit bank accounts across the country.

Now that the money is here, or on its way, it is time to think about doing everything you can to ensure the highest possible forgiveness amount. As of this writing, we still do not have the final Small Business Administration (SBA) rules on how the forgiveness provisions will work, but we do have the statute to give us some level of guidance. Here is a detailed look at the math, as best we know it. (The key terms are defined at the bottom of the article; pay close attention to these definitions.)

**THE EIGHT-WEEK PERIOD.** **Once the PPP funds hit your account, that starts an eight-week race.** To be assured of maximum forgiveness, plan to spend 100% of those funds before the end of the eight-week period. The CARES Act computes forgiveness based, in part, on “[approved] costs incurred and payments made during [the eight-week period],” and there is no guidance yet on whether there is any leeway on timing of these expenditures. Also, **you are going to need to prove all of this later, so you must keep meticulous records of what you spent PPP funds on and when.**

Take some time to plan out how you will budget and allocate these funds once they arrive. *First*, we suggest you open a separate deposit account solely for the PPP funds and then write checks from that account. *Second*, spend as much as you can on designated **payroll costs** incurred during the eight-week period – **under the SBA's interim rule if you do not spend at least 75% of the loan proceeds on payroll costs, the dollar amount of the shortfall from 75% reduces the amount of forgiveness.** *Third*, all remaining proceeds not spent on **payroll costs** should be spent on the three other approved costs: **covered rent, covered utilities, and covered mortgage interest.**

The **payroll costs** math is interesting. As noted in the Interim Final Regulations, the PPP “provides a loan amount 75 percent of which is equivalent to eight weeks of payroll (8 weeks / 2.5 months = 56 days / 76 days = 74 percent rounded up to 75 percent).” So if your average monthly payroll has declined at all since the 12-month period used to compute the loan amount, you will struggle to reach 75% for the eight weeks. **If your payroll costs don't quite reach 75%, then consider whether to declare a special “thank you” bonus to rank-and-file employees during the eight weeks. Remember though, even if you don't achieve total forgiveness, what you are left with is a very nice two-year loan at 1% interest.**

**THE HEADCOUNT REDUCTION.** The amount you manage to pay out in approved costs for the eight-week period determines your maximum forgiveness. But, **this can be further reduced due to declines in headcount.**

You begin by measuring the number of full-time equivalents (FTEs) during the eight-week period. The FTEs equal the average number of employees you have over a given period who work at least 40 hours

per week. Say that for a given week you had three employees who worked 40 hours that week, two who worked 20, and four who worked 10. For that week, you would have five FTEs. For longer periods, you would take the numbers of regular hours (not to exceed 40 per week per employee) divide that by the number of weeks in the period, and divide that by 40. So, if during the eight-week period you had 1,472 regular hours, divided by eight weeks, that means 184 hours per week, then divide by 40 and you get an average of 4.6 FTEs.

After calculating your FTEs for the eight-week period, you will then compare this to the FTEs you had in either of two baseline periods. The baseline period can be either 2/15/19 to 6/30/19 or 1/1/20 to 2/29/20, whichever has fewer FTEs. If you had 10% fewer FTEs in the eight-week period than in your baseline period, then your loan forgiveness is proportionately reduced, by that same 10%.

**THE SALARY/WAGE REDUCTION.** Whatever forgiveness is left after the headcount reduction math can be further reduced, dollar-for-dollar, for major reductions in wages. To calculate this you first need to identify all employees during the eight-week period whom you employed at any point during 2019 and “who did not receive, during any single pay period during 2019, wages or salary at an annualized rate of pay in an amount more than \$100,000.” Call these the below-100 people. For each such employee, determine her average salary/wage rate for the first quarter of 2020. If 1/8<sup>th</sup> of the total amount of salary/wages paid to her for the eight-week period is at least 75% of her average weekly rate during Q1 of 2020, then there is no further reduction in loan forgiveness. But if she suffered such a major reduction in salary/wages that her pay for the eight-week period went down by more than 25%, then the dollar amount of the portion beyond 25% reduces, dollar-for-dollar, the amount of loan forgiveness.

**A COUPLE OF HAIL MARYS.** But wait, there’s more.

The statute includes a “fix” for the headcount-related reduction in forgiveness. If by June 30, 2020 you bring your FTE levels back up to where they were at February 15, 2020, then that excuses whatever reduction in forgiveness was attributable to a drop in headcount between February 15, 2020 and April 26, 2020. (The CARES Act wording is that the employer by June 30 “has eliminated” that reduction in the number of FTEs. We await guidance from the SBA on precisely what this means.)

The statute also includes a separate “fix” for the salary/wage-related reduction in forgiveness. If by June 30, 2020 you have restored the salary/wage levels of the below-100 people to at least the level existing on February 15, 2020, then that excuses any salary/wage level reductions which occurred between February 15, 2020 and April 26, 2020. (Again, the statutory wording is that the employer “has eliminated” the reduction in salary/wage.)

**DEFINITIONS.** They say the devil is in the definitions. Here are somewhat simplified versions of key statutory terms:

- **Payroll costs** are wages, salaries, commissions, tips, severance pay, and so forth – but subtract out the portion of any employee’s pay exceeding \$100,000 per year (annualized)
- **Covered rent** is rent obligated under a leasing agreement in force before February 15, 2020, and presumably includes bona fide equipment leases in addition to office leases
- **Covered utilities** means payment for a service for the distribution of electricity, gas, water, transportation, telephone, or internet access for which service began before February 15, 2020

- **Covered mortgage** interest means interest on any pre-February 15, 2020 indebtedness or debt instrument incurred by the borrower in the ordinary course of business, if secured by a mortgage on real or personal property

**BUSINESS REALITIES.** Many people these days are fixated on the forgiveness feature of the PPP loans. Forgiveness is certainly an important part of the CARES Act incentives for small businesses to retain as many employees as possible and to keep up their wage levels. However, the ultimate objective for those who own and operate such a company will be to protect the long-term health of the business. **If business realities are such that you are unable to achieve 100% forgiveness, do remind yourself that, at worst, this is a 1% loan with a two-year payback period with no collateral and no personal guarantee.** These are artificially favorable terms, and offer a significant injection of cash to help support your company's operations.

The loan forgiveness features of the Paycheck Protection Program are complex and will require detailed planning, precise execution, and meticulous documentation.