



IS MAXIMIZING PPP LOAN FORGIVENESS THE REAL ENDGAME?



On May 15, 2020, the Small Business Administration released the loan forgiveness application for the Paycheck Protection Program. The application contains a great deal of guidance and direction for assisting companies with calculating their loan forgiveness, including helpful worksheets and step by step instructions. Following the release of the application, Congress passed the Paycheck Protection Program Flexibility Act of 2020, modifying the forgiveness criteria. With this additional guidance in hand, borrowers are working diligently to determine ways to maximize their forgiveness.

But is maximizing forgiveness the real endgame?

I believe that some borrowers are doing themselves a disservice by focusing on maximum forgiveness instead of maximum long-term viability.

In a recent webinar, the New York Small Business Development Center confirmed that any PPP funds that are unused in the covered period (recently increased to 24 weeks as a result of the PPPFA) will be treated, along with the unforgiven portion of funds used in the covered period, as a five-year loan, as adjusted by the PPPFA, at 1 percent and the remaining funds can be used for any SBA approved business expenses.

Forgiveness vs. Viability

While the economy appears to be opening up, it will be a slow process and companies may encounter possible future setbacks. In evaluating their PPP funds, borrowers should be asking themselves many questions: Does the borrower have the working capital needed to weather the covered period and the months that follow? Is there enough cash to support the on-going operations until the borrower can become cash flow positive? Does it make sense for the borrower to pay employees that are underutilized or worse to sit at home when many of them can make similar or, in some cases, better wages on unemployment? These and many more questions boil down to the key question:

“Am I better off using the PPP funds to maximize payroll and forgiveness, or should I apply them to other approved uses in the covered period and then to additional SBA-approved uses after the covered period?”

To answer this question, a borrower needs to look at the bigger picture of long-term viability. Many businesses have not been able to operate during the recent months. Most, or all, of their revenues have dried up and, unfortunately, they still have significant fixed costs. They must make hard choices as to how to survive in the long run. The decisions they make should not solely be based on getting through the 24-week covered period. Companies must look to future months after that. Many borrowers may conclude that maximum forgiveness is not the best avenue forward.

Employment Levels are the Key

The biggest variable in the short term is employment. With many employees eligible for unemployment, keeping them on the payroll to do little to nothing has a net zero effect on the borrower's cash flow. You pay the employee to stay home and you get full forgiveness. If the employee can make almost as much, and in some cases more, on unemployment, a borrower may be better off by using the PPP funds for other uses or to stretch out the payroll for a smaller number of key employees.

It should be noted that the CARES Act, and the PPP in specific, are not just designed to get companies through the end of the covered period. It is part of a larger effort to keep companies viable through the end of the current economic hardships. Therefore, the effective use of funds to accomplish this goal for long-term viability supports that objective.

An Illustration

The following illustration shows the comparative resulting outcomes of a fictitious company, or borrower, based on how it deploys its PPP funding. The three scenarios are:

- Scenario 1: Full employment/maximum forgiveness
- Scenario 2: 50 percent employment/50 percent forgiveness
- Scenario 3: 25 percent employment/25 percent forgiveness

There are many factors that go into making employment decisions. Borrowers should consider the well-being of their employees when moving forward. This analysis assumes several factors regarding employment and operating decisions:

- Most or all of the employees are eligible for enhanced unemployment benefits and may have the ability to maintain compensation levels close to those prior to unemployment for a period of time.
- The borrower only plans on reducing the work force until such time as it is able to support the salaries through restored cash flow.
- The example assumes that no revenue is coming in for the entire covered period. This is an extreme case but best illustrates the potential benefits of a cash conservation strategy in a worst-case scenario.
- The illustration also assumes that FTE reductions mostly occurred after the April 26, 2020, deadline, thereby not allowing restoration by December 31. Again, a worst-case scenario.

Note: The example below is for illustrative purposes only and does not consider many other factors that impact cash flow and profitability, such as the tax effects of forgiveness.

Table 1 shows the assumptions used in this illustration. Please note that this analysis is oversimplified and is designed to directionally illustrate the potential outcomes given certain choices.

	Scenario 1	Scenario 2	Scenario 3
Cash before PPP	\$ 200,000	\$ 200,000	\$ 200,000
PPP loan amount	\$ 100,000	\$ 100,000	\$ 100,000
Full employment monthly payroll	\$ 40,000	\$ 40,000	\$ 40,000
Employment retained	100%	50%	25%
Other monthly PPP-approved uses	\$ 10,000	\$ 10,000	\$ 10,000
Monthly other expenses	\$ 10,000	\$ 10,000	\$ 10,000
Covered period in months	5.54	5.54	5.54

Table 2 illustrates the cash deployed during the covered period (24 weeks) for each of the scenarios. The table also shows the resulting cash positions of each scenario at the end of the covered period. As shown, there is a \$166,000 increase in cash availability from Scenario 1 to Scenario 3. It is also important to note that the borrower will not even survive the covered period in Scenario 1.

The excess cash positions in Scenarios 2 and 3 are now available for use to both survive the covered period and in the weeks and months following the covered period. Please note that the PPP funds that were not used in the covered period can still only be used for SBA-approved expenses going forward, but these uses are broader than the PPP-allowable expenses. In the scenarios shown, it is assumed that there are enough SBA-approved expenses to fully utilize remaining PPP funds.

	Scenario 1	Scenario 2	Scenario 3
Covered period uses			
Payroll uses of PPP	\$ 221,538	\$ 110,769	\$ 55,385
Other uses of PPP	\$ 55,385	\$ 55,385	\$ 55,385
Total uses of PPP	\$ 276,923	\$ 166,154	\$ 110,769
Non-PPP expenses	\$ 55,385	\$ 55,385	\$ 55,385
TOTAL CASH USES	\$ 332,308	\$ 221,538	\$ 166,154
Covered period cash position			
Beginning cash before PPP	\$ 200,000	\$ 200,000	\$ 200,000
PPP proceeds	\$ 100,000	\$ 100,000	\$ 100,000
Less: PPP uses	(\$276,923)	(\$166,154)	(\$110,769)
Less: Non-PPP uses	(\$55,385)	(\$55,385)	(\$55,385)
New cash position after covered period	(\$32,308)	\$ 78,462	\$ 133,846
Relative scenario cash position	\$ -	\$ 110,769	\$ 166,154

Table 3 shows how those additional funds can be used to stretch the viability of the borrower. Again, please note that Scenario 1 does not even support the borrower through the covered period. The table shows two possible approaches at the end of the covered period: Approach 1 assumes that full employment is restored. Approach 2 shows a case where the employment reductions must be kept at a reduced number assuming that business has not fully rebounded enough to support full payroll. Using a strategic expense deployment, this particular illustration shows that the company can extend its viability in the worst of cases by as much as 1.85 to 2.77 months. Approach 2 shows that the viability can be stretched by 5 months. This provides for more runway to execute a recovery.

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	Scenario 1	Scenario 2	Scenario 3
Approach 1: Full restoration of employment			
Monthly burn rate (no revenues)	\$ 60,000	\$ 60,000	\$60,000
Months of cash flow remaining	-0.54	1.31	2.23
Increase in months of viability over Scenario 1		1.85	2.77
Approach 2: Maintaining reduced employment			
Monthly burn rate (no revenues)	\$ 60,000	\$ 40,000	\$ 30,000
Months of cash flow remaining	-0.54	1.96	4.46
Increase in months of viability over Scenario 1		2.50	5.00

In all scenarios, it is assumed that staff reductions came after the April 26, 2020, reduction deadline so that even with full restoration by Dec. 31, 2020, the forgiveness will still be reduced by the reduction in FTE. Table 4 shows the relative cash positions for each scenario. Although the PPPFA increases the new term to five years, this illustration assumes payment after two years.

As shown, even though forgiveness is greatly reduced in Scenarios 2 and 3, the long-term benefits are significant in terms of cash preservation.

	Scenario 1	Scenario 2	Scenario 3
Loan repayment/ no forgiveness	\$ 101,480	\$ 101,480	\$ 101,480
Forgiveness	\$ 100,000	\$ 50,000	\$ 25,000
Forgiveness percentage	100%	50%	25%
Loan not forgiven	\$ -	\$ 50,000	\$ 75,000
Principal/interest payments with forgiveness	\$ -	\$ 50,740	\$ 76,110
Relative cash impact of loan forgiveness	(\$50,740)	(\$76,110)	
Relative cash position after covered period	\$ -	\$ 110,769	\$ 166,154
Net relative cash position after 2 years	\$ -	\$ 60,029	\$ 90,044

While this is only a sample illustration, it shows that there are situations where the borrower is better off forgoing the benefit of forgiveness to extend their capital.

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