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September Hangover From All the Government Programs

By Dennis Monroe

After taking advantage of targeted government programs, offered as lifelines in a drifting economic sea, the restaurant industry now heads for shore, but with a few extra passengers on board.

With Main Street loans, two rounds of PPP, state and local grants, RRF, ERC (tax credits) and EIDL loans, it's easy to get lost in the waters.

Working with two of my partners, Tim Ring and Brad Cashman, as well as Erik Ordal, a Minneapolis CPA, we've encountered a number of issues arising from these government grant and loan programs. Hopefully, we can help you navigate some of the issues. Let's go through them one-by-one:

Paycheck Protection Program (PPP).
PPP loans were designed to keep workforces employed during the pandemic. However, many restaurant companies face a multitude of issues, especially if there were mistakes or missteps with the first round. Since we are still in the forgiveness stage, it isn't clear yet how some of these issues will be resolved, particularly for larger restaurant businesses subject to audits, but it appears the smaller loans will be forgiven fairly quickly. It's critical that you follow your bank's guidelines and ensure they're on board, because unless you're dealing with a larger loan, banks seem to be the arbiter of the forgiveness process.

That said, a key problem may be with the interplay between PPP 1 and PPP 2. If the PPP 1 could not be used for payroll because your restaurant was closed, and you applied for PPP 2 with the thought that you could use the first funds (which was a requirement in obtaining PPP 2), then you're facing a real problem for PPP 2 forgiveness. We've advised clients to pay back PPP 1 and then continue with the normal forgiveness process for PPP 2, thereby avoiding, at least theoretically, a potential violation of PPP 2's provisions.

A second issue is when there is a business sale, where PPP funds have to be escrowed by the seller until forgiveness is approved by the SBA. While in theory this seems like a safety valve, in practice there is a reluctance by traditional escrow agents to hold the funds. Tim Ring suggests obtaining the cooperation of the issuing bank first, along with ensuring that the escrow provisions are clear.

Finally, although we've received many inquiries, the SBA has not made clear their audit process for the large PPP loans.

Economic Injury Disaster Loans (EIDL). Acquiring an EIDL loan over the past year was as easy as finding a job at your local restaurant. But remember: even though it has simple terms, it's still a loan. Plus, the SBA has a security interest in all your assets (UCC filing), which has superiority over any new bank financing. So, yes, even though it can be pre-paid, the security interest might limit your ability to borrow additional funds.

You still have time to get an EIDL loan. The program runs through December 31, 2021. The maximum loan amount is $2 million and the payments are deferred for the first two years (during which interest will accrue), and payments of principal and interest are made over the remaining 28 years. There is no penalty for prepayment. The SBA must approve loans greater than $500,000. The loan term is 30 years and the interest rate is 3.75% fixed. A personal guaranty is also required for loans greater than $200,000.

Main Street Loans. The most significant issue with the Main Street loans obtained by larger restaurant companies deals with the use of the funds to make a distribution to members or shareholders. Brad Cashman points out, this can be tricky. Loan guidelines allow for distributions for payment of taxes and provide a calculation, but they do not allow other distributions.

Additionally, you can't take a distribution for one year after the Main Street loan is paid back. This presents a slippery slope, because Main Street loans are typically paid back with a refinancing (as restaurants turn around, they'll have more ability to borrow), but you can't take any distributions for one year.

Another possibility, as Cashman notes, is using Main Street loan funds to invest in new projects. So while they appear to allow for investment, particularly in related projects, they don't allow for a loan to those investments, even if it is a related party. Put simply? Be careful with the use of Main Street loan proceeds. You want to avoid a default. We recently received some comments from our clients that the Boston Federal Reserve, which administers the Main Street Program, has been asking for certain audit items to ensure compliance. This adds yet another degree of potentially burdensome reporting.

Restaurant Revitalization Funds (RRF). This was probably the most open-ended program. The uses of RRF funds were broad, such as patio capital improvements, but Ordal emphasizes the value of recordkeeping, and the fact that there is an annual accounting. Further, those who received $750,000 or more are subject to a request from the SBA for an outside CPA audit. The key for these funds is not just good recordkeeping, but also compliance with the types of acceptable expenditures. As a starting point, there's a good recordkeeping form on the National Restaurant Association website.

Employee Retention Credit (ERC). The ERC is still open, and along with it, so too are a plethora of issues and questions. Most urgently, when will you get your money back? Now that most PPP periods have expired, the connection to PPP loans will be crucial. As a result, you must ensure there are clear records of non-PPP payroll expenditures. The records are for all of 2020 and 2021, and each quarter needs to be analyzed.

As Ordal points out, while it's easy to treat the ERC as nothing more than found money, users need to understand some of the related party issues regarding payroll, such as not counting payroll to family members and understanding what truly counts as payroll.

Other potential pitfalls include the documentation related to the government restrictions, the reduction in sales versus the test period, and a one-quarter carry back where you can test the previous quarter if you don't comply with the reduction for the corresponding quarter. Again, these are tricky rules. It's best to involve your accountants early and often.

Other Government Programs. Other government programs and grants tend to be broadly based and, in many cases, don't have a lot of reporting. Be sure the use for these grants is correct and that the requirements under the applications are carried out. The actual reporting has been somewhat inconsistent from state and local agencies.

In 1797, following a long tradition of English superstition, the USS Constitution launched from Boston with a ceremonial christening: a bottle of Madeira wine broken over its bow. For the next century, ships across the American coast met a similar greeting, with everything from whiskey to brandy to even non-alcoholic grape juice. At the turn of the 20th century, the drink of choice became champagne, meant to symbolize the power and elegance associated with the new era of steel ship-making.

Unfortunately, over the past two years, it seems that many restaurants and the owners tasked with steering the ship in the storm have been left holding the broken bottle. But when it comes to the government programs that helped keep them afloat, it's not too late to piece the glass back together. And if you do it right, there will be plenty of time for a celebratory toast at port.

Dennis Monroe is chair of Monroe Moxness Berg, a law firm which focuses on M&A, taxation and other business matters for multi-unit restaurant businesses. You can reach him at dmonroe@mmblawfirm.com, or at 952-885-5962.