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Fed Loan Program Hits Main Street

The Federal Reserve's Main Street Lending Facilities – as of April 10, 2020

On April 9, the Federal Reserve (the Fed) published two new term sheets (the Term Sheets) and details for the Main Street Lending Program, which had been first been announced in a short news release by the Fed on March 23, 2020, and then further supported by some sections in the CARES Act. The Main Street Lending Program will provide up to $600 billion to facilitate new financing to small and medium-sized businesses. Under the program, a Federal Reserve Bank will lend to a single special purpose vehicle (SPV) created by the Fed, and the Treasury will provide $75 billion of equity for the SPV, which in turn will purchase 95% participations in certain loans made to eligible borrowers under the Main Street Lending Program. Banks and other lenders will retain 5% of each eligible loan.

The Fed's announcement summarized the program as follows:

> "The Main Street Lending Program will enhance support for small and mid-sized businesses that were in good financial standing before the crisis by offering 4-year loans to companies employing up to 10,000 workers or with revenues of less than $2.5 billion. Principal and interest payments will be deferred for one year. ***Eligible banks may originate new Main Street loans or use Main Street loans to increase the size of existing loans to businesses***. Banks will retain a 5 percent share [of loans], selling the remaining 95 percent to the Main Street facility, which will purchase up to $600 billion of loans. Firms seeking Main Street loans must commit to make reasonable efforts to maintain payroll and retain workers. Borrowers must also follow compensation, stock repurchase, and dividend restrictions that apply to direct loan programs under the CARES Act. ***Firms that have taken advantage of the PPP may also take out Main Street loans***."

The following chart summarizes the key terms of both the "Expanded Loan Facility" and the "New Loan Facility" – and the differences between the two.

	Expanded Loan Facility	**New Loan Facility**
Program	Under each Facility, a Federal Reserve Bank will commit to lend to a single common special purpose vehicle (SPV) on a recourse basis.	Same as Expanded Loan Facility.
Eligible Borrower[1]	Any business with up to 10,000 employees or up to $2.5 billion in 2019 annual revenues. Must be a business that is created or organized in the United States or under the laws of the United States, with significant operations in and a majority of its employees based in the United States.	Same as Expanded Loan Facility.

[1] An Eligible Borrower may not seek relief under both the New Loan Facility and the Expanded Loan Facility. And as the Fed noted, an Eligible Borrower may seek relief under the Payroll Protection Program (PPP) and either the New Loan Facility or Expanded Loan Facility.

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	<u>Expanded Loan Facility</u>	**<u>New Loan Facility</u>**
Eligible Lender	U.S. insured depository institutions, U.S. bank holding companies, and U.S. savings and loan holding companies.	Same as Expanded Loan Facility.
Eligible Loan	An upsize of an existing loan made to Eligible Borrower by Eligible Lender originated **before** April 8, 2020.	A **new unsecured loan** made to Eligible Borrower by Eligible Lender that originated **on or after** April 8, 2020.
Minimum Loan Size	$1 million	$1 million
Maximum Loan Size	Lesser of: (i) $150 million; (ii) 30% of Eligible Borrower's existing outstanding and committed but undrawn debt; or (iii) the loan amount that, when added to the Eligible Borrower's existing outstanding and committed but undrawn debt, <u>does not exceed six times the Eligible Borrower's 2019 EBITDA</u>.	Lesser of: (i) $25 million or (ii) the loan amount, that when added to the Eligible Borrower's existing outstanding and committed but undrawn debt, <u>does not exceed four times the Eligible Borrower's 2019 EBITDA</u>.
Maturity	4 years	4 years
Amortization	Deferred for one year.	Deferred for one year.
Adjustable Rate SOFR, <u>plus a margin of</u>:	250 - 400 Basis Points	250 - 400 Basis Points
Prepayment Penalty	None	None
Loan Participation	The SPV will purchase a 95% participation in the upsized tranche, at par value. The Eligible Lender will retain the other 5%. The SPV and Eligible Lender will share risk in the upsized tranche on a *pari passu* basis.	95% SPV at par value; 5% Eligible Lender. The SPV and Eligible Lender will share risk on a *pari passu* basis.

	Expanded Loan Facility	**New Loan Facility**
Collateral (if any)	Any collateral securing an Eligible Loan – whether pledged under terms of the original loan or at the time of upsizing the loan – will secure the SPV's participation on a pro rata basis. This implies that any original loan collateral must also secure the upsized loan tranche, in order to secure and cover the SPV's participation.	No collateral required.
Facility Fee	N/A	Eligible Lender will be required to pay the SPV a facility fee of 100 basis points of the principal amount of the loan participation purchased by the SPV. The Eligible Lender may require the Eligible Borrower to pay this fee.
Loan Fee and Loan Servicing	Eligible Borrower to pay Eligible Lender a fee of 100 basis points of principal amount of upsized tranche. The SPV will pay Eligible Lender 25 basis points of amount of the 95% participation in upsized tranche, per annum, for loan servicing.	Eligible Borrower to pay Eligible Lender an origination fee of 100 basis points of principal amount of Eligible Loan. The SPV will pay Eligible Lender 25 basis points of amount of the 95% participation in Eligible Loan, per annum, for loan servicing.

Highlights of Key Requirements for both Main Street Loan Facilities:

1. Eligible lenders must be U.S. insured banks and depository institutions, U.S. bank holding companies and savings and loan holding companies – *as a result, this seems to exclude most non-bank lenders, unless they are owned by a bank holding company*.

2. Each lender must attest to the following:

    a. That the Main Street loan proceeds (including of any upsized tranche) **will not be used to repay or refinance pre-existing loans or lines of credit** made by that lender to the borrower.

    b. **That it will not cancel or reduce any existing lines of credit outstanding to the borrower**, and the borrower must also attest that it will not seek to cancel or reduce any of its outstanding lines of credit.

3. **Each borrower must agree not to use the proceeds of the Main Street Loan (including any upsized tranche) to repay any other loan balances** – and specifically, must agree not to repay other debt of equal or lower priority, with the exception of mandatory principal payments, unless the borrower has first repaid this new Main Street Loan in full.

a. *Comment: Under this exception, presumably a borrower will be permitted to use any of its cash (including Main Street Loan proceeds) to make mandatory principal payments required under its existing loans.*

4. Each borrower must attest (A) that it requires this financing due to exigent circumstances presented by the COVID-19 pandemic and (B) that, using the proceeds of this Main Street Loan, **it will make reasonable efforts to maintain its payroll and retain its employees** during the term of this new Main Street Loan (or of any upsized tranche).

    a. *Comment: Interested parties will want to see whether the Fed or lenders provide further clarity around this "reasonable efforts" requirement.*

    b. *Comment: The Term Sheets impose only a "reasonable efforts" standard to maintain payroll and retain employees, whereas the CARES Act seems to indicate that for loans to "mid-sized businesses," the funds must be used to retain at least 90 percent of their workforce, with full compensation and benefits, until September 30, 2020. It now seems that the Fed has clarified or relaxed this standard for the Main Street Loans program specifically.*[2]

5. **EBITDA defined**. For both types of Main Street Loans, each borrower must attest that it meets the applicable EBITDA leverage condition stated above.

    a. It is important to note that the Fed has defined EBITDA here very simply, as "earnings before interest, taxes, depreciation, and amortization." As a result, EBITDA very likely will not be defined to include other add-backs that may be set forth in any borrower's existing loan agreements.

6. **Each borrower must agree it will follow all of the compensation, stock repurchase and capital distribution restrictions** that apply to direct loan programs under Section 4003(c)(3)(A)(ii) of the CARES Act. These restrictions provide for the following, during the time such loan is outstanding <u>plus</u> an additional 12 months:

    a. No stock buybacks, except to the extent required by a pre-existing contractual obligation;

    b. No payment of dividends or other capital distributions on common stock; and

    c. Restrictions on employee compensation:

        i. For any officer or employee (excluding union employees) whose 2019 total compensation exceeded $425,000, total compensation for any 12-month period is capped at 2019 total compensation levels.

        ii. For any officer or employee whose total compensation exceeds $3.0 million in 2019, total compensation for any 12-month period is capped at

[2] A related question is whether parts of the CARES Act relating to a program for lending to "Mid-Sized Businesses" would apply to the new Main Street Loan program – e.g., including the requirement that recipients will not outsource or offshore jobs for a period. The Fed's Term Sheets indicate that these other job requirements will not apply to the Main Street Loan Program. We will update as the Fed provides further guidance on this.

the sum of (a) $3.0 million <u>plus</u> (b) 50% of the excess over $3.0 million of 2019 total compensation.

iii. For any officer or employee in either of these categories, severance payouts upon any termination are capped at twice the 2019 maximum total compensation.

Comment: These restrictions may make these program loans unworkable and thus not applicable for many companies.

7. **Amortization of loan principal**. – The Term Sheets do not specify what types of principal amortization payments are permitted to be required after the first year (in years 2 – 4), and appear to leave that as a matter to be negotiated and agreed by each eligible lender and borrower.

8. The Fed's SPV will cease purchasing participations in eligible Main Street Loans on September 30, 2020, unless the Fed and Treasury extend the Facilities – although each Reserve Bank will continue to fund the SPV until the SPV's underlying assets mature or are sold.

9. Each lender and borrower must certify that they are eligible to participate in the new Facility, including in light of the **conflicts of interest prohibition** in Section 4019(b) of the CARES Act.

    a. This provides that any company shall not be eligible for such loans (or for loan guarantees or investments under the CARES Act), if it's a company in which the President, the Vice President, an executive department head, Member of Congress, or any of such individual's spouse, child, son-in-law, or daughter-in-law, own at least 20 percent (by vote or value) of the outstanding amount of any class of equity interests in the company.

10. **Section 13(3) Requirements Applicable to Fed Loans**. Any Fed lending program must also comply with the requirements of Section 13(3) of the Federal Reserve Act, which include the following:

    a. The Fed cannot lend to an insolvent company.

    b. The Fed must be secured – and the Fed can meet this by lending to the relevant SPV, and having the SPV pledge or repledge eligible assets.

        i. The Main Street Loan Program seems to contemplate that the SPV will pledge its loan assets to the Fed, to satisfy this requirement.

    c. The Fed must charge an interest rate higher than the applicable market interest rate in "normal times" – which presumably will be deemed to be satisfied by the SOFR-adjustable rate plus the applicable margin.

    d. The program or facility must have at least 5 participants, and cannot be aimed at one company.

11. **Finally, the Fed is encouraging feedback on these new facilities** – and we also encourage any interested parties to do so prior to the April 16 deadline:

> "The Federal Reserve and the Treasury recognize that businesses vary widely in their financing needs, particularly at this time, and, as the program is being finalized, will continue to seek input from lenders, borrowers, and other stakeholders to make sure the program supports the economy as effectively and efficiently as possible while also safeguarding taxpayer funds. Comments may be sent to the feedback form until April 16."

Authored By:

Yuanshu Deng, *ydeng@goulstonstorrs.com*

Jonathan Grippo, *jgrippo@goulstonstorrs.com*

Pamela M. MacKenzie, *pmackenzie@goulstonstorrs.com*

David R. Wiles, *dwiles@goulstonstorrs.com*