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Update on Main Street Program: Companies For Which a Main Street Loan Could Be a Good Fit

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The Federal Reserve's Main Street Lending Program has been the subject of much commentary and criticism in the past two months – both in the press and in Congress – generally based on the views that the program is off to a slow start and may be too narrow and restrictive to help "main street" businesses in the United States.[1] Given such criticism, and the challenges with the Main Street program outlined below, the focus of this article is to discuss how the program may practically be used for the middle-market and smaller businesses it is designed to benefit. In particular, our goal is to discuss which companies are more likely to be interested in, and a good fit for, a Main Street loan. It is also worth noting that Eric Rosengren, the President of the Federal Reserve Bank of Boston (which is in charge of administering the program), recently said that applications to use the Main Street program have increased significantly over the past two weeks, and he thinks that its usage will continue to increase over time as borrowers and banks become more familiar with the program details.[2]

This article will not review or summarize all of the eligibility criteria, tests and requirements of the Main Street program, most of which have been reviewed and discussed in our prior articles, The Fed Updates the Main Street Lending Program – as of May 1, 2020 and The Fed Updates The Main Street Lending Program - as of June 15, 2020, but will address certain key features that seem most relevant in determining which companies are most likely to fit the program.

Your company might be a good fit for the Main Street Lending Program, and might want to consider this type of loan, if your company is in reasonably decent shape (and thus not in serious credit distress), has some existing U.S. bank relationships with lenders that are willing to consider allowing new debt in the form of a Main Street loan, has most of its operations in U.S., has a total debt to adjusted EBITDA ratio that is not greater than 4 times for New Loans, or 6 times for Priority Loans or Expanded Loans, is not an "ineligible business" under the SBA eligibility criteria (for instance, the company is not a passive real estate business), meets the size limitations for the number of employees or annual revenues, can live within certain restrictions on dividends, stock repurchases and compensation, and is comfortable dealing with very detailed financial reporting and some complexity in its loan documents.

As a reminder, the Fed's Main Street Lending Program includes three types of loan facilities – one each for New Loans, Priority Loans and Expanded Loans (which will involve "upsized tranches" of existing loans).

A potentially interested company might consider a Main Street program loan if the following circumstances apply:

1. **Must be Eligible Business; and Within Size Limits.**
   a) The company is eligible – meaning that it is not an "Ineligible Business". The Main Street program incorporates the list of Ineligible Businesses from the list used for the Paycheck Protection Program (PPP) loans, as set forth in the Small Business Administration's

regulations. The list of Ineligible Businesses includes: financial businesses including banks and finance companies; life insurance companies; firms engaged in investment or speculative businesses (such as oil wildcatting, hedge funds and private equity firms); gambling businesses; passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds (subject to certain exceptions); and businesses primarily engaged in political or lobbying activities. The list of Ineligible Businesses is set forth in the SBA regulations at 13 C.F.R. 120.110 (b)-(j) and (m)-(s), and discussed in further detail in the SBA's Standard Operating Procedure (SOP) 50 10 5(K), Lender and Development Company Programs, effective April 1, 2019.

b) The company has (i) 15,000 or fewer employees or (ii) 2019 annual revenues not greater than $5 billion. The employees and revenues of the Eligible Borrower must be aggregated with the employees and revenues of its affiliated entities. Any portfolio companies owned by private equity funds can be eligible if they qualify after taking into account these affiliation rules, although the private equity funds themselves are not permitted to borrow under the Program.

2. Significant Operations in the U.S.

Among other eligibility criteria, the company must have "significant operations" in the U.S. For this purpose, the borrower is evaluated on a consolidated basis, together with its subsidiaries (but not with its parent or sister affiliates). There are certain safe harbors outlined in the FAQs (which are illustrative and not an exhaustive list of examples), which include companies having greater than 50% of (a) their assets located in the U.S., or (b) their annual net income, or net operating revenues, generated in the U.S., or (c) their annual operating expenses generated in the U.S.

3. Could Use New Financing.

All of this analysis is relevant, of course, only if the company can use and is looking for additional loan financing in the first place, e.g., for general working capital and to help support its business operations – and, as encouraged under the Main Street program, to make good faith efforts to maintain payroll under all the applicable circumstances. Among other things, it is worth noting that:

a) While Main Street borrowers are encouraged to make commercially reasonable efforts to support their payroll under the borrower's applicable circumstances, this is not a strict requirement of the program and each borrower may generally use its judgment in how best to use the proceeds – so long as the loan proceeds are not used for an impermissible purpose, such as for repayment of other existing debts that are not "mandatory and due" or to fund a capital distribution that is not permitted under the rules; and

b) Main Street loan proceeds can be used for a wider set of business purposes, including to purchase business assets and even for acquisitions of other companies and businesses.

4. **Credit Rating of "Pass".**

Even if the company may be experiencing some distress (whether due to the pandemic or otherwise), it is still substantially in compliance with its loan document terms and is likely to receive a "pass" credit rating from its existing U.S. bank lender or a future U.S. bank lender. Only a U.S. bank lender can confirm whether this test will be satisfied or not, and it's worth noting that some business borrowers whose loans have been in default and a workout situation will not receive a "pass" rating.

a) The specifics of credit rating systems vary from bank to bank, but based on the Federal banking regulators' guidance, this means the borrower's credit must not be rated in the four lowest classifications used by the bank regulators – which are Special Mention (or "OAEM"),[3] Substandard, Doubtful, and Loss. In a typical bank credit rating system (for corporate or commercial borrowers) that uses grades from 1 to 10, with grade 1 being the highest grade (meaning the lowest credit risk), a "pass" rating would be grade 6 or better, and the four lowest ratings would be grade 7 (Special Mention) through 10 (Loss).

b) Generally speaking, the internal credit rating of each bank is confidential and not to be shared with borrowers or prospective borrowers (or with any third parties, for that matter), but under the Fed's FAQs, it is intended that banks would be able to answer this question and inform the borrower whether or not it has a "pass" rating.

c) One final related note: As noted in a July 8, 2020, article in The New York Times, the president of the Boston Fed, Eric Rosengren, has observed that the goal of the Main Street program "was not to make as many loans as possible, but to support companies that went into the pandemic in good health and had trouble getting access to credit". And in a speech on August 12, 2020, Rosengren said the Fed "is aiming to help creditworthy businesses and nonprofits that have suffered temporary cash-flow problems due to the pandemic".

5. **Solvency.**

The company is solvent and expects to be in the near future, has a reasonable basis to believe it can meet its financial obligations for at least the next 90 days after obtaining a Main Street loan, and does not expect to file for bankruptcy during that 90-day time period. Perhaps this should go without saying, especially given the "pass" credit rating test noted above.

6. **Existing Bank Relationship?**

The company has an existing loan, or other relationship, with a U.S. banking institution that is willing to consider an Expanded Loan or New Loan to the company.

a) This is because only U.S. banking institutions can qualify as eligible lenders, and it seems more likely that companies with an existing U.S. bank loan or other relationship with a U.S. bank, and which are seeking additional financing, will be able to work out terms for a New or Expanded Loan under the Main Street program.

b) In addition, in our view, the most likely scenarios for a Main Street loan to fit and be made to a company would involve either (i) an existing bank lender that is willing to consider making an Expanded Loan (also called an "upsized tranche" of the bank's existing loan), or

(ii) a bank with some other existing relationship (e.g., involving treasury management or capital markets) with a prospective borrower where that bank is asked to consider making an additional loan, which could be a New Loan or Priority Loan. Either of these situations seems more likely to work for a Main Street loan, when compared to the situation involving one or more non-bank lenders (often called "direct lenders" in the loan markets) that may be asked to consent to a new bank loan for the same borrower. In the latter case, the new bank loan would need to rank pari passu (or equally senior) with the existing non-bank lender loan and share in any relevant collateral if the existing non-bank lender loan is secured.

7. **Positive EBITDA.**

The company has a positive "adjusted EBITDA" – which is essential in order to qualify for any type of Main Street loan. Each eligible borrower must have sufficient positive adjusted EBITDA to support the minimum loan size amount – which minimum amount is $250,000 for New Loans and Priority Loans, and is $10,000,000 for Expanded Loans. This means the borrower would need to have 2019 adjusted EBITDA of at least:

i. $62,500 to support the minimum loan amount of $250,000 for a New Loan, based on maximum debt to adjusted EBITDA ratio of 4 times;

ii. $41,666 to support the minimum loan amount of $250,000 for a Priority Loan, based on a maximum debt to adjusted EBITDA ratio of 6 times; and

iii. $1,666,666.67 to support the minimum loan amount of $10,000,000 for an Expanded Loan or "upsized tranche", based on a maximum debt to adjusted EBITDA ratio of 6 times – and this amount would be in addition to the adjusted EBITDA being used to support the underlying existing loan.

8. **Limits on Leverage.**

The company is not very highly leveraged, and can live within the total debt to adjusted EBITDA ratios imposed by the Main Street loan terms – which are four (4) times total debt for the New Loan facility, and six (6) times total debt for the Priority Loan and the Expanded Loan facility.

9. **Restrictions on Dividends, Stock Repurchases and Compensation.**

The company can live within certain covenant restrictions required by the CARES Act – which generally require (i) no dividends or other capital distributions (other than for tax pass-through entities if reasonably required to cover tax obligations); (ii) no repurchases of stock or equity interests listed on a national securities exchange (unless subject to a prior contractual obligation); and (iii) limits on executive compensation. The borrower must comply with these restrictions for the life of the Main Street loan plus an additional 12 months.

a) In addition, eligible lenders will impose their own packages of covenant restrictions on borrowers, which (one would hope) will be consistent with market standards for commercial loans to similarly situated borrowers.

10. Consent of Existing Lenders; Sharing of Collateral.

If the company has debt with existing lenders, those lenders – whether they are banks or non-banks – will need to be willing to allow the borrower to take on an additional New Loan or Priority Loan under the Main Street program. If the existing loans are secured by collateral, this will require sharing of such collateral and some consent or agreement by the existing lenders that the Main Street New Loan or Priority Loan will rank at least pari passu (i.e., equally in priority) with the existing loans. These are potentially challenging intercreditor issues, and could prove to be a major obstacle to many companies being able to pursue any type of Main Street loan. And in the case of Expanded Loans, where an eligible lender bank makes an "upsized tranche" loan to its existing borrower, the upsized tranche will also need to share in relevant collateral, if the existing underlying loans are secured. As one can see, in all of these situations, the existing lenders will face the unpalatable prospect of sharing their collateral – at least to some extent – to secure new Main Street loans, thereby diluting their collateral coverage. It would seem that lenders will agree to allow additional Main Street loans and such sharing of collateral where they can see that the benefits of the new Main Street financing, for both the borrower and existing lenders, will outweigh the risks to the existing lenders of diluting their collateral coverage.

11. Financial Reporting Requirements.

The company is comfortable with the financial reporting covenants, which are substantial, requiring information that is very detailed and go well beyond what is typical for most commercial or business loans – even for most middle-market club or syndicated loan agreements. The financial reports are included in the Fed's FAQs in Appendix C, and include annual and quarterly reports on assets, liabilities, revenue, net income, EBITDA (including descriptions of EBITDA adjustments), expenses and capital expenditures, guarantor's net assets/net worth,[4] accounts receivable, inventory, accounts payable, amounts of total debt and "pari passu" debt ranking equally with the Main Street loan, types of collateral and values for collateral, and information on any covenant defaults and cures.

12. Complexity of Documents.

The company is comfortable dealing with a fairly high level of complexity in the various loan and other form documents required in connection with the Main Street loans. There are many required form certifications and covenants, and other form documents required in the Main Street program, which introduce some concepts into middle-market or even smaller business loans that are not typical – including participation agreements, servicing agreements, and co-lender agreements, among others.

13. Indemnity of the Fed, Treasury and Lender.

The company should be comfortable with the indemnity required by each borrower. Each borrower must indemnify all "beneficiaries" of the borrower's loan covenants and certifications (which beneficiaries include the Main Street Lender, as well as the Fed and U.S. Treasury) for any liabilities, claims, costs, losses or damages they incur as a result of or arising out of a material breach of any of the borrower's certifications and covenants. An indemnity provision like this is unprecedented in private commercial loan documents and, in addition to other Main Street provisions, the indemnity provides added pressure for each borrower to ensure it can comply with all of the mandatory certifications and covenants.

We hope this discussion is helpful in outlining the issues and considerations for each company that could, under applicable circumstances, consider applying for a Main Street loan and working through the process. Our team is available to answer any questions, provide additional assistance and advice, or discuss any points further.

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[1] See, for example, the following: (i) the New York Times article on August 10, 2020, "Fed's Main Street program funneled its first loans to casinos, roofers and dentists"; (ii) the Washington Post article on August 7, 2020, "Months into recession, Fed's Main Street loan program is at a crossroads"; (iii) the LSTA Loans Magazine (Summer 2020 issue, published July 28, 2020), which included the article "The Main Street Lending Program: Much Ado About Very Little"; and (iv) the New York Times article on July 8, 2020, "Big Banks Aren't Embracing Fed's Main Street Loan Program".

[2] See "The COVID-19 Pandemic, the Economic Outlook, and the Main Street Lending Program," Remarks to the South Shore Chamber of Commerce, by Eric S. Rosengren, President and Chief Executive Officer of the Federal Reserve Bank of Boston ("Rosengren"), on August 12, 2020; and the Bloomberg TV interview with Rosengren on August 12, 2020.

[3] OAEM is an abbreviation for Other Assets Especially Mentioned.

[4] Guarantors are not required under the Main Street program, unless the borrower is a holding company, in which case it must certify (i) that the loan is fully guaranteed on a joint and several basis by all of its subsidiaries that are included in the EBITDA calculation, and (ii) if the loan is secured, that such guarantees are also secured. In addition, under the Main Street program, eligible lenders have the discretion whether to approve each Main Street loan and in doing so may impose additional requirements – such as requiring guarantees from a borrower's parent companies, subsidiaries, or even individual owners.