

# The Fed Updates the Main Street Lending Program – as of May 1, 2020

May 1, 2020

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## **Executive Summary**

On April 30, the Federal Reserve Board (Fed) announced revisions to the scope and eligibility requirements for the Main Street Lending Program (the MSLP or Program) in response to over 2,200 comment letters. The changes generally expand the parameters of the Program, but also include new rules that will limit eligibility for some borrowers and which must be carefully navigated.

The updated program is now described in three term sheets and an FAQ document all available [here](#). The start date for the Program remains unannounced. We anticipate that additional clarifications, guidance and interpretations with respect to the Program may follow. Accordingly, the information herein, based on the April 30 Program materials, is subject to further changes.

The MSLP now contemplates three types of loans:

- New Loans up to \$25,000,000 (total leverage capped at four times adjusted EBITDA);
- Priority Loans up to \$25,000,000 (total leverage capped at six times adjusted EBITDA); and
- Expanded Loans up to \$200,000,000 in aggregate facility size (total leverage capped at six times adjusted EBITDA).

Under the new Priority Loan Facility structure, lenders will retain a 15% share of loans, with the Fed purchasing the balance. This compares to the New Loan and Expanded Loan options where lenders retain a 5% share.

Under all of the loan options, lenders will apply their industry-specific expertise and underwriting standards to best measure a borrower's income. This will likely include additional adjustments to earnings (i.e. EBITDA add-backs) which were not contemplated under the Fed's earlier formulation of the MSLP.

Additionally, businesses with up to 15,000 employees or up to \$5 billion in annual revenue are now eligible, compared to the initial program terms, which were for companies with up to 10,000 employees and \$2.5 billion in revenue. The minimum loan size for New Loans and Priority Loans was also lowered to \$500,000 from \$1 million. With the changes, the Program will now potentially offer more options to a wider set of eligible small and medium-size businesses. We note, however, that the Program now also includes rules requiring business to account for affiliates in their eligibility calculations which will limit access by some otherwise eligible companies.

This alert (A) highlights some of the more significant changes the Fed made in the Program in the April 30 update, (B) summarizes current MSLP program requirements and (C) includes a table providing a grid view of certain terms of the three MSLP programs.

**A. Key Changes in the Main Street Lending Program.**

**1. Adjusted EBITDA** – The MSLP now allows use of a negotiated “adjusted EBITDA” by the Eligible Lender and each Lender can use the same methodology it previously used to calculate adjusted 2019 EBITDA when extending credit to the Eligible Borrower or “similarly situated borrowers” on or before April 24, 2020. This is a significant change that will potentially make these loans available to many more borrowers using their negotiated adjustments to EBITDA.

**2. Permitted Tax Distributions.** As an exception to the rule that no dividends or distributions will be permitted, the Fed clarified that for pass-through tax entities (such as partnerships, most LLCs and S corps), such *borrowers may make tax distributions to the extent reasonably required to cover its owners' tax obligations* in respect of the entity's earnings.

**3. Inclusion of existing Revolving Credit Facilities.** For the Expanded Loan Facility, the Fed has included existing revolving credit facilities along with existing term loans as eligible facilities to be expanded, though the expansion loan may still need to be in the form of a term loan, not an additional revolver. We expect further clarification on this point.

**4. Priority Loan Facility.** As noted above, there is a new Priority Loan Facility option, which allows greater leverage of up to six (6) times adjusted EBITDA for new loans, with greater 15% risk sharing for the lender.

**5. Calculation of “outstanding debt.”** The original term sheets indicated that borrowers would need to include all unfunded loan commitments as indebtedness for purposes of calculating leverage. The Fed has now addressed and clarified this important question in the FAQ, as follows:

“Existing outstanding and undrawn available debt’ includes all amounts borrowed under any loan facility, including unsecured or secured loans from any bank, non-bank financial institution, or private lender, as well as any publicly issued bonds or private placement facilities. It also includes all unused commitments under any loan facility, *excluding* (1) any undrawn commitment that serves as a backup line for commercial paper issuance, (2) any undrawn commitment that is used to finance receivables (including seasonal financing of inventory), (3) any undrawn commitment that cannot be drawn without additional collateral, and (4) any undrawn commitment that is no longer available due to change in circumstance. Existing outstanding and undrawn available debt should be calculated as of the date of the loan application.”

**6. Secured and unsecured term loans.** The MSLP now includes both unsecured and secured options for new loans under the New Loan and Priority Loan Facilities.

**7. Expanded Eligibility for Lenders.** In addition to U.S. banks, savings and loans and credit unions, and US bank holding companies, the Program now includes U.S. branches or agencies of foreign banks, and any U.S. subsidiary of a foreign bank. Importantly, private debt funds are not within the expanded list of Eligible Lenders.

**8. Facilities with some ineligible lenders.** The Expanded Loan Facility allows Eligible Lenders to upsize a multi-lender facility in which other non-eligible lenders participated. *This could be critical for a Borrower's existing loan facilities that include both eligible and non-eligible lenders.*

**9. Eligible Borrowers.** The program defines a "Business" as a U.S. business legal entity. The business must have been formed prior to March 13, 2020 – and organized under the laws of the U.S., a U.S. state, the District of Columbia, any U.S. territories or possessions or an Indian Tribal government. Almost any type of legal entity may be included, but a joint venture cannot have more than 49% participation by foreign business entities.

**a. Non-profit organizations.** Non-profits are not currently eligible under the MSLP, but the Fed acknowledges the need for funding to non-profits. The Fed and Treasury will continue to evaluate the feasibility of adjusting the borrower and loan eligibility metrics for non-profits.

**10. Affiliation Rules.** For counting employees and revenues of a "Business," the Program now includes affiliate aggregation rules (similar to the rules for PPP Loans but without the food service, hospitality, franchise and SBIC-investor exceptions under the CARES Act) – and must count all employees and revenues of affiliated entities. See the FAQ, E.1.(3).

**a. Aggregation for maximum loan size?** One question, which is not directly addressed, is whether affiliated Borrowers will be aggregated for purposes of maximum loan size – in applying the dollar caps or multiples of 2019 adjusted EBITDA. There is no such requirement in the Term Sheets or FAQ, but parties should monitor any future guidance from the Fed on this point.

**11. The Borrower must not be an "Ineligible Business,"** which means certain lines of business are excluded from the SBA and PPP loan programs, including: financial businesses including banks and finance companies, passive businesses owned by developers and landlords that do not actively use or occupy the assets acquired or improved with the loan proceeds (except "Eligible Passive Companies" that satisfy 13 CFR 120.111), life insurance companies, gambling businesses, speculative businesses (such as oil wildcatting), and businesses primarily engaged in political or lobbying activities.<sup>[1]</sup>

**12. Underwriting by Lenders.** The eligibility criteria in each Term Sheet set the minimum requirements for each Eligible Loan. Eligible Lenders are expected to apply their own underwriting standards in evaluating the financial condition and creditworthiness of each borrower, *and may require additional information and documentation for each loan* – "and will ultimately determine whether an Eligible Borrower is approved for a Program loan in light of these considerations". In addition, the Fed makes clear *that even if businesses otherwise meet the Eligible Borrower requirements, they may not be approved for a loan or receive the maximum allowable* – key decisions which seem to be left to the credit judgment of each Eligible Lender.

## **B. Primary Requirements of the Loan Facilities.**

All three programs share common requirements around Eligible Lenders, Eligible Borrowers, required certifications by lenders and borrowers, and other key features, with a few differences as noted below.

**1. Eligible Lenders.** Includes any U.S. bank, savings and loan or credit union, and now includes any U.S. branch or agency of a foreign bank, and a U.S. subsidiary of any foreign banking

organization. In an Expanded Loan, the Eligible Lender must be one of the lenders that holds an interest in the underlying loan at the time of upsizing. In a multi-lender facility, only the Eligible Lender for the Expanded Loan is required to meet these criteria, even if there are other non-eligible lenders in the existing facility.

**2. Eligible Borrowers.** Includes any “Business” that:

- a.** was established prior to March 13, 2020;
- b.** is not an Ineligible Business;
- c.** meets at least one of the following two conditions: (i) has 15,000 employees or fewer; or (ii) had 2019 annual revenues of \$5 billion or less;
- d.** 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;
- e.** does not participate in more than one Main Street Lending Program, or in the Primary Market Corporate Credit Facility; and
- f.** has not received specific support pursuant to the Coronavirus Economic Stabilization Act of 2020 (Subtitle A of Title IV of the CARES Act).

**Sound Financial Condition.** In addition, each Eligible Borrower cannot be insolvent, and must be in a sound financial condition prior to the onset of the COVID-19 pandemic. In order to qualify for any Eligible Loan, any existing loan (or the underlying loan for Expanded Loan Facility) the borrower had with an Eligible Lender as of December 31, 2019, must have had an internal risk rating (based on the Eligible Lender’s risk rating system) that was equivalent to a “pass” in the Federal Financial Institutions Examination Council’s (FFIEC) supervisory rating system as of that date.

**Asset-Based Borrowers.** Note that the adjusted EBITDA levels also function as an eligibility test for Borrowers to participate as well. In particular, the FAQ notes that for asset-based borrowers, the use of EBITDA is not generally applicable in practice for their loans, and that the Fed and Treasury will be evaluating the feasibility of adjusting the loan eligibility metrics to work for such borrowers.

**3. Eligible Loans.** The key details will vary for each program.

- a.** For the New Loan and Priority Loan Facilities, an Eligible Loan is a **secured or unsecured term loan** made by Eligible Lender(s) to an Eligible Borrower that was originated after April 24, 2020, provided it has other required features.
- b.** For the Expanded Loan Facility, an Eligible Loan is a **secured or unsecured term loan or revolving credit facility** made by one or more Eligible Lenders to an Eligible Borrower that was originated on or before April 24, 2020, and that has **a remaining maturity of at least 18 months** (taking into account any adjustment made to the maturity of the loan after April 24, 2020, including at the time of upsizing), provided the upsized tranche of the loan has all other required features. The FAQ provides that **both existing term loans and revolving credit facilities may be expanded or upsized (by adding a new increment or tranche)**, though the Term Sheet is

a bit confusing in that it refers only to new “term loans” – which seems to be a holdover from the original Term Sheet. We expect that further detailed guidance will be provided on this point.

**c.** Other key details for Eligible Loans are summarized in the table below.

**4. Assessment of Financial condition.** Lenders are expected to conduct an assessment of each potential borrower’s financial condition at the time of application.

**5. Loan Participations.** The Fed’s new special purpose vehicle (SPV) will purchase a 95% participation in eligible New Loans and Expanded Loans, while the SPV will purchase an 85% participation in Priority Loans, and in all cases the SPV and Eligible Lender will share risk on a pari passu basis. Each participation will be structured as a “true sale” and must be completed “expeditiously” after the Eligible Loan is originated.

In all loan types, the Eligible Lender must retain its 5% or 15% of the Eligible Loan until the loan matures or the SPV sells the participation, whichever comes first. For Expanded Loans, the Eligible Lender must also retain its interest in the underlying Eligible Loan

**6. Collateral.** Eligible loans may be secured or unsecured; however, if there is any collateral securing the underlying loan for an Expanded Loan Facility (at the time of upsizing or on any subsequent date), it must also secure the upsized tranche on a pro rata basis.

**7. Lender Certifications and Covenants.** Eligible Lenders will be required to make the following certifications and covenants:

**a.** The Eligible Lender must commit that it will not request the Eligible Borrower to repay debt extended by the Eligible Lender to the Eligible Borrower, or pay interest on such outstanding obligations, until the Eligible Loan (or Eligible Loan upsized tranche) is repaid in full, unless the debt or interest payment is mandatory and due, or in the case of default and acceleration.

**b.** The Eligible Lender must commit that it will not cancel or reduce any existing committed lines of credit to the Eligible Borrower, except in an event of default.

**c.** The Eligible Lender must certify that the methodology used for calculating the Eligible Borrower’s adjusted 2019 EBITDA for the applicable leverage requirement (see the Table below), is the methodology it previously used for adjusting EBITDA when extending credit to the Eligible Borrower or similarly situated borrowers (or for Expanded Loans, when originating or amending the Eligible Loan), in each case on or before April 24, 2020.

**d.** The Eligible Lender must certify that it is eligible to participate in the Program, including in light of the conflicts of interest prohibition in section 4019(b) of the CARES Act.

**8. Borrower Certifications and Covenants.** In addition to other certifications required by applicable statutes and regulations, Eligible Borrowers will be required to make the following certifications and covenants:

**a. Restriction on payments or cancellations of other debt.** The Eligible Borrower must commit not to pay any principal of, or any interest on, any other debt until the Eligible Loan (or upsized tranche for Expanded Loans) is repaid in full, *unless the debt or interest payment is mandatory and due*. However, for any Priority Loan, the Borrower may, at the time of originating a Priority Loan, refinance existing debt owed by the Borrower to another lender that is **not** the Eligible Lender. The

Eligible Borrower must also commit that it will not seek to cancel or reduce any of its committed lines of credit with the Eligible Lender or any other lender.

In the FAQ, the Fed provided important clarifications, including that these covenants would not prohibit a Borrower from doing any of the following during the term of an Eligible Loan:

- i. Repaying a line of credit in accordance with the Borrower's normal course of business usage for such line of credit;
- ii. Taking on and paying additional debt obligations required in the normal course of business and on standard terms, including inventory and equipment financing, provided that such debt is secured by newly acquired property and, apart from such security, is of equal or lower priority to the Eligible Loan; or
- iii. Refinancing maturing debt.

**b. No insolvency or bankruptcy.** The Eligible Borrower must certify that it has a reasonable basis to believe that, as of the date of origination of the Eligible Loan (or upsizing of the Eligible Loan) and after giving effect to such upsizing, it has the ability to meet its financial obligations for at least the next 90 days and does not expect to file for bankruptcy during that time period.

**c. The Eligible Borrower must commit to follow certain compensation, stock repurchase, and capital distribution restrictions** that apply to direct loan programs under section 4003(c)(3)(A)(ii) of the CARES Act, except that an S-corporation or other tax pass-through entity that is an Eligible Borrower may make distributions to the extent reasonably required to cover its owners' tax obligations in respect of the entity's earnings. Those other restrictions provide for the following, during the time such loan is outstanding plus an additional 12 months:

- i. No stock buybacks, except to the extent required by a pre-existing contractual obligation;
- ii. No payment of dividends or other capital distributions on common stock – except as noted above for pass-through tax entities; and
- iii. Restrictions on employee compensation:
  - a) 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.
  - b) For any officer or employee whose total compensation exceeds \$3.0 million in 2019, total compensation for any 12-month period is capped at the sum of (a) \$3.0 million plus (b) 50% of the excess over \$3.0 million of 2019 total compensation.
  - c) For any officer or employee in either of these categories, severance payouts upon any termination are capped at twice the 2019 maximum total compensation.

**d. The Eligible Borrower must certify that it is eligible to participate in the Facility, including in light of the conflicts of interest prohibition in section 4019(b) of the CARES Act.**

- i. This provides that any borrower shall not be eligible for such loans (or for loan guarantees or investments under the CARES Act), if the company is one 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.

**e. Lender Role in Verifying Certifications and Covenants.** An Eligible Lender must collect the required certifications and covenants from each Eligible Borrower at the time of origination or upsizing, and Eligible Lenders may rely on those certifications and covenants, as well as any subsequent self-reporting by an Eligible Borrower. However, the Eligible Lender is not expected to independently verify certifications or actively monitor ongoing compliance with covenants – but if it learns of a material breach, an Eligible Lender should notify the Federal Reserve Bank of Boston (FRB Boston).

**f. Retaining Employees.** Each Eligible Borrower that participates in the Facility *should make commercially reasonable efforts to maintain its payroll and retain its employees* during the time the Eligible Loan (or upsized tranche) is outstanding. In the FAQ, the Fed also explains the following: “*Specifically, an Eligible Borrower should undertake good-faith efforts to maintain payroll and retain employees, in light of its capacities, the economic environment, its available resources, and the business need for labor.* Borrowers that have already laid-off or furloughed workers as a result of the disruptions from COVID-19 are eligible to apply for Main Street loans.”

**9. Types of Fees.** The program also provides for certain fees, including: (i) a transaction fee that the Eligible Lender will pay the SPV on loan principal (which the Eligible Lender may require the Eligible Borrower to pay); (ii) a loan origination fee, which the Eligible Borrower will pay the Eligible Lender; and (iii) and a loan servicing fee, which the SPV will pay the Eligible Lender on the participation amount. These fees are further detailed in the table below.

**10. FRB Administration.** The FRB Boston will administer the Program, and will establish the Main Street SPV to purchase loan participations from Eligible Lenders in any of the twelve Federal Reserve districts. More detail on how the Program will be operationalized will be made available in the future.

[1] This probably will require a more detailed analysis in each case, but in general we think that most property management companies will be eligible and not excluded under these provisions.

***Summary of Certain Key Terms:***

**Main Street**

**Lending**

**Program Loan**

**New Loans**

**Priority Loans**

**Expanded Loans**

**Options**

**Term / Maturity**

4 years

4 years

4 years

**Minimum Loan**

\$500,000

\$500,000

\$10,000,000

**Size**

<b>Maximum Loan Size</b>	Lesser of \$25M or 4x 2019 adjusted EBITDA.	Lesser of \$25M or 6x 2019 adjusted EBITDA.	Lesser of \$200M, 35% of outstanding and undrawn available debt, or 6x 2019 adjusted EBITDA.
<b>Risk Retention</b>	5%	15%	5%
<b>Amortization payments (year one deferred for all)</b>	Years 2-4: 33.33% each year.	Years 2-4: 15%, 15% and 70%.	Years 2-4: 15%, 15% and 70%.
<b>Interest Rate</b>	LIBOR plus 3.0%	LIBOR plus 3.0%	LIBOR plus 3.0%
<b>Transaction Fee</b>	1.0% of loan  1.0% of Eligible Loan, paid by  Borrower to	1.0% of loan  1.0% of Eligible Loan, paid by  Borrower to	0.75% of upsized tranche  0.75% of upsized tranche – paid by  Borrower to Lender.
<b>Fees for Loan</b>	Lender.	Lender.	Borrower to Lender.
<b>Origination and Servicing</b>	SPV will pay  Lender 0.25% of the participation amount, for loan servicing.	SPV will pay  Lender 0.25% of the participation amount, for loan servicing.	SPV will pay Lender 0.25% of the participation amount, for loan servicing.
<b>Prepayment permitted</b>	Prepayment permitted without penalty.	Prepayment permitted without penalty.	Prepayment permitted without penalty.
<b>Collateral</b>	Optional for Lender.	Optional for Lender.	Any collateral for Eligible Loan must secure the upsized tranche on pro rata basis.
<b>Ranking and Priority</b>	Eligible Loan is not, at any time, contractually subordinated in terms of priority to any of Eligible Borrower's other	Eligible Loan is senior to or pari passu with, in terms of priority and security, the Eligible Borrower's other loans or debt instruments, other than mortgage debt.	The upsized tranche is senior to or pari passu with, in terms of priority and security, the Eligible Borrower's other loans or debt instruments, other than mortgage debt.

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