Main Street Lending Program: Decisions for Boards and Ownership

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In this alert we summarize the parameters outlined by the Department of the Treasury and the Federal Reserve for eligible lenders making loans under the Main Street Lending Program (the "Program"), that portion of the CARES Act (the Coronavirus Economic Stabilization Act) for which certain businesses with either (a) 15,000 employees or fewer or (b) 2019 annual revenues of $5 billion or less may be eligible, and review the factors that boards of directors and owners, including private equity investors, need to weigh when deciding to obtain funding through this program.

The Federal Reserve and the Department of the Treasury should be commended for their ongoing efforts to support U.S. businesses in a meaningful way during the COVID-19 pandemic. However, even with the thoughtful updates rolled out by the Federal Reserve in late May and early June, including lowering the minimum loan size of two facilities under the Program to $250,000, extending the maturity of all three facilities under the Program to five years and increasing the maximum loan size of all three facilities under the Program, questions remain whether the Program is a suitable solution for most small and middle market businesses.

- **What is the policy goal?** Using the unlimited purchasing power granted to the Federal Reserve, who will quickly acquire the lion's share of completed loans through participations, the policy goal is for banks to lend up to a combined $600 billion under the Program. The Program is designed to provide support to small and medium-sized businesses and their employees across the United States during the current period of financial strain by supporting the provision of credit to such businesses. The availability of additional credit is intended to help companies that were in sound financial condition prior to the onset of the COVID-19 pandemic maintain their operations and payroll until conditions normalize.

- **Who is eligible?** Businesses who meet the "Eligible Borrower" qualifications described in more detail below. The lending facilities under the Program are restricted to borrowers meeting debt to EBITDA ratios, effectively excluding some emerging growth companies, who, though employing in excess of 500 persons and thus not receiving Paycheck Protection Program ("PPP") aid, are also not eligible for this assistance if not showing positive cash flow for 2019. However, it should be noted that businesses that received PPP loans are permitted to borrow under the Program so long as they meet the other eligibility criteria.

- **Timing.** The Main Street Lending Program's SPV, MS Facilities LLC (the "SPV"), which will purchase participations in 95% of Program loans, will stop purchasing participations on September 30, 2020 unless the Federal Reserve and the Department of the Treasury extend the Program. As eligible lenders need to engage in their formal underwriting process for any Program loans, if companies want to take advantage of the Program, they need to move quickly.

This alert assumes some familiarity with the CARES Act, signed by the President on March 27, 2020, and the reader can access prior alerts at www.sycr.com to understand the relief package more fully.

1. Overview

The Federal Reserve has launched three parallel loan programs: 1) the Main Street New Loan Facility ("MSNLF"), 2) the Main Street Priority Loan Facility ("MSPLF") and 3) the Main Street Expanded Loan Facility ("MSELF"). The key terms of each of these facilities are summarized in the table below and are detailed under the releases linked at the end of this alert. Borrowers seeking to obtain new loans under the MSNLF or MSPLF, or to upsize existing loans under the MSELF, must apply through an eligible lender (which are U.S. federally-insured depository institutions such as banks, savings associations and credit unions, US branches or agencies of foreign banks and certain like organizations, in each case who choose to participate in, and register for, the Program; the Program does not extend eligibility to nonbank lenders currently). Unlike the PPP where if businesses certified that they met the basic eligibility requirements and then could have their loan applications processed by eligible lenders with minimal additional review by such lender, under the Program, in addition to the basic eligibility requirements for borrowers, eligible lenders will conduct their own assessment of each potential borrower's financial condition at the time of the potential borrower's application, applying their own underwriting standards in evaluating the financial condition and creditworthiness of a potential borrower.

2. Borrower Eligibility Criteria

A borrower must meet certain eligibility requirements to obtain a loan under the Program. The "Eligible Borrower" criteria are the same across all three loan facilities:

a. The Borrower must have been established prior to March 13, 2020.

b. The Borrower cannot be an "Ineligible Business" (these include financial businesses primarily engaged in lending, businesses located in a foreign country, businesses deriving more than one-third of gross annual revenue from legal gambling activities, businesses engaged primarily in political or lobbying activities, speculative businesses and others set forth in 13 CFR 120.110(b)-(j), (m)-(s), as the Federal Reserve may modify these criteria further from time to time).

c. The Borrower must either (i) have fewer than 15,000 employees[1] or (ii) have 2019 revenue of $5 billion or less.

d. The Borrower must be (i) created or organized under US law, (ii) have significant operations in the US, and (iii) have a majority of its employees in the US.[2]

e. The Borrower must not have participated in another Main Street facility or in the Primary Market Corporate Credit Facility.[3] This does not preclude borrowers from having both a Main Street loan and a PPP loan if a borrower is eligible for both programs.

f. The Borrower must not have received certain specified support under the CARES Act.[4] This does not preclude borrowers from having both a Main Street loan and a PPP loan if a borrower is eligible for both programs.

g. The Borrower must be able to make required certifications and covenants under the Program.

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1 As per 13 CFR 121.106 ("How does SBA calculate number of employees?"), the number of employees counted include all full-time, part-time, seasonal or otherwise employed persons, excluding volunteers and independent contractors. In order to determine the applicable number of employees, borrowers should use the average of the total number of persons employed by the borrower and its affiliates for each pay period over the 12 months prior to the origination (or upsizing) of the Program loan.

2 In a public webinar on June 15, 2020, representatives from the Federal Reserve noted that sole proprietorships are not eligible to participate in the Program.

3 The Primary Market Corporate Credit Facility is a facility intended to support large companies through the purchase of eligible corporate bonds from, and lending through syndicated loans to, such companies.

4 The Borrower cannot have received support pursuant to Section 4003(b)(1)-(3) of the CARES Act, which pertains to direct Treasury support for passenger air carriers and certain specified related businesses, cargo air carriers, and businesses critical to maintaining national security.

Fundamentally, based on the design of the program, any participating borrower must have been in sound financial condition prior to the onset of the COVID-19 pandemic. In order for an eligible borrower to receive any Program loan, any existing loan it had outstanding with the applicable 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 supervisory rating system as of that date.

Notably, both the employee count and revenue tests require aggregation with the borrower's affiliates, which could adversely affect the ability of private equity-backed or venture capital-backed entities from accessing loans under the Program. The application of the Small Business Administration's affiliation rules rendered some companies unable to obtain funding under the PPP, despite having less than 500 employees on a standalone basis and otherwise being able to certify that economic conditions made obtaining the PPP necessary. Unlike the PPP, exceptions do not exist in the Program currently for certain businesses in the hospitality and restaurant sectors or for SBIC-funded businesses, which may further negatively impact the ability of some borrowers to obtain Program loans.

3. Basic Required Loan Terms

If an entity meets the above eligibility requirements, then it may seek to apply for a loan from an eligible lender. The following table summarizes the key basic terms that will apply to loans originated under the Program:

	MSNLF (New)	MSPLF (Priority)	MSELF (Expanded)
Loan Type	New Term Loan	New Term Loan	Upsized Term Loan Tranche of an Existing Term Loan or Revolver[5]
Maturity	5 years for all Program loans		
Principal Repayments	Deferred 2 years, then, 15% at end of year 3, 15% at end of year 4 and a balloon payment of 70% at maturity at the end of the 5th year[6]		
Interest Payments	Deferred 1 year (unpaid interest is capitalized)		
Interest Rate	LIBOR[7] + 3.00%		
Minimum Loan Size	$250,000	$250,000	$10,000,000
Maximum Loan Size	Lesser of (1) $35 million or (2) an amount, when added to outstanding and undrawn available debt, does not exceed 4x 2019 adjusted EBITDA[8]	Lesser of (1) $50 million or (2) an amount, when added to outstanding and undrawn available debt, does not exceed 6x 2019 adjusted EBITDA	Lesser of (1) $300 million or (2) an amount, when added to outstanding and undrawn available debt, does not exceed 6x 2019 adjusted EBITDA

5 Under the MSELF, the existing loan facility may be either a term loan or a revolving credit facility. However, the upsize tranche must be a term loan tranche. The existing loan must have been originated on or before April 24, 2020 and have a remaining maturity of at least 18 months.

6 Deferring principal for 2 years will be meaningful for participating borrowers. We note that there is no loan forgiveness concept for the Program as there was for PPP loans.

7 Under each program, LIBOR may be either a 1 month or 3 month rate.

8 Note that under the current program rules, the methodology used to calculate EBITDA must be the same as the lender has previously used when extending credit to such borrower or, if the lender has not previously extended credit to the borrower, it must be the same methodology applied by the lender to similarly situated borrowers on or before April 24, 2020.

	MSNLF (New)	MSPLF (Priority)	MSELF (Expanded)
Security/Priority	All Program loans can be secured or unsecured; provided however that an MSPLF loan or MSELF upsized tranche must be secured if, at the time of origination, the borrower has any other secured loans or debt instruments, other than mortgage debt or limited recourse equipment financings. MSPLF loans and MSELF upsized tranches must be, at the time of origination and at all times thereafter, senior to or pari passu with, in terms of priority and security, the borrower's other loans or debt instruments, other than mortgage debt or limited recourse equipment financings.		
Seniority	Any Program loan, at the time of origination or at any time during its term, may not be contractually subordinated in terms of priority to the borrower's other loans or debt instruments.		
Voluntary Prepayments	Permitted without penalty		
Borrower Certifications and Covenants	The Borrower must make specific certifications and covenants with respect to all Program loans, as provided on a separate form from the Federal Reserve (see the applicable links at the end of this memo)		
Use of Proceeds	Cannot be used to refinance any existing loans. If borrower is a subsidiary of a foreign company, borrower must commit to use proceeds just for borrower's benefit, its consolidated US subsidiaries, and other affiliates of the borrower that are US businesses.	Cannot refinance existing loans from the Eligible Lender providing the Program loans (but can refinance loans owed to other lenders at the time of origination of the MSPLF loan). As with MSNLF, cannot use proceeds for the benefit of foreign parents, affiliates or subsidiaries.	Cannot refinance any existing loans. As with MSNLF, cannot use proceeds for the benefit of foreign parents, affiliates or subsidiaries.
Cross-Acceleration	Must include cross-acceleration provisions. For MSELF upsized tranches where the underlying loan is part of a multi-lender facility, any cross-default or cross-acceleration provision that was negotiated in good faith prior to April 24, 2020 as part of the underlying loan is sufficient.		
Reporting	Extensive quarterly and annual financial reporting requirements are applicable (see linked June 8, 2020 frequently asked questions from the Federal Reserve (the "FAQs")). For MSELF upsized tranches, where the underlying loan is part of a multi-lender facility, financial reporting covenants negotiated in good faith on or before April 24, 2020 in such facility may be used instead.		

	MSNLF (New)	MSPLF (Priority)	MSELF (Expanded)
Fees	Transaction Fee: Eligible Lenders owe the SPV that will acquire participations in the loans a fee of 1.00% on the principal amount of the loan, due at origination. Eligible Lenders may (and almost certainly will) require the borrower to pay this fee. Origination Fee: Borrower to pay lender up to 1.00% on the principal amount of the loan, due at time of origination. Servicing Fee: The SPV will pay the lender 0.25% per annum of the principal amount of its participation in the loan		Transaction Fee: Eligible Lenders owe the SPV a fee of 0.75% on the principal amount of the upsize tranche, due at time of upsizing. Eligible Lenders may require Borrower to pay this fee. Upsizing Fee: 0.75% on the principal amount of the upsize tranche, due at time of upsizing Servicing Fee: Same as MSNLF and MSPLF.

4. Material Restrictions on Borrowers

Unlike PPP funding, which restricted each borrower's use of proceeds and incentivized borrowers to retain employees but did not impose operational restrictions on borrowers, the Program places material restrictions on borrowers, including:

a. *Managing the balance sheet*. The borrower must commit to refrain from repaying the principal balance of, or paying any interest on, any debt until the Program loan is repaid in full, unless the debt or interest payment is mandatory and due; provided that the MSPLF permits the borrower, at the time origination of the MSPLF loan, to refinance existing debt owed to a lender that is not the lender providing the MSPLF loan. The borrower must also commit that it will not seek to cancel or reduce any of its committed lines of credit. These two limitations make it more challenging for a borrower to manage its balance sheet.

b. *Commercially reasonable efforts to maintain payroll and retain employees*. The borrower should make commercially reasonable efforts to maintain its payroll and retain its employees during the time a Program loan is outstanding. According to the FAQs, borrowers "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." An important goal of both the PPP and the Program is to keep Americans employed, but the ambiguity in the foregoing standard may prove challenging for borrowers to interpret and implement.

c. *Limits on compensation*. The borrower must commit that it will follow the compensation restrictions that apply to direct loan programs under section 4003(c)(3)(A)(ii) of the CARES Act. The compensation limits in general limit the total compensation (including the value of equity grants) of an executive who made between $425,000 and $3 million to their 2019 compensation level for the term of the Program loan and one year following repayment. The compensation limits also preclude employees and officers whose total compensation exceeded $3 million in 2019 from receiving total compensation during the term of the Program loan and one year following repayment in excess of the sum of $3 million and 50% of the excess over $3 million in total compensation received in 2019.

d. *Limits on dividends*. The borrower must also commit that it will follow the capital distribution restrictions that apply to direct loan programs under section 4003(c)(3)(A)(ii) of the CARES Act. The borrower must

agree not to pay dividends or make other capital distributions with respect to its common stock (or equivalent interests in partnerships and limited liability companies), except that a tax pass-through entity can make permitted tax distributions to cover its owners' tax obligations in respect of the borrower's earnings. Also, preferred stock or other equity interests that provide for mandatory or preferential payments of dividends or other distributions are subject to similar restrictions unless such equity interests and the obligations to make such payments existed as of March 27, 2020.

e. *Limits on stock buybacks*. The borrower must also commit that it will not engage in any stock buybacks of equity securities of borrower or its parent company that are listed on a national securities exchange for the term of the loan and for one year thereafter (unless required under a contract in effect as of March 27, 2020).

f. *Inability to obtain other credit*. The borrower needs to certify that it is unable to secure adequate credit accommodations from other banking institutions. This does not mean that no other credit is available, but rather that it is not available to the borrower because the amount, price or terms of credit available from other sources are inadequate. As a technical matter, borrowers don't need to demonstrate that applications for credit have been denied or document that the amount, price or terms of credit available to it are inadequate, but in light of the potential penalties for making material misrepresentations in connection with obtaining government funds, it would be prudent for borrowers to assess through discussions with other lenders what terms are available to it.

g. *Solvency*. The borrower must certify that it has a reasonable basis to believe that, as of the date of origination of the Eligible Loan and after giving effect to such loan, 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.

5. Significant Additional Program Details

It should be noted that, in addition to the above eligibility criteria and required terms, loans under the Program are subject to the underwriting procedures of eligible lenders. Thus, Program loans will be subject to additional documentation requirements and will contain other terms and conditions that are customarily applicable to similar loans made by the applicable eligible lender. Unlike PPP funding, whereby significant numbers of borrowers were able to access the program in many cases in a relatively timely manner and participating banks relied on borrower certifications rather than any underwriting process, a bank's underwriting for a Program loan could take several weeks or months, and even then there is no guarantee that a participating bank will decide to make a Program loan. Given that the CARES Act was signed into law on March 27, 2020, and the negative impacts of the COVID-19 crisis began even earlier than that, one justifiable criticism of the program is whether there are that many borrowers who would even benefit from the Program at this point in time. The portal for lender registration opened on June 15, 2020, months after the Program was initially announced. Certainly the number of borrowers who obtained PPP loans is expected to significantly exceed the number of borrowers who obtain Program loans.

Furthermore, based on informal discussions with various participating lenders, it is clear that most lenders will be focusing their efforts, at least for the initial round of Program loans, on existing customers. While the lenders with whom we spoke may be willing to expand their Program loans to borrowers who are not customers currently, this may further delay providing relief to companies who may need it that do not currently have a banking relationship with a participating lender.

The foregoing issue is exacerbated by the fact that non-bank financial institutions such as private debt funds and direct lenders are not currently allowed to participate in the program. Non-bank financial institutions often tout their ability to move more quickly in their underwriting than traditional banks. Also, some of the mid-sized companies that the Program is trying to benefit have lending relationships with non-bank financial institutions

and may not have lending relationships with bank participants, further potentially slowing down the on-boarding and underwriting process.

6. A Complicated Weighing of Costs and Benefits

The Main Street Lending Program could be helpful for businesses that were performing well in 2019 and would otherwise shed employees due to the COVID-19 crisis but for the availability of low-cost financing through this program. Particularly if the business is closely held, and not publicly traded, a company suffering from a dramatic decline in revenue due to government shutdowns and other disruptions is positioned to benefit from this program.

However, emerging companies, even if successful and growing in the U.S., may not have meaningful 2019 EBITDA, as their products and services gain market acceptance, and thus would not be able to fully benefit from the Program. A company that ran into headwinds in 2019 through disruptions in international trade, fluctuations in commodity prices, or other factors, could have lower reported EBITDA that does not reflect the long-term viability of the business.

With the overall, critical societal goal of retaining employment and stabilizing our communities as a background, directors, private equity general partners and other managers find themselves at a difficult point. Private equity funds are not permitted to borrow under the program as the SBA has determined that private equity funds are primarily engaged in investment or speculation. As for the portfolio companies of private equity funds, even well-performing companies are relinquishing considerable operating flexibility to participate in the Main Street Lending Program, if they're even able to participate in the Program at all due to the SBA's affiliation rules applicable for the employee count and revenue eligibility tests.

Businesses should give additional consideration to participation in the Program in light of the disclosure and oversight requirements. Decision makers will need to consider the potential for headline risk if participation in the program by their business garners public attention. As a condition to obtaining a Program loan, borrowers are required to certify that they acknowledge the Federal Reserve, the Treasury and other organizations may disclose the borrower's identity, the amount of the loan, the material terms of the loan and other information. Moreover, when determining whether to participate in the program, weight should be given to the possibility that a business is subjected to potentially burdensome congressional oversight and investigatory processes, as well as the attendant potential for additional headline risk these processes may bring.

The decision makers are caught, perhaps, between their duty of care to shareholders, to take the steps that in their business judgment would deliver returns, and their duty, as citizens, to provide for employees and communities, by accepting solutions that provide liquidity in order to maintain payrolls through the COVID-19 crisis. Every fact pattern is unique, and the weight placed on these countervailing duties may vary based on the company's state of incorporation. Careful consultation with advisors is necessary to determine whether, and at what level, to use the Main Street Lending Program.

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Federal Reserve Documents

Main Street New Loan Facility

Main Street New Loan Facility terms
Main Street New Loan Facility Borrower Certifications and Covenants—Instructions and Guidance

Main Street Priority Loan Facility

Main Street Priority Loan Facility terms
Main Street Priority Loan Facility Borrower Certifications and Covenants—Instructions and Guidance

Main Street Expanded Loan Facility

Main Street Expanded Loan Facility terms
Main Street Expanded Loan Facility Borrower Certifications and Covenants—Instructions and Guidance

Main Street Lending Program Frequently Asked Questions (FAQs)