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Update: Federal Reserve announces new details of Main Street Lending Program

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Torys previously provided guidance on the preliminary details of two new loan programs created under the Main Street Lending Program (MSLP) established by the Coronavirus Aid, Relief, and Economic Security Act (CARES Act). The Main Street programs will make up to $600B in loans available to small- and medium-sized businesses impacted by the COVID-19 pandemic.

In this bulletin we discuss the Federal Reserve's announcement of a third loan option under the MSLP and several critical changes and clarifications to its earlier guidance on its previously announced programs—the Main Street New Loan Facility (MSNLF) and Main Street Expanded Loan Facility (MSELF).

The news is mixed for private equity-sponsored businesses. Helpful changes include relaxing the programs' leverage tests by allowing lenders to apply adjustments to EBITDA and clarifying that multi-lender loans with non-bank lenders in the lender group are eligible for upsize tranches under the MSELF. Potential challenges include the adoption of the Small Business Association's (SBA) affiliation rules for purposes of the programs' size eligibility standards.

Announcement of the Main Street Priority Loan Facility

The Federal Reserve announced the creation of the Main Street Priority Loan Program (MSPLF), designed to make loans available to borrowers with higher leverage ratios than the previous programs allowed. Under MSPLF, lenders will be able to make loans up to the lesser of $25M or an amount that, when added to outstanding and undrawn available debt of the potential borrower, does not exceed six times the borrower's 2019 adjusted EBITDA. This compares with four times 2019 adjusted EBITDA permitted under the MSNLF. Lenders will be required to retain a greater proportion of the risk on MSPLF loans, 15% as compared with 5% under the MSNLF and MSELF. Otherwise, loans under the MSPLF will share many of the characteristics of loans under the MSNLF and MSELF, including the newly announced changes described below.

Key changes to the Main Street Loan Program

The Federal Reserve's guidance sets out several changes to the previously announced programs, which also generally apply to the new MSPLF. The key changes include:

- The criteria for an "Eligible Borrower" will now include businesses with up to 15,000 employees or 2019 annual revenues up to $5B. Previously, these limits were set at 10,000 employees and annual revenues up to $2.5B.

- Critically for private equity and pension fund-sponsored businesses, the Federal Reserve has adopted the SBA's affiliation rules (the same rules that apply to the SBA's Paycheck Protection Program), which require an applicant to aggregate with its affiliates under common control in calculating its number of employees and 2019 annual revenues. This additional limitation will likely counteract the positive impact of increasing the number of employees and revenue limits for Eligible Borrowers.
- A potential borrower's 2019 EBITDA, used to establish maximum loan size and financial covenants, may now be calculated on an "adjusted" basis. The adjustment methodology used must be consistent with the methodology the lender has previously used when extending credit to the potential borrower or similarly situated borrowers (or in the case of the MSELF, when the underlying loan was originated or amended). Torys previously reported on problems many borrowers would face if EBITDA were not defined to allow the types of adjustments that borrowers typically rely on to improve their leverage ratio.
- The applicable interest rate for Main Street loans will be LIBOR (1 or 3 month) + 300 basis points. The Federal Reserve's previous guidance provided that interest rates would be based on the Secured Overnight Funding Rate (SOFR) + 250-400 basis points, which posed an issue as SOFR has not yet been widely adopted in the loan markets. While principal and interest will remain deferred for 1 year, the Federal Reserve has clarified that interest will be capitalized during the term of the loan.
- The definition of "Eligible Lenders" under the Main Street program continues to exclude direct lenders, however the Federal Reserve has clarified that only the financial institution that is the lender for the upsize tranche itself is required to meet the Eligible Lender criteria. Therefore, even if the underlying loan is a multi-lender facility with a non-bank lender in the group, the loan will be eligible for an upsize tranche under the MSELF.
- Other new "Eligible Borrower" requirements include being a business established before March 13, 2020 and not otherwise being in one of the categories of "Ineligible Business" defined in the SBA regulations[1].
- Among the changes for potential lenders, a lender is now required to hold its participation in the loan or upsize tranche until the loan or tranche matures, or until the Federal Reserve sells all of its participation in that loan. The new guidance expressly provides that lenders are expected to assess each potential borrower's financial condition at the time of application and collect the required certifications and covenants from each potential borrower at the time of origination. U.S. branches and agencies of foreign banks are now included as Eligible Lenders.

Key terms of the loans

	Main Street New Loan Facility	Main Street Priority Loan Facility	Main Street Existing Loan Facility
Maturity:	4 years		
Interest rate:	Adjustable; LIBOR + 300 basis points		
Deferral:	1-year deferral of amortization of principal and interest; unpaid interest is capitalized		
Minimum loan:	$500,000	$500,000	$10 million

Maximum loan:	Lesser of a) $25 million; and b) an amount that, when added to the borrower's existing outstanding and committed but undrawn debt, does not exceed four times the borrower's 2019 "adjusted" EBITDA	Lesser of a) $25 million; and b) an amount that, when added to the borrower's existing outstanding and committed but undrawn debt, does not exceed six times the borrower's 2019 "adjusted" EBITDA	The lesser of a) $200 million; b) 35% of the borrower's existing outstanding and undrawn available debt that is pari passu with the Main Street loan and equivalent in secured status; or c) an amount that, when added to the borrower's existing outstanding and committed but undrawn debt, does not exceed six times the borrower's 2019 "adjusted" EBITDA
Eligible loan:	An unsecured or secured term loan originated on or after April 24, 2020		An upsize tranche originated after April 24, 2020 of an unsecured or secured term loan or revolving credit facility, originated before April 24, 2020, that has a remaining maturity of at least 18 months (taking into account any adjustments made to the maturity of the loan after April 24, 2020, including at the time of upsizing)
Payment:	33% at the end of each of years 2-4	15% at the end of each of years 2-3 70% balloon payment at maturity in year 4	15% at the end of each of years 2-3 70% balloon payment at maturity in year 4
Prepayment:	Permitted without penalty		
Transaction fee:	Transaction fee of 100 basis points of the principal amount of the loan, payable by the lender to the Federal Reserve's special purpose vehicle. The facility fee may be passed on to the borrower		Transaction fee of 75 basis points of the principal amount of the upsize tranche, payable by the lender to the Federal Reserve's special purpose vehicle. The facility fee may be passed on to the borrower
Loan origination / upsize fee:	Origination fee of 100 basis point of the principal amount of the loan		Upsize fee of 75 basis point of the principal amount of the upsize tranche
Servicing fee:	The Federal Reserve's special purpose vehicle will pay the lender 25 basis points per annum of the principal amount of its participation in the loan / upsize tranche		
Participation retained by lender:	5%	15%	5%

Loan classification:	If the borrower had other loans outstanding with the lender as of December 31, 2019, such loans must have had an internal risk rating equivalent to a "pass" in the Federal Financial Institutions Examination Council's (FFIEC) supervisory rating system on that date		The underlying loan must have had an internal risk rating equivalent to a "pass" in the FFIEC's supervisory rating system as of December 31, 2019
Priority:	The loan must not be (at any time) contractually subordinated in terms of priority to any of the borrower's other debt	The loan must be (at all times) senior to or pari passu with, in terms of payment priority and lien priority, the borrower's other debt (other than mortgage debt)	The upsize tranche must be (at all times) senior to or pari passu with, in terms of payment priority and lien priority, the borrower's other debt (other than mortgage debt)
Security:	Unsecured	Unsecured	Any collateral securing the original loan (at any time) must secure the upsize tranche on a pro rata basis as between the lender and the Federal Reserve's special purpose vehicle
Facility termination:	Unless extended by the Federal Reserve, will close to new participations September 30, 2020		

Considerations for Eligible Borrowers

As we previously discussed, potential borrowers and private equity sponsors should be aware that the Main Street program imposes certain operational restrictions on borrowers, including restrictions on compensation, stock repurchases and distributions, and must make certain attestations in connection with receiving Main Street loans. A description of those operational restrictions and attestations can be found here .

The new guidance also provides that borrowers will be required to refrain from repaying principal and interest on any other debt until the Main Street loan is repaid (other than mandatory payments) and refrain from seeking to cancel or reduce committed lines of credit. A potential borrower must certify that it has a reasonable basis to believe it can meet its financial obligations for the next 90 days (after giving effect to the Main Street loan) and does not expect to file for bankruptcy in the next 90 days.

Next steps

As before, the terms of the Main Street programs are subject to additional guidance from the U.S. Treasury and the Federal Reserve. According to the Federal Reserve, operationalization of the Main Street program is underway, including the creation of the Federal Reserve's special purpose vehicle to purchase eligible loan participations from eligible lenders. Potential borrowers are advised to assess their eligibility for the Main Street programs and to contact an eligible lender for assistance in preparing to apply.

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[1] Specifically as defined in 13 CFR 120.110(b)-(j) and (m)-(s), as modified by regulations implementing the Paycheck Protection Program established by section 1102 of the CARES Act on or before April 24, 2020.

To discuss these issues, please contact the author(s).