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Debt Financing

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Federal Reserve–Initial Launch, Main Street Loan Facilities

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Certain provisions of the Coronavirus/Covid-19 economic stimulus legislation are subject to the issuance of government regulations and other government action, thus certain details regarding the legislation may be clarified or added.

As we previously reported on March 27, 2020, the Coronavirus Aid, Relief, and Economic Security Act of 2020 (the CARES Act) established guideposts and appropriated funds to provide at least $500 billion in liquidity to financial markets in the form of loans, loan guarantees and investments to and in eligible businesses.

In the two weeks since passage of the CARES Act, the Department of the Treasury has largely focused on establishing the Small Business Administration's Paycheck Protection Program (PPP). Our coverage of that $349 billion program for forgivable loans to businesses with less than 500 employees can be found here. However, with PPP lenders accepting loan applications since last Friday, April 3, 2020, the Department of the Treasury is shifting its focus to other policy objectives within the CARES Act.

Effective April 9, 2020, the Federal Reserve Board has provided additional details for two loan facilities intended to promote lending to small and medium-sized businesses struggling as a result of COVID-19. These facilities–titled the Main Street New Loan Facility and the Main Street Expanded Loan Facility–incentivize eligible lenders to extend credit by backstopping eligible loans with 95% participations purchased by a Federal Reserve special purpose vehicle (SPV). Loans under these two facilities may be in the form of either unsecured new money loans (under the Main Street New Loan Facility) or upsized tranches of an existing secured or unsecured debt facility (under the Main Street Expanded Loan Facility), and are structured to provide relatively inexpensive capital for U.S.-based businesses with up to 10,000 employees or up to $2.5 billion in 2019 annual revenue. Each SPV is initially capitalized with $75 billion of CARES Act funds, and the aggregate credit extended under both loan facilities may be increased up to $600 billion.

These Main Street loan facilities may be attractive for businesses which either are unable to take advantage of forgivable PPP loans (due to size or other factors) or are PPP borrowers with remaining liquidity needs to fund payroll and ongoing operations during the COVID-19 crisis. *Unlike PPP loans, these new Main Street loan facilities do require repayment. Nonetheless, they may provide a lifeline on favorable interest rate, amortization, and loan sizing terms for businesses otherwise running out of cash and other credit to fund payroll and operations.*

General Features and Borrower Eligibility

Features of the two respective loan facilities are largely consistent, other than a handful of terms relating to maximum loan size, collateral requirements, and facility fees. A borrower can elect to seek funding under either facility, but not under both. If a borrower has an existing credit facility, it may nevertheless seek a loan under the Main Street New Loan Facility, but the lower lending limits and/or existing lender consent requirements may influence a borrower's determination of the most suitable facility.

Eligible borrowers under these loan facilities are businesses with up to 10,000 employees or up to $2.5 billion in 2019 annual revenues. The business also must be created or organized in the U.S. or under the laws of the U.S. and have significant operations and a majority of its employees based in the U.S. Businesses that exceed both the employee and revenue limits, or do not satisfy the geographic requirements, will be unable to participate.

Facility-Specific Provisions – Main Street Expanded Loan Facility

Loans made under the Main Street Expanded Loan Facility will be subject to the following (in addition to generally applicable provisions described below):

- Maximum loan size is the lesser of (1) $150 million, (2) 30% of the sum of the borrower's existing outstanding debt plus the borrower's committed but undrawn bank debt (e.g., if the borrower has $50 million of term debt and a $20 million committed revolver (regardless of how much is drawn), this limit would be $21 million), or (3) an amount that, when added to the borrower's existing outstanding debt plus the borrower's committed but undrawn bank debt, does not exceed six times (6x) the borrower's 2019 EBITDA.
- Upsized tranche of new debt must share pro rata in any collateral securing the upsized existing debt.

Facility-Specific Provisions – Main Street New Loan Facility

Loans made under the Main Street New Loan Facility will be subject to the following (in addition to generally applicable provisions described below):

- Maximum loan size is the lesser of (1) $25 million, or (2) an amount that, when added to the borrower's existing outstanding and committed but undrawn bank debt, does not exceed four times (4x) the borrower's 2019 EBITDA.
- New loans under this facility are unsecured.
- Lenders extending new money loans to borrowers must pay a 100 basis point fee (on the 95% participation) to the applicable Federal Reserve SPV, which fee may be passed along to the borrower.

Common Features of *both* the Main Street Expanded Loan Facility and the Main Street New Loan Facility

Generally applicable terms for each loan facility (either new loans or upsized tranches) include:

- Four-year maturity.
- Amortization of principal and interest deferred for one year.
- Adjustable rate of the secured overnight financing rate (SOFR) *plus* 250-400 basis points.[1]
- Minimum loan size of $1 million.
- Prepayment permitted without penalty.
- 100 basis point origination fee (on new money) payable to lender.

Use of proceeds for facility funds are limited as follows:

- Proceeds of a new loan or upsized tranche may not be used to repay or refinance other loan balances (including loans or lines of credit made by the lender to the borrower).
- During the term, the borrower may not make optional principal payments on indebtedness with equal or lower priority (mandatory principal payments are permitted).

Further eligibility requirements for lenders and borrowers under both facilities include:

- The lender's commitment to not cancel or reduce any existing lines of credit outstanding to the borrower, and the borrower's commitment to not seek to cancel or reduce any of its outstanding lines of credit with the facility lender *or any other lender*.[2]
- The borrower's attestation that it requires Main Street loan facility financing due to the exigent circumstances presented by COVID-19, and that in using the proceeds of the loan it will make "reasonable efforts" to maintain its payroll and retain its employees during the term of the loan.

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[1] We note that parameters to determine the applicable rate within this band have not yet been provided. As of April 8, 2020, prior day SOFR was 0.01%, 30-day SOFR was 0.267%, 90-day SOFR was 1.108% and 180-day SFOR was 1.372%. The Federal Reserve Board has not yet specified which SOFR rate is applicable for these loans.

[2] We expect that this particular commitment of lenders and borrowers may require additional clarification from the Federal Reserve and Department of the Treasury. These restrictions are understandably designed to prevent this lower-cost, favorable-term funding from becoming a substitute for in-place higher-cost funding; Main Street loan facilities are intended to provide liquidity where it is needed, rather than opportunistically optimize a business's capitalization.

- During the term and for 12 months after, a prohibition on the borrower repurchasing its shares, or those of any parent company, to the extent listed on a national securities exchange (except under a prior contractual obligation).
- During the term and for 12 months after, a prohibition on the borrower paying dividends on its common stock.
- During the term and for 12 months after: (1) employees of the borrower earning more than $425,000 in calendar year 2019 cannot receive a compensation increase over any 12-month period and (2) employees of the borrower earning more than $3 million in calendar year 2019 cannot be paid more in any 12-month period than $3 million plus 50% of the amount in excess of the $3 million they earned in calendar year 2019.[3]

The Federal Reserve Board is incentivizing eligible lenders to participate by offering to backstop the new credit. The Federal Reserve intends to fund a newly formed SPV for each loan facility, which SPVs will purchase 95% participations in new money loans or upsized tranches of existing indebtedness. The SPVs will cease purchasing participations as of September 30, 2020, unless that deadline is extended by the Department of the Treasury and the Federal Reserve Board. This relatively short timeline, together with the limited funding available, is yet another factor that suggests an urgency in seeking these new loans.

Borrowers may seek these loans from eligible lenders under the program. Eligible lenders consist of U.S.-insured depository institutions, U.S. bank holding companies, and U.S. savings and loan holding companies. Eligible lenders providing new money loans or an upsized tranche will retain 5% of the new money loans or upsized tranches, after the respective SPV acquires their 95% through participation at par. An eligible lender's ability to participate and/or assign its residual stub has not yet been addressed.

Commentary and Discussion

Restrictions on dividends, share repurchases, executive compensation, and use of proceeds are consistent with expectations for Main Street lending facilities under the CARES Act. For some potential borrowers, attractiveness of the respective Main Street loan facilities will depend on their ability to tolerate program restrictions, including newly expounded limits like the prohibition on restructuring existing indebtedness.

For businesses facing gaps to fund payroll and continue operations during the crisis created by COVID-19, we expect these new loan facilities to be a valuable source of relatively inexpensive capital with favorable terms (including no amortization for one year and simple parameters for sizing and collateralizing loans). However, these programs require otherwise eligible borrowers to solve for themselves consent and amendment requirements with existing lenders and debt facilities. Further, although we now have much greater detail on these loan facilities' terms, the form and full terms of documentation (including intercreditor provisions), as well as the specific process for eligible borrowers to apply with eligible lenders, remain unknown.

As with the application process for PPP loans, businesses that position themselves at the front of the line—by proactively establishing their eligibility and starting conversations with existing lending relationships—are likely to have the greatest optionality to choose to participate as well as whether to take an unsecured new money loan, or as applicable upsize an existing tranche of indebtedness. *We will continue to monitor these programs as details regarding the application process are released, and stand ready to assist clients in applying for and negotiating documentation for Main Street loans as well as addressing existing lender consents and other amendments to existing debt facilities.*

To see our prior alerts and other material related to the pandemic, please visit the Coronavirus/COVID-19: Facts, Insights & Resources page of our website by clicking here.

[3] Compensation is defined broadly in the CARES Act to include salary, bonuses, awards of stock, and other financial benefits. We expect further clarification may be required given high variability of compensation arrangements across businesses and industries

Contacts

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