LEGAL UPDATES

PUBLISHED: MAY 1, 2020

Changes to the Main Street Lending Program

Service

Banking & Finance

Professional

NATE VOLZ
MILWAUKEE:
414.978.5428
NATE.VOLZ@
HUSCHBLACKWELL.COM

The Coronavirus Aid, Relief, and Economic Security Act granted the Federal Reserve the authority to establish a "Main Street Lending Program" (Program) to support small and mid-sized businesses. We previously published an overview of the initial Program here. On April 30, 2020, following receipt of comments from lenders, borrowers and other stakeholders, the Federal Reserve announced changes to the Program. This alert outlines some of the key changes to the Program. The term sheets for each loan facility and the Federal Reserve's frequently asked questions (FAQs) guidance about the Program are linked below. Our in-depth analysis with practical implications for borrowers and lenders will follow at a later date.

Key Changes to the Main Street Program

In response to industry criticism that the Program would exclude many borrowers and lenders, the Federal Reserve, among other changes, loosened the eligibility requirements and expanded the loan options available to businesses. The key changes to the Program include:

Creating a third loan facility, with increased risk sharing by lenders for borrowers with greater leverage (i.e., lenders would sell 85% rather than 95%);

The use of 2019 adjusted EBITDA for purposes of the leverage test;

Expanding the pool of businesses eligible to borrow;

Changing the interest rate from SOFR to LIBOR; and

Permitting S-corporations and other tax pass-through entities to make permitted tax distributions.

All three facilities use the same eligible lender and eligible borrower criteria and have many of the same features, including the same maturity, interest rate, deferral of principal and interest for one year, and ability of the borrower to prepay without penalty.

While the Federal Reserve clarified that U.S. branches of foreign banks are eligible lenders, non-bank lenders, including private debt funds, are still not eligible to provide Main Street loans. The Federal Reserve also clarified that non-profits are not eligible to receive Main Street loans; however, it has indicated that it is evaluating a separate approach for non-profit institutions, including hospitals and universities (but no such program has yet been announced).

While certain borrower eligibility requirements were broadened, the Federal Reserve did announce several clarifications that might restrict the pool of eligible borrowers:

Eligible borrowers must have been in sound financial condition prior to the onset of the COVID-19 pandemic, and any existing loan an eligible borrower had outstanding with the 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.

The calculation of the number of employees and 2019 revenue should follow the attribution framework applicable to PPP loans (i.e., the eligible borrower must count affiliates).

Creation of Priority Loan Facility

The Federal Reserve previously authorized two lending facilities: the Main Street New Loan Facility (New Loan Facility) and the Main Street Expanded Loan Facility (Expanded Loan Facility). Today's release announced a third lending facility – the Main Street Priority Loan Facility (Priority Loan Facility). This newly-authorized facility is a hybrid of the New Loan Facility and the Expanded Loan Facility and allows for smaller loans to borrowers with greater leverage.

An eligible loan under the Priority Loan Facility is a new **secured or unsecured** term loan that was originated **after** April 24, 2020, *provided* that the loan has the following features:

1. Four-year maturity;
2. Amortization of principal and interest deferred for one year;
3. Adjustable interest rate of London Interbank Offered Rate (LIBOR) (1 or 3 month) + 300 basis points;

4. Principal amortization of 15% at the end of the second year, 15% at the end of the third year, and a balloon payment of 70% at maturity at the end of the fourth year;
5. Minimum loan size of $500,000;
6. Maximum loan size equal to the lesser of (i) $25 million or (ii) an amount that, when added to the borrower's existing outstanding and committed but undrawn debt, does not exceed 6x 2019 adjusted EBITDA;
7. At the time of origination and at all times the loan is outstanding, the loan is senior to or pari passu with, in terms of priority and security, the borrower's other loans or debt instruments, other than mortgage debt; and
8. No early prepayment penalty.

Unlike the other facilities under the Program, eligible borrowers may, at the time of origination of the eligible loan, refinance existing debt owed by the eligible borrower to a lender that is not the eligible lender.

Changes to New Loan Facility and Expanded Loan Facility

The revised term sheets also change some of the terms under the New Loan Facility and Expanded Loan Facility. These changes include the following:

1. <u>Eligible Borrowers</u>. Businesses with up to 15,000 employees (increased from 10,000) or $5 billion in 2019 revenue (up from $2.5 billion) are now eligible. This requirement is consistent across all three lending facilities.
2. <u>Interest rate</u>. Eligible loans will bear interest at LIBOR (1 or 3 month) + 300 bps (changed from SOFR + 250-400 bps). Loan documentation will contain customary LIBOR replacement language.
3. <u>Amortization schedule</u>. Amortization of principal and interest remain deferred for one year (deferred interest will be capitalized). For the New Loan Facility, eligible loans have principal amortization of 333% at the end of the second year, 33.33% at the end of the third year and 33.33% at maturity. For the Expanded Loan Facility, the upsized tranche has principal amortization of 15% at the end of the second year, 15% at the end of the third year and a balloon payment of 70% at maturity.
4. <u>Seniority</u>. Under the New Loan Facility, eligible loans cannot be contractually subordinated to any of the borrower's other loans or debt instruments at the time of origination or any time during the term of the loan. Under the Expanded Loan Facility, the upsized tranche must be

senior to, or pari passu with, in terms of priority and security, the borrower's other loans or debt instruments, other than mortgage debt.

5. Minimum Loan Size. Minimum loan size for eligible New Loan Facility loans decreased from $1 million to $500,000. Minimum loan size for eligible Expanded Loan Facility upsized tranches increased from $1 million to $10 million.
6. Maximum Loan Size. Maximum loan size for eligible Expanded Loan Facility upsized tranches increased to the lesser of (i) $200 million, (ii) 35% of the borrower's existing outstanding and committed but undrawn bank debt that is pari passu in priority and equivalent in secured status, or (iii) an amount that, when added to the borrower's existing outstanding and committed but undrawn debt, does not exceed 6x 2019 adjusted EBITDA.
7. Type of Loan. The Expanded Loan Facility now permits an upsize to not only an existing term loan, but also a revolving credit facility.

Application Process and Public Disclosure

The Federal Reserve has not yet announced when the Program will be launched but will make such information available on its Main Street page. The Federal Reserve stated that the term sheets contain the minimum requirements for the Program, that eligible borrowers do not automatically qualify for Main Street loans and that eligible lenders are expected to conduct an assessment of each potential borrower's financial conditions at the time of application. Eligible lenders will apply their own underwriting standards in evaluating the financial condition and creditworthiness of a potential borrower. Businesses that otherwise meet the eligible borrower requirements may not be approved for a loan or may not receive the maximum allowable amount.

The Federal Reserve will publicly disclose information regarding the Program during the operation of the facilities, including information regarding names of lenders and borrowers, amounts borrowed and interest rates charged, and overall costs, revenues and other fees.

Additional Resources

Main Street Lending Program Frequently Asked Questions (Federal Reserve April 30, 2020)
Term Sheet: Main Street New Loan Facility (updated April 30, 2020)
Term Sheet: Main Street Priority Loan Facility (new April 30, 2020)
Term Sheet: Main Street Expanded Loan Facility (updated April 30, 2020)

Contact Us

If you have further questions or require more information regarding this update, please contact Kate Bechen, Robin Lehninger, Nate Volz or your Husch Blackwell attorney.

Comprehensive CARES Act and COVID-19 Guidance

Husch Blackwell's CARES Act resource team helps clients identify available assistance using industry-specific updates on changing agency rulemakings. Our COVID-19 response team provides clients with an online legal Toolkit to address challenges presented by the coronavirus outbreak, including rapidly changing orders on a state-by-state basis. Contact these legal teams or your Husch Blackwell attorney to plan a way through and beyond the pandemic.