

Federal Reserve Announces \$600 Billion Loan Program for Small to Mid-size Businesses

by Joseph Lynyak and Troy M. Keller

This morning, the Federal Reserve announced new facilities to provide up to \$600 billion in loans to support small to mid-size businesses. While the Fed's Main Street Lending Programs (MSLPs) are still being finalized, the announcement describes the broad structure and outlines many important details. As a practical matter, this and other Federal Reserve facilities described today are intended to accomplish two primary goals. The first is to provide liquidity into the banking system to enable (and encourage) financial institutions to extend credit to mid-sized businesses that have experienced severe financial losses related to the COVID-19 emergency. The second, in recognition that the national emergency will eventually end, is to provide working capital loans to businesses following the resumption of their operations. The facilities may significantly diminish the credit risk that many of eligible business will have as the national economy is restarted.

Summary of the Main Street Lending Programs:

The MSLPs will operate through the commercial banking system. Eligible lenders are U.S. insured depository institutions, U.S. bank holding companies, and U.S. savings and loan holding companies. Eligible borrowers are businesses with up to 10,000 employees or up to \$2.5 billion in 2019 annual revenues. Each eligible borrower must be a business that 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. Businesses that have borrowed under the Paycheck Protection Program (PPP) may also borrow under the MSLPs.

The eligible loans are divided into two categories: (a) upsized loans of an existing credit facility with banks, and (b) loans under new credit facilities with banks. All eligible loans will have the following terms: (i) 4 year maturity; (ii) payment of principal and interest deferred for one year; (iii) adjustable rate based upon the SOFR + 250-400 basis points; and (iv) prepayment permitted without penalty.

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For new loans, the maximum loan size is the lesser of (i) \$25 million or (ii) an amount that, when added to the eligible borrower's existing outstanding and committed but undrawn debt, does not exceed four times the eligible borrower's 2019 earnings before interest, taxes, depreciation, and amortization ("EBITDA"). For upsized loans, the maximum loan size is the lesser of (i) \$150 million, (ii) 30% of the eligible borrower's existing outstanding and committed but undrawn bank debt, or (iii) an amount that, when added to the eligible borrower's existing outstanding and committed but undrawn debt, does not exceed six times the eligible borrower's 2019 EBITDA.

Loans under these facilities cannot be used to repay existing debt and eligible borrowers must attest that they require financing due to the exigent circumstances presented by the coronavirus disease 2019 ("COVID-19") pandemic. Borrowers must agree to make reasonable efforts to maintain payroll and retain their employees during the term of the eligible loan. Eligible borrowers must follow the compensation, stock repurchase, and capital distribution restrictions that apply to direct loan programs under the CARES Act.

The funding for the MSLPs will be provided by a special purpose vehicle (SPV) that will have up to \$600 billion of capacity, with Treasury supplying the equity for the SPV. The SPV will buy 95% of eligible loans at par from lenders, who will retain 5% of the loans. Any collateral securing a loan, whether such collateral was pledged under the terms of an existing loan or at the time of upsizing a loan or originating a new loan, will secure the SPV and the lender on a pro rata basis. The borrower will pay the lender a fee of 100 basis points of the principal amount of the loan at the time of origination. The SPV will pay the lender 25 basis points of the principal amount of its participation in the loan per annum for loan servicing.

Observations:

Here are some initial observations for companies considering the MSLPs:

- It should be noted that the terms of the MSLPs are not the same as those outlined under "Assistance for Mid-sized Businesses" in Section 4003(c)(3)(D) of the CARES Act. The MSLPs and other facilities announced today will use only a portion of the funds allocated to Treasury under the CARES Act, so further programs/facilities may be possible, and the full relationship between these facilities and the MSLPs are not defined by today's actions.
- The fact that participation in the PPP does not bar participation in the MSLPs may provide additional resources for companies that have more significant liquidity needs than can be met by the PPP.
- Because the loan proceeds under these programs cannot be used to pay off or refinance pre-existing debt, borrowers will need to work within the covenant restrictions of their current debt facilities. As such, exploring the willingness of existing lenders to provide waivers will be important even as we await the programs to formally be rolled out.
- The incentive for **lenders** to participate in the MSLPs is found in the 1% origination fee they can charge on a loan that they can then sell 95% of back to the SPV. Whether that incentive will be enough for lenders to work with interested borrowers will be a facts-and-circumstances determination. As such, for most companies, working with their existing relationship banks will be key.

- The restrictions on dividends, stock buybacks and executive compensation may make these loans unpalatable for many companies. For example, under Section 4004 of the CARES Act, these restrictions generally cap executive compensation at 2019 levels for executives who received less than \$3mm total comp in 2019 (additional restrictions for those who received more).
- Because it is unclear at this stage what level of “due diligence” will be done by lenders, prospective borrowers may be wise to begin preparing backup support for the attestations they will be required to make, particularly with respect to the impact on their company of the pandemic and the “reasonable efforts” they will make to maintain payroll and employees during the term of the loan.

Feedback to the Fed:

Finally, please note, that the Fed announcement solicited feedback:

The Federal Reserve and the Treasury recognize that businesses vary widely in their financing needs, particularly at this time, and, as the program is being finalized, will continue to seek input from lenders, borrowers, and other stakeholders to make sure the program supports the economy as effectively and efficiently as possible while also safeguarding taxpayer funds. Comments may be sent to the [feedback form](#) until April 16.

Interested parties should act promptly to use the feedback form and other means of communication to the Fed and Treasury to provide suggestions for ways to help shape the Main Street Lending Programs to be more effective and better serve the economy.