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The "Main Street Lending Program" for Small and Mid-Size Businesses

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The Federal Reserve Board ("**FRB**") announced on April 30, 2020 an expanded and updated Main Street Lending Program (the "**Lending Program**") as part of its efforts to support the economy by providing credit to small and mid-size businesses that were in sound financial condition prior to the onset of the COVID-19 pandemic. The Lending Program, authorized under Section 13(3) of the Federal Reserve Act, now consists of three loan facilities:

1. The Main Street New Loan Facility, which provides for new unsecured or secured term loans originated on or after April 24, 2020 (the "**New Loan Facility**");

2. The Main Street Priority Loan Facility, which also provides for new unsecured or secured term loans originated on or after April 24, 2020, but with different repayment and other terms and conditions as explained below (the "**Priority Loan Facility**"); and

3. The Main Street Expanded Loan Facility, which provides for increases in existing term loans or lines of credit made by Eligible Lenders (defined below) prior to April 24, 2020 (the "**Expanded Loan Facility**").

The combined size of the three loan facilities is initially set at $600 billion. Overall, the Treasury Department has deployed only about one-third of the funds allocated to it under the CARES Act for such purposes, and if the Lending Program needs to be increased or expanded, the Treasury Department and Federal Reserve can do so without going back to Congress.

The Lending Program start date has not been announced, and further guidance from the FRB is expected. We will provide updates as more information becomes available.

The Federal Reserve has also indicated that the borrower eligibility requirements and loan metric requirements are merely minimum requirements and that lenders must underwrite each loan using their customary requirements. Thus, a company may be eligible and may seek a loan consistent with the requirements and loan metrics in the applicable term sheet and yet still not receive a loan because it does not meet its lender's underwriting standards.

Program Structure

Under the Lending Program, loans will be made to Eligible Borrowers (defined below) by Eligible Lenders. "**Eligible Lenders**" include U.S. federally-insured depositary institutions, including banks, savings and loan associations, and credit unions; U.S. branches or agencies of foreign banks; and certain other institutions. Eligible Lenders will sell participations in Program loans to a special-purpose funding vehicle ("**SPV**") established by the FRB. The SPV will purchase 95 percent participations in loans under the New Loan Facility and Expanded Loan Facility, and 85 percent participations in loans under the Priority Loan Facility. Eligible Lenders will hold the remaining portion of each loan, and bear the related risk, until the earlier of maturity of the loan or sale by the SPV of its participation. An Eligible Borrower may not participate in more than one of the Loan Program Facilities but may receive more than one loan under a single Loan Program Facility so long as the maximum aggregate amount provided under the facility does not exceed the maximum amounts for such facility to the Eligible Borrower.

Eligible Borrowers

An "**Eligible Borrower**" is an entity organized for profit as a corporation, limited liability company, partnership, association, trust or cooperative; a joint venture with no more than 49 percent non-U.S. ownership; or a tribal business concern. In addition, an Eligible Business:

- Was established prior to March 13,2020;
- Has either (1) 15,000 or fewer employees; or (2) 2019 annual revenue of $5 billion or less;
- Is organized under U.S. law with significant operations in the U.S. and a majority of its employees in the U.S.;
- Has not received support under Subtitle A of Title IV of the CARES Act (including direct loans pursuant to Section 4003 of the CARES Act) (*For clarity, an Eligible Borrower that has received a loan under the Paycheck Protection Program (“**PPP**”) established by Title I of the CARES Act (the “**Act**”) is not disqualified from obtaining a loan under the Lending Program*); and
- Is not an Ineligible Business (as defined below).

For purposes of determining employee headcount, applicants must include full-time, part-time and temporary employees, and then take the average over the preceding 12 months. Revenue may be determined by using either total 2019 revenue under U.S. GAAP or total 2019 receipts as reported for federal income tax purposes. Importantly, the Small Business Administration (“**SBA**”) “affiliation rules” at 13 C.F.R. § 121.301 must be applied when determining both number of employees and 2019 revenue. In other words, the Eligible Borrower’s employees and revenues will be aggregated with those of its U.S. and foreign affiliates in determining eligibility under the employee headcount and revenue tests.

Additionally, for purposes of determining annual revenues, annual revenues for 2019 are calculated by aggregating the revenues of the Eligible Borrower together with its affiliates. Some of the acceptable methods for calculating annual revenues include using GAAP audited financial statements or annual receipts for the Eligible Borrower’s 2019 fiscal year as it reports to the Internal Revenue Service. Eligible Borrowers that do not have this information for 2019 should use the most recent information available to it.

Ineligible Businesses

An “**Ineligible Business**” is any business listed in the SBA regulations at 13 C.F.R. §§ 120.110(b)-(j) and 120.110 (m)-(s), as modified by the rules issued by the SBA in connection with the PPP on or before April 24, 2020. In addition to businesses engaged in various illegal activities, which list includes businesses primarily engaged in lending and passive real estate investment businesses. At present, nonprofit businesses are also excluded, although the FRB has stated that participation by nonprofits is under evaluation.

Evaluation of Creditworthiness

In contrast to the PPP, the Lending Program eligibility criteria are minimum requirements, and meeting them does not guarantee that a Lending Program loan will be approved. Instead, each Eligible Lender will apply its own loan underwriting standards in evaluating the financial condition and creditworthiness of a potential Lending Program Eligible Borrower and will make the ultimate decision whether to approve a loan. Therefore, an Eligible Borrower may seek a loan consistent with the minimum requirements and loan metrics set by the FRB and yet still not receive a loan because it does not meet its Eligible Lender’s underwriting standards.

In addition, the FRB has established certain specific conditions:

- The Eligible Borrower must have been in sound financial condition prior to the onset of the COVID-19 pandemic;
- The Eligible Borrower must certify that it reasonably believes that at the time of loan origination and after giving effect to the loan it has the ability to meet its financial obligations, and does not expect to file for bankruptcy protection, for at least the 90-day period after loan origination; and
- If the Eligible Borrower had an existing loan with the Eligible Lender as of December 31, 2019, that loan had a “pass” risk rating at that date.

Loan Terms and Conditions

The following chart provides a summary of the Loan Programs terms for the three loan facilities as provided in the FRB’s press release on April 30, 2020:

	New Loan Facility	Priority Loan Facility	Expanded Loan Facility
Term	4 years	4 years	4 years
Minimum Loan Size	$500,000	$500,000	$500,000
Maximum Loan Size	The lesser of (a) $25M or (b) 4x the 2019 adjusted EBITDA when added to outstanding and undrawn available debt	The lesser of (a) $25M or (b) 6x the 2019 adjusted EBITDA when added to outstanding and undrawn available debt	The lesser of (a) $200M, (b) 35% of outstanding and undrawn available debt for facility, or (c) 6x the 2019 adjusted EBITDA when added to outstanding and undrawn available debt
Interest Rate	LIBOR + 300 basis points	LIBOR + 300 basis points	LIBOR + 300 basis points
Payment Terms	Year 1: No Payments required – Unpaid Interest will be capitalized Year 2: 33.33% Year: 3: 33.33% Year 4: 33.33 %	Year 1: No Payments required – Unpaid Interest will be capitalized Year 2: 15% Year: 3: 15% Year 4: 70%	Year 1: No Payments required – Unpaid Interest will be capitalized Year 2: 15% Year: 3: 15% Year 4: 70%
Priority of Any Security Interest	Loan is not contractually subordinated in terms of priority to any of the borrower's other loans or debt instruments	Upsized tranche 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	Loan is senior to or *pari passu* with the borrower's other loans or debt instruments, other than mortgage debt
Maximum Eligible Lender's Origination Fees	100 basis points of principal amount of Eligible Loan	100 basis points of principal amount of Eligible Loan	75 basis points of principal amount of upsized tranche
Transaction Fees Eligible Lenders May Pass to Eligible Borrower's	100 basis points of principal amount of Eligible Loan paid by Eligible Lender to SPV	100 basis points of principal amount of Eligible Loan paid by Eligible Lender to SPV	75 basis points of principal amount of upsized tranche paid by Eligible Lender to SPV

The FRB provided Eligible Lenders and Eligible Borrowers with guidance regarding the proper calculations and methodologies that should be used for the metrics outlined for each facility.

For purposes of calculating the adjusted EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) used for determining loan size, the methodology used by the Eligible Lender for the New Loan and Priority Loan Facilities to calculate adjusted 2019 EBITDA for an Eligible Borrower must be the same methodology the Eligible Lender previously used for adjusting EBITDA when it extended credit to the Eligible Borrower or to similarly situated borrowers on or before

April 24, 2020 and the methodology for the Expanded Loan Facility must be consistent with the methodology the Eligible Lender used for adjusting EBITDA when originating or amending the underlying loan of the Eligible Borrower on or before April 24, 2020.

As it is used for the calculation of maximum loan size under each loan facility, the FRB stated in the term sheets for the facilities that the outstanding and undrawn available debt "includes all amounts borrowed under any loan facility, including unsecured or secured loans from any bank, non-bank financial institution, or private lender, as well as any publicly issued bonds or private placement facilities. It also includes all unused commitments under any loan facility, excluding (1) any undrawn commitment that serves as a backup line for commercial paper issuance, (2) any undrawn commitment that is used to finance receivables (including seasonal financing of inventory), (3) any undrawn commitment that cannot be drawn without additional collateral, and (4) any undrawn commitment that is no longer available due to change in circumstance." Additionally, the outstanding and undrawn available debt should be calculated as of the date of the loan application.

The upsized tranches for each of the loan facilities may be secured or unsecured; provided, however that an upsized tranche under the Expanded Loan Facility must be secured if the underlying loan for the facility is secured on a *pari passu* basis with all other secured debt. In such cases, Eligible Lenders have the ability to require that Eligible Borrowers pledge and/or grant a security interest in additional collateral to secure the upsized tranche of the Expanded Loan Facility as a condition of approval of the facility.

Borrower Certifications and Covenants

- Restrictions on capital distributions. During the term of the loan and for 12 months after it is fully repaid, the borrower will not pay dividends on its common stock, nor will it repurchase its own or any parent company's equity securities that are listed on a national exchange, unless required to do so under a contractual obligation in existence on the date of enactment of the Act. *However, the FRB has clarified that this restriction on distributions will not apply to reasonably required tax distributions made by an S corporation or other pass-through entity.*

- Restrictions on compensation of highly-paid individuals. During the term of the loan and for 12 months after it is fully repaid, the borrower must abide by the following rules:

  - No officer or employee of the borrower whose total compensation exceeded $425,000 in calendar year 2019 can receive: (1) total compensation which exceeds, during any 12 consecutive months of such period, the total compensation received by the officer or employee in calendar year 2019; and (2) severance pay or other benefits upon termination of employment with the borrower which exceeds twice the maximum total compensation received by the officer or employee from the borrower in calendar year 2019.

  - No officer or employee of the borrower whose total compensation exceeded $3 million in calendar year 2019 will receive from the borrower during any 12 consecutive months of such period total compensation in excess of the sum of: (1) $3 million; and (2) 50% of the excess over $3 million of the total compensation received by the officer or employee from the borrower in calendar year 2019. "**Total compensation**" includes salary, bonuses, awards of stock, and other financial benefits provided by the borrower to the officer or employee.

- Restrictions on repayment of other debt. The borrower must commit that it will (1) refrain from making voluntary principal or interest payments on any other debt until loans under the New Loan Facility and the Expanded Loan Facility are repaid in full, and (2) not seek to cancel or reduce any of committed line of credit with the Eligible Lender or any other lender. A borrower under the Priority Loan Facility must commit to the same restrictions, except that the borrower may, at the time of loan origination, refinance existing debt owed by the borrower to a lender that is not the Eligible Lender. Despite these restrictions, the borrower **is** permitted to:

  - Repay a line of credit in the ordinary course of business usage for such line of credit;

  - Incur and pay additional debt obligations in the ordinary course of business and on standard terms, provided that the new debt is secured by newly acquired property and is of equal or lower priority than the Lending Program loan; and

  - Refinance maturing debt.

- Retention of employees. The borrower should (but is not required to certify that it will) make commercially reasonable efforts to retain employees during the term of the Lending Program loan. Specifically, the borrower 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.

The Lending Program differs from the PPP and/or the direct lending program for mid-size businesses authorized by Title IV of the Act in that the following certifications and covenants are **not** required:

- Need for financing. The borrower is not required to certify that the borrower's business has been adversely affected by the COVID-19 pandemic and that the Lending Program loan is necessary to maintain its business operations.
- Union neutrality. The borrower is not required to certify that it will (1) remain neutral in any union organizing efforts, and (2) not abrogate existing collective bargaining agreements during the term of the loan and for two years after full repayment.
- Warrants. The borrower is not required to issue warrants or equity interests in the borrower entity, as is required for loans to certain large businesses under Title IV of the Act.
- Offshoring. The borrower is not required to certify that it will not offshore jobs during the loan term and for two years after full repayment.
- Workforce retention. The borrower is not required to certify that loan proceeds will be used to retain at least 90 percent of its workforce at full compensation and benefits until September 30, 2020.
- Workforce restoration. The borrower is not required to certify that it intends to restore at least 90 percent of its February 15, 2020, workforce at full compensation and benefits no later than four months after termination of the COVID-19 public health emergency.

Application Procedure

To obtain a loan under the Lending Program, the Eligible Borrower must submit a loan application and any other documentation required by the Eligible Lender to the Eligible Lender. Eligible Borrowers should contact their existing lenders for information on whether the Eligible Lender plans to participate in the Lending Program and to request more information on the application process.

Updates regarding the Lending Program, including the official start date and the date on which the SPV will begin purchasing participations in Lending Program loans, will be issued by the FRB. We will provide updates as more information becomes available.

For More Information

Saul Ewing Arnstein & Lehr corporate attorneys regularly counsel businesses on how federal regulations apply to their companies. Please feel free to contact the authors if you have questions about eligibility for loans under the Main Street Lending Program.

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