CARES Act Main Street Lending Program

What You Need to Know Now

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Panelists

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Evolution of the CARES Act Main Street Lending Program

- Section 4003(c)(3) of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) permits the Federal Reserve to establish a Main Street Lending Program (MSLP) or other similar program or facility under Section 13(3) of the Federal Reserve Act (12 USC §344(3)), that supports lending to small and mid-sized businesses including any entity to which the Treasury Secretary’s Mid-sized Businesses Program makes a loan, loan guarantee, or other investment.

- On March 23, 2020 before the CARES Act’s enactment, the Federal Reserve announced its intent to establish a MSLP facility.

Evolution of the CARES Act Main Street Lending Program

- On April 9, 2020, the Federal Reserve, acting under the CARES Act, announced the creation of a new MSLP under the Federal Reserve's Section 13(3) emergency lending authority.

- The MSLP is leveraging $75 billion in U.S. Treasury equity funding to purchase of up to $600 billion in loans to eligible small and mid-sized businesses that were in good financial standing prior to the COVID-19 crisis.

- Stakeholder feedback sought until April 16, 2020 on the Federal Reserve's proposed MSLP terms and conditions.

- On April 30, 2020, after receiving public feedback on potential refinements, the Federal Reserve Board announced an expansion of the scope, terms and eligibility for the MSLP.

Main Street Lending Program

Main Street Lending Program

- Designed to provide capital to small- and medium-sized businesses that were in sound financial condition before the pandemic.
- The program operates through three facilities:
  - Main Street New Loan Facility
  - Main Street Expanded Loan Facility
  - Main Street Priority Loan Facility
- Federal Reserve Bank of Boston will set up a special purpose vehicle that will purchase portions of loans originated by eligible lenders.

Loan Terms

- Origination:
  - *New Loan and Priority Loan Facilities:* After April 24.
  - *Expanded Loan Facility:* On or Before April 24.
- Security: Can be secured or unsecured
- Maturity: 4 Years
- Interest Rate: LIBOR + 3%
- Prepayment: Permitted without penalty

Loan Terms

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- Minimum Loan Size:
  - *New Loan and Priority Loan Facilities:* $500,000
  - *Expanded Loan Facility:* $10,000,000
- Maximum Loan Size:
  - *New Loan Facility*: Lesser of (i) $25M or (ii) an amount, when added to Borrower's existing outstanding and undrawn available debt does not exceed **4x** adjusted 2019 EBITDA.
  - *Priority Loan Facility*: Lesser of (i) $25M or (ii) an amount, when added to Borrower's existing outstanding and undrawn available debt does not exceed ***6x*** adjusted 2019 EBITDA.
  - *Expanded Loan Facility*: Lesser of (i) $200 million, (ii) 35% of the Borrower's existing outstanding and undrawn available debt or (iii) an amount, when added to Borrower's existing outstanding and undrawn available debt does not exceed ***6x*** adjusted 2019 EBITDA.

Loan Terms

- Amortization:
  - All principal and interest deferred for one year (unpaid interest will be capitalized)
  - *New Loan Facility:* Years 2-4: 33.33% each year
  - *Priority and Expanded Loan Facilities:* Years 2-4: 15%, 15%, 70%
- Priority:
  - *New Loan Facility:* May not be "contractually subordinated in terms of priority"
    - Loans must not be junior in priority in bankruptcy to Borrower's other **unsecured** loans or debt instruments
  - *Priority and Expanded Loan Facilities:* Must be senior or *pari passu* in terms of priority and security to other loans and debt instruments
    - Exception for mortgage debt

How to apply

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- Contact an Eligible Lender for an application and any other documentation required by such lender.

- Eligible Lenders may have additional requirements

Borrower Considerations

Businesses Eligible for Main Street Loans

- In existence prior to March 13, 2020
- Organized as a ***for profit*** entity
  - However, door left open for other forms of organizations to be eligible at Fed's discretion (including non-profits)
- With ≤15,000 employees ***or*** with 2019 annual revenues ≤ $5 billion
- ***Not ineligible*** for an SBA Loan (with some exceptions)
- Created or organized in the US or under US law with significant operations and a majority of employees in the US
- Has not received specific support pursuant to Coronavirus Economic Stabilization Act of 2020 ***however,*** businesses that have received PPP loans are permitted

Determining Employees and Revenues

Employees

- Average of total number of employees of Borrower for each pay period during the 12 months prior to origination
- Employees include full-time, part-time, seasonal or otherwise employed individuals, excluding volunteers and independent contractors
- Borrower should count its own employees ***and*** those of its affiliates

Revenue

- Two tests (Borrower can choose which is more beneficial):
  - 2019 GAAP revenue reflected on audited financial statements; ***or***
  - 2019 receipts reported on 2019 federal tax return
- Borrower must aggregate its revenues with its affiliates
- If 2019 data not available, use most recent audited financials or tax returns

Determining affiliates

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- Same affiliation test used for PPP is used for Main Street loans
- Entities are affiliates if one controls or has power to control the other or when a third party controls or has power to control both
  - >50% Ownership
  - Ability to block certain "operational" actions, whether as a stockholder or through Board of Directors
  - Common management (e.g. individual serves as CEO for multiple companies)
- The same affiliation issues that affected portfolio companies of VC/PE funds exist here; <u>however</u>, the maximum number of employees is significantly greater
- No industry-specific exclusions

Maximum Loan Size Considerations

- Maximum size of loan dependent upon EBITDA leverage ratios
  - *New Loan Facility:* Lesser of (i) $25m and (ii) an amount, when added to Borrower's existing outstanding and undrawn available debt does not exceed **4x** 2019 adjusted EBITDA
  - *Priority Loan Facility:* Lesser of (i) $25m and (ii) an amount, when added to Borrower's existing outstanding and undrawn available debt does not exceed **6x** 2019 adjusted EBITDA
  - *Expanded Loan Facility:* Lesser of (i) $200 million, (ii) 35% of the Borrower's existing outstanding and undrawn available debt or (iii) an amount, when added to Borrower's existing outstanding and undrawn available debt does not exceed ***6x*** 2019 adjusted EBITDA
- EBITDA adjustments determined by Lender based on Lender
  - Methodology previously used by the same Lender to extend credit to Borrower or the methodology used for similarly situated borrowers on or prior to April 24, 2020
- "Existing outstanding and undrawn available debt" calculated as of date of loan application
  - Includes: All amounts borrowed ***and*** any unused commitments under any loan facility (whether a bank, non-bank financial institution or private lender), all publicly issued bonds and all private placement facilities
  - Excludes undrawn commitments: serving as backup line for commercial paper, used to finance receivables, requiring additional collateral to draw, no longer available due to change in circumstance

Required Certifications/Covenants

- Cannot use proceeds to repay other loans
- Cannot seek to cancel or reduce any outstanding credit lines
- Reasonable basis to believe business has ability to meet obligations for the next 90 days and will not file bankruptcy
- Commercially reasonable efforts to maintain payroll of retain employees
- Commit to follow CARES Act one-year post-repayment restrictions on compensation, equity repurchases and capital distributions
  - Exclusion for tax distributions in flow-through entities
  - Unintended consequences for some equity comp structures and exit structures.

PE/VC-Backed Company Considerations

- Analyze affiliates to ensure eligibility
- Difficulty with EBITDA leverage test for growth companies
- Coordination with existing investors and lenders
- Relatively short maturity with significant annual payments
- Time and transaction costs for underwriting and documentation
- CARES Act restrictions

Lender Considerations

Eligible Lenders

- Eligible financial institutions under the Program include:
  - U.S. federally-insured depository institutions (including banks, savings associations, and credit unions)
  - U.S. branches or agencies of foreign banks
  - U.S. bank holding companies
  - U.S. savings and loan holding companies
  - U.S. intermediate holding companies of foreign banking organizations
  - Any U.S. subsidiary of any of the foregoing
- Nonbank financial institutions are not considered Eligible Lenders for purposes of the Program

Required Certifications/Covenants

- Eligible Lender cannot request repayment of debt or payment of interest on outstanding obligations until the loan is repaid in full, unless mandatory and due

- Eligible Lender cannot cancel or reduce existing committed lines of credit

- Eligible Lender must certify as to methodology used for calculating the borrower’s adjusted 2019 EBITDA

- Eligible Lender must be eligible to participate, including in light of conflicts of interest prohibition

Risk Retention

- Under all facilities, the Eligible Lender will retain a portion of the loan until maturity or until the SPV sells all of its participation, whichever comes first
  - New Loans: 5%
  - Priority Loans: 15%
  - Expanded Loans: 5%
- Eligible Lender and SPV will share in any losses on the loan on a *pari passu* basis

Suitability of Loan

- Any existing loan the 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 FFIEC supervisory rating system as of that date

Evaluation of Creditworthiness

- Lenders should view the eligibility term sheets as the <u>minimum</u> requirements for the Program; Lenders are expected to conduct an assessment of each potential borrower’s financial condition at the time of the application

- Lenders should apply their own underwriting standards in evaluating the financial condition and creditworthiness of a potential borrower

- Lenders may require additional information and documentation in making this evaluation and will ultimately determine whether a borrower is approved for a loan in light of these considerations

- Businesses that otherwise meet the “Eligible Borrower” requirements may not be approved for a loan or receive the maximum allowable amount

Verification of Borrower Covenants

- Lender is required to collect the required certifications and covenants from each borrower at the time of origination or upsizing of the loan

- Lenders may rely on a borrower’s certifications and covenants in addition to any self-reporting made by the borrower

- Lender is not expected to independently verify the borrower’s certifications or actively monitor ongoing compliance with covenants

Key Points for Existing Loans

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- An Eligible Lender that has extended an existing term loan or revolving credit facility to a borrower may increase (or “upsize”) that extension of credit by adding a new increment (or “tranche”)
- The underlying loan must have a remaining maturity of at least 18 months – Lenders may amend in advance to comply
- The Eligible Lender must retain its interest in the underlying loan until the underlying loan matures, until the upsized tranche matures, or until the SPV sells all of its participation, whichever comes first
- Any collateral that secures the underlying loan must secure the upsized tranche on a pro rata basis

Multi-Lender Considerations

- If the loan underlying an upsized tranche is part of a multi-lender facility, the Eligible Lender must be one of the lenders that holds an interest in the underlying loan at the date of upsizing

- Only the Eligible Lender is required to meet the “Eligible Lender” criteria

  - Other members of the multi-lender facility are not required to be “Eligible Lenders”

Other Unresolved Considerations

Degree of interaction/negotiation with Fed:

- Terms of participation agreement (not yet posted to Fed site)
  - Voting Rights; Exercise of Remedies; Put Back Ability
- Standardized loan forms for New Loan/Priority Loan; Directions for Upsizing
- No guidance as to publishing forms or if subject to comment
- Level of Fed review of loan documents

Other Unresolved Considerations

Loan level information that the SPV will receive: certifications, covenants, lender, loan terms, and loan performance as well as the borrower, borrower fundamentals, collateral, and other characteristics.

- Other information that will be required?
- What is the time of the delivery of this information?

Other Unresolved Considerations

“Fallback contract rate” for unavailability of LIBOR – consistent with Alternate Reference Rates Committee.

- Standard language used by eligible lender?
- Not all lenders have same loan language regarding LIBOR unavailability. Lender discretion on replacement/Prime/etc.
- No standardization across the program so rates could vary when LIBOR becomes unavailable – which it will in all of the loans that aren’t prepaid or accelerated prior to the end of 2021

Other Unresolved Considerations

- As we saw, and continue to see with the PPP, ongoing guidance is often provided as the COVID-19 relief programs are implemented.

- Reasonable to expect that ongoing Main Street Lending Program guidance will be released, and provision of form of participation agreement will occur.

- Lenders need to be vigilant in monitoring developments.

QUESTIONS?

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Upcoming Webinar

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Moving Forward to the ‘New Normal’:

Applying Lessons Learned from Around the World to Our Region

Wednesday, May 6, 5-6PM

Panelists:

Paul Ayoub, Partner, Executive Committee, Nutter
Board Chair, Greater Boston Chamber of Commerce

John Farina, Northeast Managing Partner, PwC
Member of PwC’s U.S. and Global Board of Partners

David Karam, CEO, Sbarro, Inc.

Ying Shin Lee, Managing Director, Knight Frank Shanghai
Former member, General Electric’s Global Real Estate Team

Sharon McCollam, Board Chair, Sutter Health, California
Board member, Advance Auto Parts, Inc.; Chewy Inc.; GetYourGuide AG; Hallmark Cards, Inc.; Signet Jewelers, Ltd., and Stitch Fix, Inc.