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Debt Financing

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Federal Reserve–Industry Commentary, Main Street Loan Facilities

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Certain provisions of the coronavirus economic stimulus legislation are subject to the ongoing issuance of government regulations and other government action; thus, certain details regarding the legislation may be clarified, revised, or added.

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In the weeks since the Federal Reserve Board provided term sheets for two "Main Street" loan facilities (see also our prior Client Alert, "Federal Reserve-Initial Launch, Main Street Loan Facilities"), many of our clients as well as prominent lending and business advocacy organizations have identified challenges in interpreting and applying the facilities' high-level provisions. The Main Street loan facilities consist of the Main Street New Loan Facility (the MSNLF) and the Main Street Expanded Loan Facility (the MSELF and, together with the MSNLF, the Main Street Programs), which together are intended to promote lending to small and medium-sized businesses struggling as a result of the novel coronavirus disease 2019 (COVID-19). Funds for the Main Street Programs have been appropriated under the Coronavirus Aid, Relief, and Economic Security Act of 2020 (the CARES Act).

The Federal Reserve Board sought comments in respect of the term sheets for the Main Street Programs between April 9 and April 16. Several notable advocacy organizations–including the Loan Syndications and Trading Associations (LSTA), the Consumer Bankers Association, the American Bankers Association, and the Independent Community Bankers of America, among others–submitted public comments to the Federal Reserve Board.

As our corporate and lending clients await further guidance from the Federal Reserve Board on implementation of the Main Street Programs, certain themes have emerged in our discussions with clients as well as in public commentary by advocacy organizations. We believe it is likely that subsequent guidance from the Federal Reserve Board on implementation of the Main Street Programs will attempt to address the issues highlighted below as well as engage with commenters' proposed solutions.

***Issue #1**: The proposed EBITDA-based leverage test may exclude otherwise creditworthy borrowers from participating in the Main Street Programs.*

A recurring topic in public commentary on the Main Street Programs is the Federal Reserve Board's proposed EBITDA-based leverage test (used to determine the maximum size of loans). Commenters assert that tests purely relying on EBITDA, in contrast to the more prevalent construct "Adjusted EBITDA," may not provide an accurate representation of a certain business' creditworthiness. For example, nonprofits and growth-stage companies are unlikely to be eligible for the Main Street Program using a pure EBITDA-based test, but may otherwise be creditworthy and within the intended mandate of the Main Street Programs under the CARES Act.

Commenters propose that Main Street Program lenders be permitted to use a definition of "Adjusted EBITDA" that is either consistent with a business' existing loan documentation (for MSELF) or in line with market convention (for MSNLF). Additionally, in circumstances where neither EBITDA nor adjusted EBITDA accurately reflects a business' creditworthiness, commenters have proposed greater discretion for lenders to utilize alternative metrics–including net operating income, multiple of recurring revenue, or a post-money valuation from the borrower's most recent financing round–to determine maximum loan size.

Issue #2: *Blocking all distributions by participating borrowers, without exceptions for tax distributions and ordinary course overhead, is prohibitive for certain otherwise-eligible borrowers.*

In order for pass-through entities to participate in the Main Street Programs, tax distributions must be exempted from the limitations on distributions set forth in the CARES Act. Tax liabilities will accrue to the owners of such pass-through entities, even if dividends and distributions are not declared. It is crucial for owners of pass-through businesses, as well as structured vehicles such as REITs, that their participation in the Main Street Program does not hamper their ability to make necessary tax distributions. Further, where the corporate existence and operations of a parent entity are funded in the ordinary course by distributions from a downstream business, distributions must be permitted to support such parent's continued corporate existence.

Issue #3: *Definition of "eligible lenders" is prohibitively narrow.*

Currently, eligible lenders in the Main Street Program are limited to "U.S. insured depository institutions, U.S. bank holding companies, and U.S. saving and loan holding companies." Borrowers who currently bank with U.S. branches of foreign banks or whose debt is held by nonbank lenders (e.g., funds and other investment vehicles) would be unable to leverage those existing banking relationships to more quickly access funds. Commenters propose that, at a minimum, the definition of eligible lenders be clarified or expanded to include U.S. branches of foreign banks in order to expedite loans to as many businesses in need as possible.

Issue #4: *Businesses with existing indebtedness in many cases will be prohibited from incurring new indebtedness under a Main Street Program without existing lender consent.*

The Main Street Programs contemplate either unsecured new indebtedness or "upsized" indebtedness that shares collateral pro rata with existing indebtedness. In either case, businesses with existing debt may be contractually prohibited from incurring additional indebtedness unless a basket or exception applies. Lenders with consent rights may be unwilling or unable to accommodate amendments and/or waivers to permit businesses to borrow under the Main Street Programs.

This issue is likely to be pervasive among potential borrowers under the Main Street Programs, but it may be ameliorated, at least in part, if lenders are allowed greater structural flexibility to lend to direct and indirect holding companies of businesses constrained by covenants in existing indebtedness, with proceeds to be invested in the downstream business. In any event, greater clarity on how Main Street Program indebtedness will coexist with existing indebtedness is necessary to permit borrowers to engage meaningfully with their existing lenders regarding possible waivers and/or amendments.

Issue #5: *Commenters request clarification of the Main Street Program requirement that a borrower may not seek to cancel or reduce any of its outstanding lines of credit.*

The term sheets for the Main Street Programs provide that borrower participants may not seek to cancel or reduce outstanding lines of credit. However, commenters note that the Federal Reserve Board should make certain practical exceptions to this blanket rule to enable as many small businesses as possible to participate. Proposed carve-outs include repayment of short-term revolving lines of credit, maturing debt, and any Small Business Administration (SBA) loans (whether or not such loans were incurred during the COVID-19 crisis).

Issue #6: *Generally, commenters are requesting more discretion for lenders to tailor loan terms in light of their experience and the specific characteristics of borrowers.*

Commenters across the board are looking for greater flexibility for participating lenders—who will retain 5 percent exposure to loans—to adjust loan terms that appear to be prescribed in the term sheets for the Main Street Programs. Without greater flexibility, commenters argue, potentially eligible lenders will be less inclined to participate, and rollout of funds under the Main Street Programs will be delayed.

Particular areas where lenders desire greater flexibility include (i) variable loan tenor of greater than or less than the four years prescribed in the term sheets, (ii) ability to extend loans of less than the $1 million "minimum loan size" prescribed in the term sheets, (iii) flexibility for lenders to elect either LIBOR or SOFR for the adjustable rate of Main Street Program loans, and (iv) ability for lenders to rely to a greater extent on borrower eligibility certifications, as in the SBA's Paycheck Protection Program.

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