Weil Alert

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The CARES Act: An Updated Guide to the Main Street Lending Program for Small and Mid-Sized Businesses

On April 30, 2020, the Federal Reserve Board announced expansions to the scope and eligibility of the Main Street Lending Program following the solicitation of public comments. The Main Street Lending Program, originally announced on April 9, 2020, provides for the purchase by the Federal Reserve of up to $600 billion in loans to small and mid-sized businesses that are originated by eligible financial institutions – for more information regarding the structure of the program, see our previous client alert here. The Main Street Lending Program will now consist of three separate purchase facilities:

- the Main Street New Loan Facility (the "New Facility"), through which eligible lenders may originate new secured or unsecured term loans of up to $25 million to eligible businesses and subject to a 4.0x leverage ratio cap;
- the Main Street Priority Loan Facility (the "Priority Facility"), through which eligible lenders may originate new secured or unsecured term loans of up to $25 million to eligible businesses with greater leverage and subject to a 6.0x leverage ratio cap; and
- the Main Street Expanded Loan Facility (the "Expanded Facility"), through which eligible lenders may provide increases of up to $200 million under existing secured or unsecured term or revolving loan facilities to eligible businesses and subject to a 6.0x leverage ratio cap and a 35% debt capitalization cap.

Key terms and conditions of the New Facility, the Priority Facility and the Expanded Facility are summarized below – these remain subject to further guidance and modifications by the Federal Reserve Board and the Secretary of the Treasury. Notably, in addition to now offering two different options for new loans, the maximum size of the facilities has been increased (from $20 to $25 million and $150 to $200 million, respectively), interest is now LIBOR plus 300 basis points (vs. SOFR plus 250-400 basis points) and amortization requirements have been specified. In addition, key questions with respect to EBITDA calculations and borrower and lender eligibility criteria have also been addressed. Eligible borrowers will now include businesses with up to 15,000 employees (vs. 10,000) or $5 billion of revenue (vs. $2.5 billion), though in each case these thresholds will be calculated subject to certain affiliation rules as discussed below.

The revised facility terms should enhance the ability of many businesses to participate in the program. However, the eligibility criteria and facility requirements will need to be carefully evaluated in connection with any potential participation. Each participating lending institution will also develop its own procedures and criteria in connection with originating loans under the program. The facility terms are not exclusive, and lenders may impose additional requirements and covenants in connection with any loan.

EBITDA Calculations

EBITDA remains the key underwriting mechanic for all three facilities. For each facility, the eligible loans may not exceed an amount that, when added to the borrower's existing outstanding and undrawn available debt, exceeds a specified leverage ratio cap calculated from the borrower's adjusted 2019 EBITDA. **EBITDA is now permitted to be adjusted as follows:**

- For the New and Priority Facilities, the methodology used by the eligible lender to calculate adjusted 2019 EBITDA for an eligible borrower "must be a **methodology it previously used for adjusting EBITDA when extending credit to the Eligible Borrower** or to similarly situated borrowers on or before April 24, 2020." The use of a methodology for similarly situated borrowers would be limited to instances where the eligible lender did not previously extend credit to the borrower (or possibly where credit was extended based on other credit metrics (e.g. in connection with an asset-based facility)).
- For the Expanded Facility, the methodology used by the eligible lender to calculate adjusted 2019 EBITDA for the eligible borrower "must be the methodology it previously used for adjusting EBITDA when originating or amending the underlying loan on or before April 24, 2020."

To the extent EBITDA was adjusted in connection with any prior extensions of credit, such adjustments may be used in connection with calculating the leverage caps applicable to the Main Street program facilities. It is possible however that, in some cases, these EBITDA adjustments may differ from EBITDA adjustments included in the borrower's credit agreement.

Borrower Eligibility. All 3 facilities use the same eligibility criteria to determine "eligible borrowers".

- The borrower must be a business **organized in the US prior to March 13** – created or organized prior to March 13, 2020 under the laws of the United States, one of the several states, the District of Columbia, any of the territories and possessions of the United States, or an Indian Tribal government.
  - **Note re: foreign participation** – For purposes of the facilities, "a Business is an entity that is organized for profit as a partnership; a limited liability company; a corporation; an association; a trust; a cooperative; a joint venture *with no more than 49 percent participation by foreign business entities*; or a tribal business concern as defined in 15 U.S.C. § 657a(b)(2)(C)". It appears that the foreign participation limit is intended to be limited to JVs.
- The borrower must have **significant operations** in and a **majority of its employees** based **in the United States.**
- To be an eligible borrower, a business must meet at least one (but not both) of the following two conditions: the borrower **may not be an "Ineligible Businesses" under current SBA rules** – listed in 13 CFR 120.110(b)-(j), (m)-(s), as modified and clarified by Small Business Administration ("SBA") regulations for purposes of the Paycheck Protection Program.
  - **Note re: ineligibility** – This includes businesses in various industries ranging from banks to "speculative" companies. **Hedge funds and private equity funds themselves** are interpreted by the Treasury Department and the SBA as being ineligible under 13 CFR 120.110(s), as they are primarily engaged in investment or speculation. **However, portfolio companies may still be eligible (subject to the SBA's affiliation rules).**

- The borrower **may not have more than 15,000 employees or more than $5 billion in 2019 annual revenues**, in each case, **when aggregated with the employees and revenues of affiliated entities**.
  - **Note re: affiliation rules** – **The calculation of these thresholds are subject to the existing SBA affiliation rules. These will generally aggregate holdings of private equity funds (or that of any shareholder or investor) in controlled or owned entities** which, in some cases, may include minority holdings as well. Affiliation rules require specialized analysis for each business in which a holding company or a private equity or other investment fund has an ownership interest or other "control" relationship.
- **Additional notes re: eligibility:**
  - **The borrower may not also be participating in (a) any other Main Street Lending Program, (b) the Primary Market Corporate Credit Facility** implemented by the Federal Reserve Board or (c) the "(b)(1)," "(b)(2)," or "(b)(3)" direct lending programs for aviation and critical national security businesses under Title IV of the CARES Act.
    - Note: Participating in the Paycheck Protection Program does not preclude a business from participating in the Main Street Lending Program.
  - The borrower must be able to make all of the certifications and covenants required under the Main Street Lending Program set forth below, including the conflict of interest certification.
  - Any existing loans of the borrower with the eligible lender **must have had a "pass" rating as of 12/3/19**.

Key Structural Considerations

New Facility. The New Facility provides for loans that may be behind existing secured debt – such loans may be unsecured or secured on a junior lien basis. The loans may not be contractually subordinated. The terms require lower leverage and higher amortization and there is no ability to refinance existing debt at incurrence.

- Even though New Facility loans may be behind existing secured debt, they will still retain certain priority features, including amortization, the requirement to be voluntarily prepaid (if at all) ahead of the borrower's existing debt and potentially a maturity inside of existing debt. In many cases, these features will require obtaining consents from existing lenders. This may be conditioned on higher pricing and tightening terms under the existing debt.
- The retention percentage for the eligible lender is 5% and additional eligible lender requirements or concerns may impact structure and terms (including changes to the existing debt required by other lenders (e.g. the liquidity impact of increased interest expense)).

New Facility loans must satisfy the following criteria:

- **new loans originated after April 24, 2020** by an eligible lender(s) to an eligible borrower;
- loan amount **between $500,000 and $25 million but may not exceed:**
  - an amount that, when added to the eligible borrower's existing outstanding and undrawn available debt, does not exceed **4.0x** the eligible borrower's adjusted **2019 EBITDA**; and
- must **not be contractually subordinated** in terms of priority to any of the eligible borrower's other loans or debt instruments, at origination or at any time during the term.

Priority Facility. The Priority Facility provides for loans which must rank senior in the borrower's existing debt capital structure. To the extent a borrower has existing debt, loans must rank senior to or equally with the borrower's non-subordinated debt. If the existing debt is also secured, loans must also be secured on a senior or equal basis (except with respect to pre-existing mortgage debt). The terms permit higher leverage and allow lower amortization. The Priority Facility is required to be voluntarily prepaid (if at all) ahead of the borrower's existing debt.

- Importantly, the Priority Facility, unlike the New Facility and Expanded Facility, allows the borrower to refinance existing debt provided by non-eligible lenders at the time of incurrence of the Priority Facility loans. This is the only means to effect a refinancing in connection with the incurrence of any of the Main Street Lending Program loans and can facilitate the incurrence of senior secured debt for more highly leveraged borrowers with restrictive existing debt terms. The Priority Facility loans still need to be provided and held by eligible lenders.
- The Priority Facility requires a higher retention percentage (15%) for the eligible lender which could impact underwriting, structure and terms. The priority structure and terms may require consents under existing debt (to the extent not refinanced) and, as noted above, changes to the existing debt required by other lenders may also impact the required terms from eligible lenders.

Priority Facility loans must satisfy the following criteria:

- **new loans originated after April 24, 2020** by an eligible lender(s) to an eligible borrower;
- loan amount between $500,000 and **$25 million but may not exceed:**
  - an amount that, when added to the eligible borrower's existing outstanding and undrawn available debt, does not exceed **6.0x** the eligible borrower's adjusted **2019 EBITDA**; and
  - must be **senior to or pari passu with**, in terms of priority and security, the eligible borrower's other loans or debt instruments (other than mortgage debt), at origination and at all times thereafter.

Expanded Facility. The Expanded Facility allows for an 'upsized' term loan under an existing term loan or revolving facility of the eligible borrower. The existing facility may be secured or unsecured. The Expanded Facility loans must be term loans and must rank senior to or equally with the existing facility subject to increase. The terms permit higher leverage and allow lower amortization. The Expanded Facility is required to be voluntarily prepaid (if at all) ahead of the borrower's existing debt.

- There is no ability to refinance existing debt from a non-eligible lender at the time of incurrence of Expanded Facility loans. However, the existing facility is only required to include one eligible lender – this expands the scope of the Expanded Facility by allowing existing multi-lender facilities to be eligible under the program (e.g. syndicated or "clubbed" facilities can now qualify, so long as at least one lender is eligible). The Expanded Facility loans, however, must be provided by an eligible lender.
- The ability to incur Expanded Facility loans without the consent of existing lenders will depend on the terms of the existing facility. If the existing facility permits "incremental facilities", these may be used to incur the loans. However, in many cases the priority features noted above (relating to prepayments, amortization and maturity) will not be permitted by typical incremental facilities and consents from existing lenders will be required.

Expanded Facility loans must satisfy the following criteria:

- **an "upsized" term loan tranche to term loans or revolving credit loans originated on or before April 24, 2020 with a remaining maturity of at least 18 months** by an eligible lender(s) to an eligible borrower,

- loan amount between $10 million and **$200 million but will be reduced to the lower of:**
  - **35%** of the eligible borrower's existing outstanding and undrawn available debt that is *pari passu* in priority with the eligible loan and equivalent in secured status (i.e., secured or unsecured); and
  - an amount that, when added to the eligible borrower's existing outstanding and undrawn debt, does not exceed **6.0x** the eligible borrower's **2019 EBITDA**; and
- must be **senior to or *pari passu* with**, in terms of priority and security, the eligible borrower's other loans or debt instruments (other than mortgage debt), at the time of upsizing and at all times thereafter.

Key Loan Terms

- Maturity – 4 years.
- Interest – Adjustable rate of LIBOR (1 or 3 month) *plus* 300 basis points.
- Amortization of principal and interest – Deferred for one year. Unpaid interest will be capitalized.
  - For New Facility loans, principal amortization of:
    - 1/3 at the end of the second year,
    - 1/3 at the end of the third year, and
    - 1/3 at maturity at the end of the fourth year.
  - For Priority Facility and Expanded Facility loans, principal amortization of:
    - 15% at the end of the second year,
    - 15% at the end of the third year, and
    - 70% at maturity at the end of the fourth year.
- Prepayment – Permitted without penalty.
- Loan Classification –
  - **Pass rating** – If the eligible borrower under the New Facility or the Priority Facility **had other loans outstanding with the eligible lender as of December 31, 2019, such loans must have had an internal risk rating equivalent to a "pass"** in the Federal Financial Institutions Examination Council's supervisory rating system on that date.
  - For the Expanded Facility, **the eligible loan must have satisfied such rating**.
- New Facility and Priority Facility Fees –
  - *Transaction fee*: Each eligible lender will pay the SPV a facility fee of **100 basis points** of the principal amount of the eligible loan at the time of original. This can be passed through to be paid by the borrower.
  - *Origination fee*: Each borrower will pay the eligible lender an origination fee of up to **100 basis points** of the principal amount of the eligible loan at the time of origination.
  - *Servicing fee*: The SPV will pay each eligible lender an annual loan servicing fee of **25 basis points** of the principal amount of its participation.

- Expanded Facility Fees –
  - *Upsizing fee*: Each eligible borrower will pay the eligible lender an upsizing fee of **75 basis points** of the principal amount of the upsized tranche of the eligible loan at the time of upsizing.
  - *Servicing fee*: The SPV will pay each eligible lender an annual loan servicing fee of **25 basis points** of the principal amount of its participation in the upsized tranche of the eligible loan.

Key Covenants and Restrictions

- Eligible Borrower Certifications and Covenants. In addition to certifications required by applicable statutes and regulations, the following certifications and covenants are required from each eligible borrower:
  - *Use of proceeds* – The proceeds of the eligible loan will not be used to repay the principal balance of, or any interest on, any other debt (except mandatory principal or interest payments that are due and, in the case of the Priority Facility, refinancing of existing debt at the time of origination, as described below) unless the eligible borrower has first repaid the eligible loan in full.
    - For the Priority Facility, the eligible borrower 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.
    - Notwithstanding the foregoing, the Federal Reserve has issued guidance confirming that eligible borrowers are not prohibited from undertaking the following actions during the term of the eligible loans:
      - repaying a line of credit (including a credit card) in accordance with the eligible borrower's normal course of business;
      - taking on and paying additional debt obligations required in the normal course of business and on standard terms, including inventory and equipment financing, provided that such debt is secured by newly acquired property (e.g. inventory or equipment), and, apart from such security, is of equal or lower priority than the eligible loan; and
      - refinancing maturing debt.
  - *Committed lines of credit* – The eligible borrower will not seek to cancel or reduce any of its committed lines of credit with the eligible lender or any other lender.
  - *Financial obligations* – The eligible borrower has a reasonable basis to believe that, as of the date of origination or upsizing, as applicable, of the eligible loan and after giving effect to such loan, it has the ability to meet its financial obligations for at least the next 90 days and does not expect to file for bankruptcy during that time period.
  - *Share buyback restriction* – Until 12 months after the eligible loan is repaid, the eligible borrower will not purchase any equity security of the eligible borrower or of any parent company, in each case listed on a national securities exchange (unless contractually obligated prior to March 27, 2020). (This requirement is incorporated by reference from Section 4003(c)(3)(A)(ii)(I) of the CARES Act).

- *Dividend restriction* – Until 12 months after the eligible loan is repaid, the eligible borrower will not pay dividends or make other capital distributions with respect to the common stock of the eligible borrower. (This requirement is incorporated by reference from Section 4003(c)(3)(A)(ii)(II) of the CARES Act). This requirement could be a significant limitation for private companies for ordinary course actions unrelated to extraordinary dividends for equity holders, including possibly limiting (1) distributions from an operating company through its corporate structure to finance share buybacks from departing employees and (2) tax distributions for pass-through structures.
  - **Exception: An S corporation or other tax pass-through entity that is an eligible borrower may make distributions to the extent reasonably required to cover its owners' tax obligations in respect of the entity's earnings.**
- *Executive compensation limits* – The eligible borrower will comply with the limitations on compensation set forth in Section 4004 of the CARES Act. (This requirement is incorporated by reference from Section 4003(c)(3)(A)(ii)(III) of the CARES Act).
  - Note: The compensation limitations raise numerous interpretive and practical issues that will need to be addressed in future guidance, including what is treated as compensation and how to measure it. Implementation will also need to be addressed, including the possibility of requiring clawbacks. A discussion of some of these issues can be found here.
- *Eligibility* – The eligible borrower is eligible to participate in the applicable program, including in light of the conflicts of interest prohibition in Section 4019(b) of the CARES Act (relating to the President, Vice President, heads of federal departments and agencies, Members of Congress and certain family members).

- Retaining Employees – Each eligible borrower should make **commercially reasonable efforts to maintain its payroll and retain its employees** during the time the eligible loan is outstanding.
  - Specifically, the Federal Reserve advises that each eligible 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. Borrowers that have already laid-off or furloughed workers as a result of the disruptions from COVID-19 are still eligible to apply for Main Street loans.

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If you have questions concerning the contents of this alert, or would like more information, please speak to your regular contact at Weil or to any of the following:

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