ROPES & GRAY

CORONAVIRUS
INFORMATION & UPDATES

April 9, 2020

Federal Reserve Issues Guidance on new "Main Street Lending Program"

*****This legal development is still in progress. We will update this Alert as additional information is provided.*****

As previously described in a prior Alert issued March 27, the bipartisan Coronavirus Aid, Relief, and Economic Security Act (CARES Act), commonly referred to as Phase 3 of the federal government's response to the coronavirus outbreak, was approved by the House and signed into law by the President. Title IV of the CARES Act directs the Federal Reserve to establish programs and facilities through its mandate to support impacted businesses. On April 9, the Federal Reserve announced a $2.3 trillion series of new programs under the CARES Act. Term sheets for each of these programs can be found here. Among the Federal Reserve programs is the creation of a new "Main Street Lending Program," which will make loans available for U.S.-based borrowers with up to 10,000 employees or up to $2.5 billion in 2019 annual revenues. The program will include facilities that both fund new term loans and expand existing term loans.

The term sheets include a number of potential issues that may limit the ability of many borrowers to access these facilities, including the following:

- ***EBITDA/Leverage Test Requirements:*** *maximum leverage is (i) 4X 2019 EBITDA for the New Loan Facility (subject to a maximum loan amount of $25 million) and (ii) the lesser of 6X 2019 EBITDA and 30% of outstanding and committed but undrawn bank debt for the Expanded Loan Facilities (subject to a maximum loan amount of $150 million). Note also that most borrowers use "adjusted" EBITDA (which includes add-backs and other adjustments to actual EBITDA) in reporting under existing credit agreements, and the term sheets do not address whether these adjustments will be used in the calculation of EBITDA.*

- ***Eligible Lenders:*** *non-bank lenders are not currently eligible to serve as lenders under this program. This may limit the ability of borrowers that have existing credit agreements with non-bank lenders to participate in the Expanded Loan Facility.*

- ***Executive Compensation/Dividend Limitations:*** *borrowers will be required to agree to limitations on executive compensation and dividends and capital distributions during the term of the loan and for 12 months after repayment. Unless the Federal Reserve issues additional guidance, these restrictions may create issues in effecting a sale transaction during this period.*

- ***Exigent Circumstances:*** *Borrower must attest that financing is due to "exigent" circumstances presented by COVID-19.*

A summary of the terms of these facilities, along with initial considerations and potential issues for borrowers, is set forth below. We expect the Federal Reserve to issue additional guidance on the requirements for these facilities, which may address some of the identified considerations.

Main Street Lending Program

The Main Street Lending Program includes both the Main Street New Loan Facility (New Loan Facility) and the Main Street Expanded Loan Facility (Expanded Loan Facility), which have been authorized under Section 13(3) of the Federal Reserve Act. The combined size of the New Loan Facility and the Expanded Loan Facility will be up to $600 billion. Under each facility, a newly formed SPV (that is funded by the Fed as well as a $75 billion equity investment from Treasury) will purchase a 95% participation of loans made by lenders, and lenders will retain 5% of each loan.

New Loan Facility: loans under this facility would be structured as new term loans.

- *In general, this facility may be available to borrowers that either do not have existing credit agreements or that have sufficient basket capacity under existing credit agreements to incur indebtedness under this facility. It is possible that entities other than a current borrower might be eligible to borrow under this facility.*

Expanded Loan Facility: loans under this facility are structured as increases to term loan facilities that are already outstanding. As a result, loans under this facility seem to be directed toward borrowers that have accordion provisions in existing credit agreements.

- *If an existing credit agreement does not include accordion provisions, consent of the borrowers' existing lenders will be required in order for a borrower to participate.*

Unlike PPP loans issued under SBA programs, loans issued under these facilities will not be subject to forgiveness. In addition, based on information currently available, the "affiliation" rules applicable to PPP loans would not limit borrowers' ability to participate in these facilities.

Eligible Lenders

The term sheets clarify that eligible borrowers will enter into loan agreements with "eligible lenders" and not the Federal Reserve directly. As a result, loans under this program will not be "direct loans" under the CARES Act.

"Eligible Lenders" are limited to U.S. insured depository institutions, U.S. bank holding companies and U.S. savings and loan holding companies.

- *This may limit availability of the Expanded Loan Facility for borrowers that have existing credit agreements with non-bank lenders. In many instances, credit agreements with direct lenders do not include any "eligible lender" as part of the lending syndicate.*

- *It may be possible for borrowers with existing credit agreements with non-bank lenders to cause an eligible lender to join the lending syndicate (making the Expanded Loan Facility available), but borrowers should determine whether there are any rights of first offer or similar provisions that require that any incremental term loan be offered to existing lenders prior to being offered to new lenders.*

- *In addition, the impact of the "eligible lender" requirement for borrowers with syndicated term loans that have been arranged by eligible lenders but have been sold, all or in part, in the debt capital markets to ultimate holders that are not eligible lenders, is unclear.*

"Eligible Borrowers" are businesses with up to 10,000 employees or up to $2.5 billion in 2019 annual revenues. In addition, each eligible borrower must be a business that is created or organized in the United States with significant operations in and a majority of its employees based in the United States.

- *Term sheets do not offer guidance on how borrowers should interpret "significant" operations or whether U.S. subsidiaries of foreign companies will be eligible.*
- *Borrowers that have participated in the PPP loan program will still be eligible to participate in these facilities.*
- *Borrowers may participate in the New Loan Facility or the Expanded Loan Facility (but not both).*

Key Loan Terms

<u>Maturity</u>: four years.

- *This may create an issue for borrowers seeking loans under the Expanded Loan Facility that have existing credit agreements that mature beyond four years. Accordion provisions will typically require that any incremental term loan matures no earlier than the maturity of existing loans. As a result, if the four-year term required under the Expanded Loan Facility is inside the maturity of an existing term loan, participation in the Expanded Loan Facility will likely not be permitted absent an "inside maturity" basket (i.e., a limited basket that permits earlier maturing debt) or consent of the borrower's existing lenders.*

<u>Loan Amount</u>:

- Minimum loan amount of $1 million.
- Maximum loan amount:
  - For borrowers under the New Loan Facility, maximum loan amount is equal to the lesser of (i) $25 million and (ii) an amount that, when added to the borrower's existing outstanding and committed but undrawn debt, does not exceed 4X 2019 EBITDA
  - For borrowers under the Expanded Loan Facility, maximum loan amount is equal to the lesser (i) $150 million, (ii) 30% of the borrower's existing outstanding and committed but undrawn bank debt and (iii) an amount that, when added to the borrower's existing outstanding and committed but undrawn debt, does not exceed 6X 2019 EBITDA
- *The reference to "bank debt" in the limitation on loans available under the Expanded Loan Facility is unclear – read literally, it would preclude any borrower whose credit facilities are with non-bank lenders from participating in this program.*
- *Note that the leverage test includes both drawn and committed but undrawn debt. As a result, the full amount of undrawn revolving commitments and the full amount of delayed-draw term loan commitments that have not been utilized would be included as debt for purposes of this test.*

- *Under most existing credit agreements, the definition of "EBITDA" is negotiated and includes a number of negotiated add-backs and adjustments. In most cases, "actual" or "unadjusted" EBITDA is lower than the "adjusted" EBITDA that borrowers are reporting under existing credit agreements. It is not clear that borrowers under these facilities will get the benefit of such adjustments.*

Interest: Adjustable rate of SOFR + 250-400 basis points.

- *Stipulated interest is considerably lower than current market rates. If eligible lenders are required, as a result of mark to market accounting, to immediately write down the value of new loans, they may be disinclined to participate.*

- *As with any incremental loan, borrowers should confirm that MFN provisions under existing credit agreements are not triggered (which would result in a gross-up of the interest rate on existing loans). Given that the interest rate for these loans is low compared to LIBOR and the margin is relatively low, applicability of MFN provisions is unlikely but should be confirmed.*

Amortization: principal and interest deferred for one year.

- *The required level of amortization has not been specified. This may create an issue for borrowers seeking loans under the Expanded Loan Facility that have existing credit agreements with a longer weighted average life to maturity than the loans to be obtained under the Expanded Loan Facility. Accordion provisions will typically require that any incremental term loan have a weighted average life to maturity that is no shorter than the weighted average life to maturity of the existing term loans. As a result, if the amortization of the loans to be obtained under the Expanded Loan Facility, together with the four-year term required under the Expanded Loan Facility, results in a shorter weighted average life to maturity than any existing term loan, participation in the Expanded Loan Facility will likely not be permitted absent an "inside maturity" basket or consent of the borrower's existing lenders.*

Prepayment: permitted without penalty.

Collateral:

- Loans under the New Loan Facility will be unsecured.

- For loans under the Expanded Loan Facility, any collateral securing the existing loan will secure the expanded loan on a pro rata basis.

Use of Proceeds: Borrowers cannot use loan proceeds to repay other loan balances. In addition, borrowers will not be able to repay other debt of equal or lower priority, with the exception of mandatory principal payments, unless the loan has been fully repaid.

- *Additional guidance will be needed to clarify that borrowers are permitted to repay revolving credit facilities and other working capital lines and trade debt before both existing term loans and loans under these programs are repaid in full.*

- *In addition, the prohibition on repaying other debt seems to apply until both the loan obtained through the Expanded Loan Facility program and the existing loan that was expanded are repaid in full.*

Fees:

- For loans under the New Loan Facility, lenders will be required to pay the Federal Reserve a facility fee of 100 basis points of the principal amount of the loan participation purchased by the Federal Reserve (which will be 95%). Lenders may require borrowers to pay this fee. Borrowers will also pay lenders an origination fee of 100 basis points of the principal amount of the loan.

- For loans under the Expanded Loan Facility, borrowers will pay lenders a fee of 100 basis points of the principal amount of the upsized tranche.

Borrower Attestations

In order to participate in either program, borrowers will be required to make certain attestations, including the following:

- Borrower requires financing due to exigent circumstances presented by COVID-19, and, using proceeds of the loan, it will make reasonable efforts to maintain its payroll and retain its employees during the term of the loan.

- Borrower will follow executive compensation, stock repurchase and capital distribution limitations described in the CARES Act applicable to direct loans. These include the following so long as the loan is outstanding and for twelve months after repayment:
  - Employees who received total compensation in 2019 of over $425,000 cannot receive total compensation during any 12-month period that exceeds the amount received in 2019 or termination benefits that exceed two times 2019 compensation.
  - Employees who received total compensation in 2019 of over $3 million may not receive more than $3 million plus 50% of the excess over $3 million received in 2019 during any 12-month period.
    - *"Total compensation" is defined as salary, bonuses, awards of stock, and other financial benefits provided by an eligible business to an officer or employee. The CARES Act does not specify when or how "awards of stock" are to be valued for purposes of determining total compensation, which may have implications on future sale transactions.*
  - Borrower cannot repurchase equity securities.
    - *Note that under the CARES Act this provision applies only to publicly traded securities.*
  - Borrower can not pay dividends or make other capital distributions.
    - *Absent additional guidance, this provision may have implications on future sale transactions.*

- *The term sheets do not contemplate permission for tax distributions, or other ordinary course distributions (for example, distributions for franchise taxes, corporate overhead and audit expenses) that are common for borrowers that are wholly owned by holding companies.*