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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Main Street Lending Program Offers Liquidity With Limits

By **Tom Zanki**

Law360 (May 7, 2020, 6:39 PM EDT) -- The Federal Reserve's Main Street Lending Program promises relief for cash-starved businesses struggling amid the coronavirus pandemic, including larger companies that missed out on prior government aid, though experts warn the central bank's loan effort is not a cure-all.

Lawyers say they are receiving interest from clients about the recently expanded loan program, which is expected to be implemented soon. Unlike the federal government's Paycheck Protection Program, which provides small businesses loans that function like grants if money is spent on payroll and other approved uses, the Fed program is available to larger businesses.

In effect, the Fed program could serve as a Plan B for companies that were not eligible for the PPP and have difficulty raising funding through traditional capital markets right now.

"You could definitely look at this as something valuable for larger companies that are not public companies but would have a hard time accessing capital markets," Greenberg Glusker LLP counsel Eric Perlmutter-Gumbiner said.

Perlmutter-Gumbiner added there are limits regarding whom banks will deem qualified for the loans, a point echoed by other experts. CohnReznick LLP managing principal Jeremy Swan noted that banks must conduct internal risk assessments of existing clients and confirm those clients have a "pass" rating under specifications set by the Federal Financial Institutions Examination Council.

Swan described that as a "very high standard" that could limit eligibility of certain companies, specifically those that were under duress before recent economic turmoil. The loans are largely backstopped by the Federal Reserve with some support from the Treasury Department.

"They are not anticipating getting into loans that are going to be high-risk," said Swan, who leads the financial sponsors and financial services industry practice at the accounting giant.

Since unveiling the loan program April 9, the Fed has significantly broadened its scope. The central bank last week expanded eligibility to include companies with up to 15,000 employees and $5 billion in revenue, up from an original criteria of 10,000 employees and $2.5 billion in revenue. By comparison, the PPP was limited to businesses with fewer than 500 workers.

The Fed also lowered the minimum loan amount from $1 million to $500,000 last week, hoping to appeal to more businesses.

Another key difference between the Fed's program and the PPP — both of which were authorized under the Coronavirus Aid, Relief and Economic Security, or CARES, Act — is that Fed-backed loans must be repaid. The PPP, which was administered separately by the Small Business Administration, was on its face a loan program, yet it contained generous forgiveness rules if companies used most proceeds to preserve jobs, making the loans akin to grants.

"The Main Street Lending Program is truly a loan, and it will provide liquidity for companies that need liquidity," Morgan Lewis & Bockius LLP partner Joanne Soslow said. "But it's not on super-generous terms."

The $600 billion Fed program offers three different kinds of four-year loans, all of which require no principal or interest to be paid in the first year with varying requirements thereafter. Interest rates on the loans are 3 percentage points above the London interbank offered rate, or Libor.

The Fed's expansion last week created a third type of loan, so-called priority loans, which are open to companies with higher preexisting debt loads. For priority loans, the central bank purchases 85% of the loan while the original lender holds onto a 15% chunk. The Fed buys 95% of eligible loans to businesses that are made by qualifying lenders in its other two loan programs, one of which backs new loans while the other backs expansion of existing loans.

The priority loans are capped at the lesser of $25 million or six times the borrower's adjusted 2019 earnings before interest, taxes, depreciation and amortization — a measure of cash flow known as adjusted Ebitda. The Fed's other program for new loans, which appeals to borrowers on stronger footing, is capped at the lesser of $25 million or four times 2019 adjusted Ebitda.

Lawyers note that the recent modifications will capture a wider swath of businesses. But the Fed's adjusted Ebitda tests still presume some degree of positive cash flow, which many early-stage companies have yet to generate as they spend money growing their businesses.

"We have small public company clients that don't have Ebitda," Soslow said, adding that life sciences companies could fall in that category.

Baker Botts LLP partner Michael Torosian pointed out that many young private and public companies may be operating at a loss because they are investing heavily in research and development, new technologies, or other forms of product and business development.

"From our perspective, there is no reason why growth companies should be excluded given their impact on the economy," Torosian said.

The Federal Reserve did not immediately return a request for comment Thursday.

The Fed's revised Main Street Lending Program also won't be available for private equity and venture capital firms that are deemed to be primarily in the business of investment speculations, according to a May 4 memo by Baker Botts. The firm said it expects that certain companies backed largely by private equity investors won't be eligible for the program if their employment exceeds 15,000 when measuring employment by the SBA's affiliation rules, which also govern the Fed program.

Attorneys are hoping for a smoother rollout of the Fed's Main Street Lending Program compared with the PPP. The SBA's program generated a backlash after certain public companies accessed funds that were billed as aid for mom-and-pop businesses, even though the PPP did not expressly prohibit public companies from applying.

The Treasury Department, in updated guidance April 23, said companies needed to certify in good faith that their PPP loan was necessary, adding that public companies of "substantial market value and access to capital markets" would likely be ineligible. Several large public companies, notably Ruth's Hospitality Group and Shake Shack, afterward returned their funds.

The small business-targeted PPP quickly exhausted its initial $349 billion allocation as applications flooded SBA offices, before Congress authorized an additional $310 billion that reportedly may soon run out.

Given its more flexible criteria, the Main Street Lending Program could serve as a backup plan for businesses that didn't meet PPP criteria. Soslow said the Fed-backed loans may benefit "companies that have revenues and have fallen on hard times." She added that could include public companies whose stock has dropped, making traditional capital markets less appealing.

The Fed program is expected to be implemented soon, but as of Thursday had not begun. Perlmutter-Gumbiner said time is critical for companies given current economic turmoil.

"Coming off a terrible economic quarter and entering into one where projections are that it could be even worse, I don't know if people can afford to wait a long time for money," Perlmutter-Gumbiner said.

--Additional reporting by Elise Hansen. Editing by Philip Shea and Kelly Duncan.