June 29, 2020

Main Street Loan Program Opens

The "Main Street Loan Program" officially opened for business on June 15, 2020. This new government loan option will be particularly attractive to U.S. businesses that could not, or chose not to, obtain a Payroll Protection Program loan. Those who did obtain PPP loans are still eligible for a Main Street loan.

The Treasury Department touts the program as "designed to help ensure that small and medium-sized businesses have access to the credit they need to get through this challenging period." Government support comes from the fact that participating banks will retain on their balance sheets only 5% of the principal of the loans, with the Federal Reserve absorbing the other 95%.

Here are the main points to consider about the Main Street Loan Program:

<u>Eligibility</u>

- The borrower must have been in sound financial condition prior to the onset of the COVID-19 pandemic. Note that 2019 EBITDA will directly affect the maximum amount of the loan
- Borrowers of PPP loans (or whose affiliates may have obtained PPP loans) remain eligible for Main Street loans, but the amount of the PPP loan that has not yet been forgiven must be combined with the potential amount of the Main Street loan when determining the maximum possible Main Street loan (see immediately preceding bullet point)
- Applicants must have not more than 15,000 employees ***<u>or</u>*** not more than $5 billion in 2019 revenues
- In counting the number of employees and the amount of 2019 revenues, an applicant must consider the same affiliation rules that applied to PPP applicants. However, the ability to qualify based on ***<u>either</u>*** less than 15,000 employees ***<u>or</u>*** less than $5 billion in 2019 revenues is likely to markedly enlarge the pool of prospective applicants regardless of affiliation rules
- Borrowers must be businesses established prior to March 13, 2020, that are created or organized in the U.S. and that have significant operations in and a majority of its employees based in the U.S. This requirement applies to the U.S. applicant, not its owners, and consequently does not prevent foreign ownership.

<u>Foreign Ownership</u>

- An eligible borrower may be owned by a foreign company or individual but must use the proceeds of a Main Street loan only for the benefit of the eligible borrower, its consolidated U.S. subsidiaries and other affiliates of the U.S. borrower that are U.S. businesses
- Conversely, the proceeds of a Main Street loan may not be used for the benefit of an eligible borrower's foreign parents, affiliates or subsidiaries
- Although the borrower may have foreign owners, it must be a separate entity formed in the U.S. A simple division or branch of a foreign company will not be eligible
- Joint ventures with foreign participation are acceptable so long as foreign business entities do not have more than 49% participation

- An eligible borrower may be a subsidiary of a foreign company, provided that the borrower itself is created or organized in, or under the laws of, the United States, and the borrower on a consolidated basis has significant operations in and a majority of its employees based in the United States.

Loan Repayment Terms

- Interest rate of LIBOR + 3%
- Loan term – 5 years
- No interest or principal payable the first year
- Interest will be capitalized in the first year and payments will commence in second year
- Principal (including capitalized interest) must be paid 15% at the end of the third year, 15% at the end of the 4th year and 70% at the end of the 5th year
- Prepayments permitted without penalty
- **In contrast to PPP loans, no part of a Main Street loan is forgivable.**

Amount of Loan

- The minimum loan is $250,000, and the maximum possible loan under the program is $300 million. These constraints vary with which of the three different facilities available under the Main Street loan program is utilized
- The maximum loan for any particular applicant is limited so that the Main Street loan combined with any remaining indebtedness must not exceed between 4 and 6 times 2019 EBITDA (depending on which of three Main Street loan facilities is used)
- In response to public comments, the government has acknowledged that the credit risk of asset-based borrowers is generally not evaluated based on EBITDA. The Federal Reserve and the Treasury Department will be evaluating the feasibility of adjusting the loan eligibility metrics of the program for such borrowers.

Bank Underwriting Decisions

- Banks will make underwriting decisions in their own business judgment and will not be limited to mathematical formulas (such as the 2.5 times average payroll calculation used to compute maximum loan amounts under the PPP program)
- Banks may include other loan requirements to the extent not inconsistent with the Main Street announced loan terms
- Banks may charge their customary fees to the borrower (in contrast to the PPP program, predetermined fees were paid to the banks by the government
- In determining 2019 EBITDA of an applicant, banks may make adjustments based on historical and prudent practices in evaluating such matters, such as excluding non-recurring, one-time events or irregular items from the calculation.

Use of Funds

- Unlike under the PPP program, there are no specific restrictions on the types of expenses to which loan funds must be devoted
- However, borrowers must agree to make “commercially reasonable efforts” to maintain payroll and retain employees during the term of the loan, in light of its capacities, the economic environment, its available resources and the business need for labor
- See discussion above regarding foreign ownership for further constraints.

Other Salient Points

- The compensation, stock repurchase and capital distribution restrictions that apply to direct loan programs under section 4003(c)(3)(A)(ii) of the CARES Act also apply to borrowers of Main Street loans. Until 12 months after the loan is no longer outstanding:
  - The borrower may not repurchase an equity security listed on a national exchange of the borrower or its parent
  - The borrower may not pay dividends or make other capital distributions, except that distributions reasonably required to cover an owner's tax obligations in respect of earnings from a pass-through entity (e.g., an S Corporation, partnership or limited liability company) will be permitted
  - The borrower must comply with compensation limits established in section 4004 of the CARES Act, relating to employees whose compensation in 2019 exceeded $425,000
- Quarterly financial reporting will be required
- The Federal Reserve will publicly disclose the names of borrowers and the amounts borrowed.

Notwithstanding the sheer number of bullet-points included above, this is only a summary. Each potential borrower may have unique and diverse issues with which to grapple that are not addressed above. We are here to help.

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Contacting Pavia & Harcourt LLP

Questions regarding matters discussed in this publication may be directed to the author, to any other Pavia & Harcourt lawyer with whom you may have consulted previously, or to any of the following members of the litigation department:

Robert D. Tolz
+1 (212) 508-2371
rtolz@pavialaw.com

Nicolo' Majnoni
+1 (212) 508-2311
nmajnoni@pavialaw.com