“I Need a Hero” – The Fed Comes to the Rescue with an Array of Weapons Aimed at Combating Economic Impacts of COVID-19; PPP Support, Main Street Business Loans and More

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Leading the charge of a cavalry of government-backed loan programs, Jerome Powell, Chairman of the Federal Reserve (affectionately, the “Fed”), rode into a morning press conference on April 9, 2020 on the proverbial white horse and announced a wide variety of new programs and enhancements to existing programs aimed at attacking the liquidity crunch facing businesses, households, markets and state and local governments as a result of the economic slowdown resulting from the COVID-19 pandemic.

The programs described in this alert were all created under the authority of Section 13(3) of the Federal Reserve Act, with the approval of the Treasury Secretary.

While many details are yet to be announced, this is what we know today:

PPP CREDIT SUPPORT

The Fed established a Paycheck Protection Program Liquidity Facility (PPPLF) to extend credit to lending institutions making PPP loans to qualifying small businesses, non-profits and other approved borrowers. Many lenders looking to issue PPP loans found that they were quickly handicapped by FDIC capital requirements. This lending bottleneck created significant angst among small business owners seeking their respective pieces of the PPP loan pie on the opening day of the program (March 3, 2020).

Under the PPPLF each of the Federal Reserve Banks will extend non-recourse loans to eligible financial institutions to fund loans guaranteed by the SBA under the PPP. Furthermore, the Fed is presenting for the approval by the FDIC Board of Directors an interim final rule that would allow lenders to neuter the impact of holding PPP loans on their balance sheets. Additionally, consistent with the mandate established in section 1102 of the CARES Act, loans originated under the PPP will receive a zero percent risk weight under the capital rules of the applicable federal agencies.

These actions make a lot of sense as the usual credit risks to lenders in issuing loans are heavily mitigated in the PPP context by the SBA’s 100% guarantee of the PPP loans and the forgiveness component of the program. These actions should provide the necessary grease to help the PPP funding engine to finally function properly. More information can be found here (memo to the FDIC), here (PPPLF Interim Final Rule) and here (PPPLF Term Sheet).

MAIN STREET BUSINESS LENDING PROGRAM

In an effort to quench the liquidity thirst shared by many medium-sized businesses who found themselves ineligible for a highly desirable (and forgivable) PPP loan available to smaller businesses, the Fed announced two complementary credit facilities – the Main Street Expanded Loan Facility (MSELF) and the Main Street New Loan Facility (MSNLF) – which combined account for the planned purchase of $600B in loans (with Treasury providing $75B in combined equity to the facilities). These facilities are collectively referred to as the “Main Street Lending Program.”

Loans issued or upsized, as applicable, under the MSELF and MSNLF include the following common elements:

– Four (4) year maturities.

– Companies with up to 10,000 employees or with revenues of less than $2.5B in 2019 are eligible.

– Principal and interest payments are to be deferred for 1 year.

– Interest will be the Secured Overnight Funding Rate (SOFR) (which is currently .01%) plus 250 to 400 basis points (in other words 2.51% to 4.01%).

– Minimum loan size of $1,000,000.

– No prepayment penalty.

– Lenders will retain 5% of each Main Street loan made on their books while the remaining 95% will be purchased by the applicable Main Street facility.

– Origination fee payable by the borrower of 1.00% of the loan amount funded.

– Lender is charged a fee by the facility equal to 1.00% of the portion of the loan to be purchased by the applicable facility (in other words, 0.95% of the total MSNLF loan amount for a new loan or of the expanded loan tranche in the case of the MSELF). This fee can be passed on by the lender to the borrower.

– The applicable facility will pay the lender a loan servicing fee equal to 0.25% of the loan amount serviced.

– Borrowers, among other certifications, must commit to make reasonable efforts to maintain payroll and retain workers.

– Borrowers must follow compensation, stock repurchase, and dividend restrictions that apply to direct loan programs under the CARES Act (so that loan funds don't end up rewarding executives and shareholders).

– Small businesses that have secured a PPP loan are still eligible to apply for an additional Main Street loan.

– Unlike PPP loans, Main Street loans are not forgivable.

– Participations will stop being purchased by the facilities on September 30, 2020, unless extended.

Key differences between the MSELF and the MSNLF are the following:

– The MSELF is only for the **upsizing of existing loans** first originated by the applicable lender to the borrower prior to April 8, 2020 and has a maximum loan amount that is the lesser of (i) $150M; (ii) 30% of the Borrower's existing outstanding and committed but undrawn bank debt; or (iii) an amount that, when added to the Borrower's existing outstanding and committed but undrawn bank debt, does not exceed six (6) times the Borrower's 2019 earnings before EBITDA.

– The MSNLF is for **new loans** originated from and after April 8, 2020 and has a maximum loan amount that is the lesser of (i) $25M; or (ii) an amount that, when added to the Borrower's existing outstanding and committed but undrawn bank debt, does not exceed four (4) times the Borrower's 2019 earnings before EBITDA.

Additional information on the MSELF can be found here and on the MSNLF can be found here.

Perhaps learning from the somewhat messy rollout of the PPP loans under the umbrella of the SBA, the Fed has decided to take a little time to work out details before these loans become available. Additional information is expected to be forthcoming following April 16, 2020, when the public comment period on the Main Street Business Lending Program will close. These programs are not likely to begin closing loans until early May and, given that lenders must hold 5% of these loans, borrowers will likely face satisfying not only Fed requirements but also lender covenants. As additional guidance is released, we will provide further updates.

MUNICIPAL LIQUIDITY FACILITY

In recognition that many state and local governments are hurting financially after spending untold amounts of money to combat the health effects of COVID-19, together with the virtually guaranteed diminished tax revenues expected, the Fed announced the creation of the Municipal Liquidity Facility (MLF) which will offer up to $500B in lending to states, heavily populated counties (with at least two million residents) and heavily populated cities (with at least one million residents). The Treasury is providing $35B in credit protection for the MLF. The MLF term sheet can be found here.

ADDITIONAL FED ACTIONS

In a huge nod to the Wall Street capital markets, the Fed previously announced on March 23, 2020 the creation and implementation of the following three facilities totaling $850B in credit (backed by $85B in credit protection provided by the Treasury):

– Primary Market Corporate Credit Facility (PMCCF) for new bond and loan issuance (the PMCCF Term Sheet can be found here).

– Secondary Market Corporate Credit Facility (SMCCF) to provide liquidity for outstanding corporate bonds (the SMCCF Term Sheet can be found here).

– Term Asset-Backed Securities Loan Facility (TALF) to support the flow of credit to consumers and businesses through enabling the creation of asset-backed securities backed by student loans, auto loans, credit card loans, loan guaranteed by the SBA, and certain other assets. Notably, this iteration of the TALF (first used in 2008 to deal with the Great Recession) expanded its reach beyond the original investment grade securities included in the 2008 version (on which the Fed made money) to include below investment grade ETFs. The TALF Term Sheet can be found here.

Despite the huge rollout of new and enhanced programs by the Fed (supported with credit protection or equity by the Treasury), there is still a lot of authorized ammunition left as Congress in the CARES Act authorized the Treasury to provide $500B to support loan programs by the Federal Reserve – $46B of which was committed by the CARES Act to the aviation industry – leaving a staggering $454B to the discretion of Secretary Mnuchin. The loan program support provided by the Treasury to the Fed for all of the Fed loan programs announced to date is less than half of what has been authorized. This all but guarantees that we will hear of yet additional historical announcements in the coming days and weeks as additional programs are created and deployed.