Evolving Main Street Lending Program Helps Banks Meet Growth and Profitability Goals in Uncertain Times

Executive Summary

The Federal Reserve's Main Street Lending Program (MSLP) has the potential to inject hundreds of billions of dollars into the economy to help borrowers and lenders meet their business needs in support of CARES Act goals.

Attractive Loan Structure for Borrowers	Meets Wide Range of Bank Strategic Goals
• 5-year term • Pricing of Libor +300 (about 3.25% today) • Deferred interest for first full year • No principal payments for years 1 and 2; 15% at end of year 3; 15% end of year 4; balloon end of year 5 • Fully prepayable at par	• New client acquisition • Flexible underwriting guidance and limited residual credit risk • Relationship expansion and fee income • Path to targeted asset growth • Strong lending economics • CRA and other community considerations

While most banks remain on the sidelines, some have recognized the MSLP's potential to meet their business goals and serve their customers. Endurance Advisory Partners is helping its bank clients build MSLP capabilities and strategies to accelerate their ability to take full advantage of the MSLP.

Background

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act, March 27, 2020) and the follow-up Paycheck Protection Program and Health Care Enhancement Act (April 24, 2020) combined for over $2.5 trillion of taxpayer funds to respond to the economic impact and uncertainties of COVID-19. Almost half of those funds were intended to support Small Business Administration (SBA) and Federal Reserve Bank (Fed) lending programs, with other funds directed to unemployment benefits, stimulus checks, and other grant programs.

The success of the Paycheck Protection Program (PPP) has been broadly noted, with over $525B of forgivable loans distributed to small businesses through August 2020. Similarly, the Fed's announcement of loan programs for municipal governments, loan and bond purchase programs for large corporations, and backing of commercial paper and money market funds has been credited with meeting market stabilization goals. However, participation in the MSLP, the Fed's program for "medium-sized" businesses, has been limited.

Endurance Advisory Partners believes the MSLP's slow start is due in large part to confusion from lenders and potential borrowers about program eligibility, restrictions, and risk as well as resource constraints that have prevented lenders from fully considering how the MSLP can help achieve business goals.

Sources: Federal Reserve Bank (https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm)

MSLP Overview

The MSLP was established to help a diverse range of US companies: large enough to need a loan of $100,000 to $350MM but with 15,000 employees or fewer or revenues of $5 billion or less. An SPV was seeded with $75B of CARES Act funds to allow the Fed to make up to $600B of loan purchases from lenders. While not forgivable, Main Street loans are nonetheless an attractive structure for a medium-sized business interested in preserving liquidity.

In addition to the borrower size requirements, the MSLP

- Limits the level of the borrower's adjusted maximum Debt/EBITDA at the time of origination;
- Requires the borrower to commit to "commercially reasonable" and "good-faith efforts to maintain payroll and retain employees"; and
- Requires borrowers to agree to CARES Act rules on compensation, dividends, and share repurchases that can apply even up to 12 months after the Main Street loan is repaid.

To encourage banks and credit unions to make these loans, the Fed agrees to purchase 95% of the qualifying loan from the lender and pay a 0.25% servicing fee on the Fed's interest. The lender also retains half of the origination fee (usually 1% of the total amount originated) on loans above $250,000 and the entire fee on loans below $250,000.

The MSLP literature makes clear that lenders should adjust underwriting criteria to only consider borrower financial condition pre-COVID and post-COVID, clearly indicating that recent performance and even expected near term performance should not prevent loans being issued as long as a borrower can represent that it expects to avoid a near-term bankruptcy.

MSLP Participation Benefits to Lenders

While the benefits to a borrower of a Main Street loan are relatively clear, lenders should be able to capitalize on the program as well.

Client Acquisition and Path to Relationship Expansion and Targeted Asset Growth

Endurance Advisory Partners believes the best strategic use of the MSLP for lenders is not in attempting to provide additional funds (i.e. more debt) to existing clients but rather in refinancing borrowers that are currently being served by other lenders. We have developed strategies and networks that banks can leverage to build a strong pipeline of MSLP client acquisition and relationship expansion opportunities:

- Client acquisition of COVID-impacted and non-COVID-impacted borrowers
- Non-interest income and deposits from sole-bank relationship expansion
- Longer term asset growth
- Industry and geography targeted growth and optionality

Strong Loan Economics

Despite the low interest rate and favorable terms for borrowers, economics are strong for lenders due to the relatively high origination fee (which is financed for borrowers) and the annual servicing fee paid by the Fed. Even without assuming any benefits from depository or fee-based business that a Main Street lender could expect to get from a new relationship, Endurance Advisory Partners estimates returns on assets and capital that dwarf conventional commercial loans.

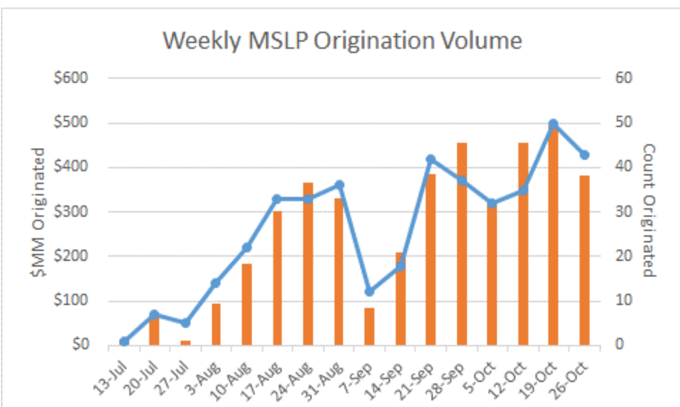
Sources: Federal Reserve Bank (https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm)

CRA and Other Community Considerations

Beyond the bottom line, potential lenders should keep in mind that the MSLP was "designed to provide support to small and medium-sized businesses and their employees across the United States during the current period of financial strain by supporting the provision of credit to such businesses." Banks stepping in to facilitate this outlay of capital are helping to fulfill this component of the CARES act. The OCC has stated that even large Main Street loans can meet Community Redevelopment Act consideration "if they help to revitalize or stabilize low- or moderate-income geographies or distressed or underserved nonmetropolitan middle-income geographies."

MSLP Participation To-Date

As of the October 31, 2020 reporting date, just 126 banks and three credit unions had extended 420 loans to for-profit companies, for a total of $4.2B. The average loan size was $9.9MM. City National Bank of Florida executed 139 loans for $679MM and Vista Bank (Texas) closed 27 for $365MM. One other lender executed more than 10 loans, and 75 did just a single loan. Loans originated averaged $400MM/week over the last four weeks of reported data vs. under $300MM in the prior eight weeks, showing a slight uptick. Yet at this pace, the $600B of MSLP loans would take almost three years to exhaust, an order of magnitude slower than the original 3-month term of the MSLP would have implied.



Borrowers to-date come from 38 states and span the entire industry spectrum: hospitality, transportation, energy, law firms, restaurants, health care providers, business services, construction, marketing firms, manufacturing and more. Lenders that have participated in the MSLP to-date are no less diverse: they span all six FDIC regions and come from banks of all sizes. As shown below, the largest banks account for only 20 of the MSLP loans originated to-date, with banks under $1B originating 5x that number.

Bank Category	MSLP Loan Amount	MSLP Loan Count	# of Banks Participating
Credit Unions	$22,250,000	3	3
<$500MM Banks	607,072,977	53	30
$500MM-$1B Banks	487,080,765	52	25
$1B-$10B Banks	1,297,523,112	131	46
$10B-$50B Banks	1,093,390,309	161	16
$50B+ Banks	654,577,580	20	9
Total	**$4,161,894,743**	**420**	**129**

Sources: Federal Reserve Bank (https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm)

MSLP Challenges and Recent Improvements and Clarifications

While the prior section discussed the characteristics of lenders and borrowers that have been successfully involved in the MSLP to-date, it is important to address the program's overall lack of participation to-date and whether the recent changes and clarifications can make the MSLP more successful going forward.

Below we list some clarifications to common concerns that our clients raise regarding the MSLP, which in our view make the program more accessible:

- **Yes, you CAN refinance existing debt:** the original MSLP facilities required borrowers to attest that proceeds would not be used to repay debt. In May 2020, the Fed announced a new facility that expressly allowed existing debt from other lenders to be refinanced at issuance.
- **Debt/EBITDA can be up to 6.0x, based on pre-COVID performance:** Early MSLP communications suggested a 4.0x maximum Debt (taking into account undrawn availability) to EBITDA ratio for the most common MSLP facility; the May announcement introduced a facility with a 6.0x threshold, clarifying that "adjusted" 2019 EBITDA should be used for the calculation.
- **Longer Maturity and Expanded Principal Deferral:** The original MSLP terms called for a 4-year tenor and payment structure of 0/33/33/33 for the most common facilities. This has been changed to 5 years with 0/0/15/15/70.
- **Lower Minimum Loan Sizes:** Down to $100,000 from $500,000 (original) and $250,000 (changed previously) for the most common facilities.
- **Higher Maximum Loan Sizes:** The two most common MSLP facilities had their maximum loan sizes increased from $25MM to $35MM for one facility and $50MM for the other. The third facility increased from $150MM to $300MM.
- **Clarity on How Underwriting Standards Should Be Relaxed:** The original guidance suggested lenders needed to use their standard processes to approve loans before the Fed would agree to its 95% purchase. Guidance issued in September (1) encouraged lenders to consider just pre-COVID performance and post-COVID prospects and (2) assured that regulators and supervisors would not criticize lenders for taking this approach.
- **Even Borrowers with Strong Performance Likely Qualify:** The Fed has expressed that even borrowers with other lending options available to them can certify that a Main Street Loan better fits its needs. There is no test for a borrower to demonstrate a direct impact from COVID or an inability to borrow from other sources.
- **Standardized Terms Among Facilities:** The various MSLP facilities are now aligned so closely in their terms, it is not important to distinguish between them except regarding their purpose and eligibility. Originally, the pricing, amortization schedules and the amount required to be retained by the lender differed, adding another layer of confusion.

Endurance Advisory Partners acknowledges ongoing weaknesses in the MSLP and opportunities for additional Fed clarifications such as the below:

- **How long will the MSLP last?** While the program deadline has already been extended once, to 12/31/20 from 9/30/20, it is still set to expire for new loan purchases on 12/31/20 even if funds are remaining at that point. While many have speculated that this deadline will again be extended, there has been no formal indication this will be the case.

Sources: Federal Reserve Bank (https://www.federalreserve.gov/monetarypolicy/mainstreetlending.htm)

- **Fees (too high/too low):** Borrowers are expected to pay a 2% fee at origination, half of which will be claimed by the Fed, the other half by the lender. While the Fed recently allowed the lender to retain the entire fee for loans under $250,000, some have questioned whether the fee is too high for borrowers, or too low for lenders to be incentivized to make the loans.
- **Lenders may not be able to help their own clients:** By design, the MSLP does not typically allow lenders to refinance their own customer's existing debt. This protects taxpayers from bad loans being sold by a lender directly to the Fed, but limits how a lender can help an existing borrower or compete against a lender offering a Main Street facility to the same client.
- **Onerous Restricted Payments Language:** Borrowers must commit to avoid pre-paying other debt (except for a permitted refinance at origination) and to rules around executive compensation, stock repurchases, and dividends. In some cases, these restrictions can last 12 months after the loan is repaid. This should encourage borrowers to refinance into a "regular way loan" as soon as possible to minimize the amount of time that these restrictions apply.
- **Other Representations:** The borrower's CEO and CFO must make representations that the borrower qualifies for the program, has not received other CARES Act support (other than PPP), does not have conflicts of interest and other points. While in many cases the Fed has clarified the nature of these representations in its FAQ documents and public information sessions, potential borrowers will still value advice from lenders and third-parties.
- **Public Disclosures:** Similar to the PPP, the Fed is publishing borrower names, loan amounts and other information regarding Main Street loans. However, since Main Street loans are not forgivable and risk is retained, it is unlikely borrowers or lenders would be criticized as having received a "bailout."

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The Endurance Advisory Partners Solution

Given the limited participation in the MSLP to-date despite attractive terms and economics for both borrowers and lenders, Endurance Advisory Partners is advocating that its banking clients seek to participate in the MSLP and is helping clients structure a MSLP platform that meets their goals while navigating the MSLP's requirements. Endurance Advisory Partners will work with its lending clients to establish a MSLP platform consistent with client goals including the following deliverables:

- Internal credit policy and underwriting guidelines updates
- "White-labeled" MSLP literature and marketing materials
- Borrower sourcing strategy
- Borrower eligibility matrix
- Modifications to loan documentation
- Legal review
- Loan portal submission process
- Ongoing servicing requirements

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