Roll Call

Fed adds Main Street business, municipal and state lending aid

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The Federal Reserve has long been the lender of last resort for Wall Street. Now it'll be for Main Street as well.

The Fed established two new lending facilities Thursday in its attempt to ensure the U.S. economy has enough credit to weather the mass shutdowns caused by the COVID-19 pandemic. The Main Street Lending Program ill offer up to $600 billion in low-interest loans to mid-sized businesses, and a Municipal Liquidity Facility will provide up to $500 billion in lending to states and municipalities.9,

The Fed also increased lending in other credit facilities it had already created. Altogether, the Fed made an additional $2.3 trillion in loans available Thursday, backed by funds appropriated to the Treasury Department in the latest coronavirus relief package.

“In the situation we face today, many borrowers will benefit from these programs, as will the overall economy,” Fed Chairman Jerome Powell said at a Brookings Institution event shortly after the announcement.

But Fed lending alone isn’t enough, Powell added. “There will also be entities of various kinds that will need direct fiscal support, rather than a loan they would struggle to repay.”

“There’s a big need for fiscal policy. I hear many voices on both sides of Capitol Hill and in both parties, talking now about further support,” Powell said. “I do think that’s likely to be appropriate.”

Through the Main Street Lending Program, the Fed said it will provide liquidity to sustain companies unable to function because of the widespread shutdowns resulting from the effort to contain the COVID-19 pandemic.

The credit facility aims to use lending to fill in a mid-sized company gap in Congress’s fiscal relief efforts. The Fed is already helping the nation’s biggest companies and banks weather the economic drought with liquidity through other lending facilities it stood up in March.

Under the rescue package enacted by Congress on March 27, small businesses can seek forgivable loans to cover payroll and some other fixed costs through the Small Business Administration’s $349 billion Paycheck Protection Program (PPP).

The Main Street program will allow businesses with up to 10,000 employees or $2.5 billion in revenue in 2019 to seek four-year adjustable rate loans from private lenders. Those lenders will be able to securitize and sell 95 percent of those loans to the Fed facility — removing most of the credit risk and freeing up bank capital for additional lending.

The rate will be pegged to the Secured Overnight Financing Rate, which is based on the cost of overnight bank lending collateralized by Treasury securities. The SOFR rate fell to 0.01 percent in March and hasn’t risen since. Banks will be able to charge an additional 2.5 to 4 percent on top of SOFR.

The loans must be at least $1 million. They’ll be capped at a percentage of the borrower’s existing debt total up to a maximum of $150 million. Amortization of principal and interest will be deferred for a year, and there is no penalty on prepayment.

Whether the Main Street Lending Program will work as planned will depend on the Fed striking the right balance on risk-sharing with banks, said George Selgin, an economist at the Cato Institute.

Banks responded cautiously to the Fed’s announcement. “We are reviewing the details of the sweeping new programs announced this morning,” the American Bankers Association said in a release.

When SBA released the PPP guidance April 3, banks complained about facing regulatory risk down the line if they didn't fully vet applications despite public assertions by officials that their goal was to get money to businesses quickly.

Selgin expects that businesses, however, will flock to access the Fed program. “It’ll be pretty attractive to them because there are a lot of them that can’t get credit otherwise.”

More expected for larger companies

Companies on the larger end of the facility’s limits will likely see the most money, Selgin said, as banks prefer to work with firms with more capital. Bigger businesses will also generally take out bigger loans, which translates into bigger servicing fees for the same amount of underwriting work as smaller loans. “I don’t know how you design a program where you completely rule out that bias,” Selgin said.

Before the Fed’s announcement, U.S. Chamber of Commerce Executive Vice President Tom Quaadman told CQ Roll Call that businesses were eager to see the credit facility in action.

“We are hearing a lot of interest from our members on this,” he said. "What we want to see is (a) system in place that will deploy that cash out to Main Street as quickly as possible.”

The Fed term sheet places a few restrictions on what borrowers can do with the debt. They need to attest that they “will make reasonable efforts to maintain its payroll and retain its employees during the term of the upsized tranche of the Eligible Loan.”

Borrowers also need to attest they need financing “due to the exigent circumstances presented by the coronavirus disease.” As required by Congress, borrowers must also promise to forego dividend payments and stock buybacks until a year after the loans are paid back and put certain caps on executive pay.

The statute allows the Treasury secretary to waive those restrictions if he decides it is “necessary to protect the interests of the Federal Government.”

The Fed loans can’t be used to refinance existing debt. But there are no explicit restrictions on using the loans to purchase other companies, which worries Marcus Stanley, policy director at Americans for Financial Reform.

“It definitely shouldn’t be used for financial restructuring and acquisitions,” he said. “The people closest to the stream of money could just buy up and restructure huge swaths of the economy, and do it at the expense of small businesses who are under the most pressure right now.”

The Main Street Lending Program doesn't have the strings Congress laid out in the third relief package for a Fed facility providing “Assistance for Mid-Sized Business.” That facility, which the Fed hasn't yet established, is supposed to provide credit to businesses and nonprofit groups with between 500 and 10,000 employees at an interest rate capped at 2 percent.

To access credit from that facility, borrowers would need to make “good faith certifications” to abide by restrictions, like maintaining 90 percent of their workforce, not offshoring jobs for two years and not opposing unionization efforts.

The law only tasks Treasury Secretary Steven Mnuchin to “endeavor” to open that facility. But if it does, it would overlap significantly with the Main Street Facility established Thursday, giving mid-sized borrowers a choice between lower interest rates or fewer restrictions — assuming that lenders are also willing to participate in both programs.

The Fed term sheet should have stronger employment protections, said Damon Silvers, policy director at the AFL-CIO. Silvers said he wanted to see “ironclad payroll maintenance guarantees,” adding: “That is the number one thing and the number two things and the number three thing.”

“Most employment is in big business. If big business is not incentivized — and there is not enough oversight to ensure that money is being used to keep people employed — we won’t be able to stop runaway unemployment,” Silvers added. “Once we get to 20 percent unemployment for more than a couple of days it’ll be very hard to put Humpty Dumpty back together again.”

State and municipal aid

The Fed also established a Municipal Liquidity Facility on Thursday that will use $35 billion from the third coronavirus relief package to buy up to $500 billion in bonds directly from state and municipal issuers. Those bonds will be capped at 20 percent of the issuer’s general revenue for fiscal 2017.

The third Congressional COVID-19 response included $150 billion in state grants, and Democrats are pushing to send them another $150 billion in an interim package. On Thursday, Maryland Democratic Sen. Chris Van Hollen blocked Senate Majority Leader Mitch McConnell’s attempt to pass just a $251 billion refill to the SBA’s paycheck program by a voice vote.

The coronavirus has devastated state and local budgets across the nation. Sales taxes have plummeted as social distancing measures have shuttered nearly a third of the U.S. economy. At the same time, they've ramped up their own spending on health care and attempts to soften the economic blow.

State and municipalities were largely left out of the fiscal stimulus packages Congress passed during the Great Recession. That forced many to cut public employee rolls dramatically to balance their budgets, which economists say slowed and weakened the economic recovery.

The Fed has stood up nine credit facilities since the coronavirus contagion started shuttering the economy in mid-March. That's more than double the number of facilities the central bank created during the 2008 financial crisis.