S&P Global Market Intelligence

Banks report mixed demand for Fed Main Street loans as launch nears

Polo Rocha

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Banks are gearing up to start lending under the Federal Reserve's new Main Street program, but how quickly businesses will seek loans remains uncertain as the program approaches its launch.

The Fed took a major step this week to get the $600 billion Main Street program operational, releasing sample loan agreements and details on what each loan document must include. A start date has not yet been set, though top Fed officials have said they expect loans to begin in the coming days.

Banks, particularly smaller lenders, are reporting mixed interest from small and medium-sized businesses thus far. Some smaller businesses have already reached out to banks to ask about Main Street loans, and larger publicly traded companies have also disclosed their interest in the program. But bankers say many businesses have yet to start inquiring about Main Street loans, perhaps because they have been more focused on how to safely re-open as states begin lifting stay-at-home orders.

At Grand Rapids, Mich.-based Independent Bank Corp., many middle-market customers whose revenues have fallen due to the coronavirus pandemic are likely a good fit for Main Street loans, said Jim Mack, the bank's head of commercial lending. But their interest has been limited so far.

"We will definitely be involved in the program [and will be] providing those loans," Mack said. "But as of yet, we don't have a great feel for where the demand will be."

Fed officials are continuing their outreach on the program, with Boston Fed President Eric Rosengren highlighting it in a May 24 interview with the CBS Sunday morning show "Face the Nation." The Boston Fed is operating the Main Street program and is hosting drop-in sessions for lenders and borrowers in the coming days.

The Fed will not lend to individual businesses under the program, which relies on banks to make four-year loans to small and medium-sized firms. The Fed will then buy either 95% or 85% of each loan, depending on what type of loan banks offer, and banks will keep the rest on their balance sheets and therefore share some of the credit risk.

The Fed's aim is to help companies that were in good shape at the end of 2019 but were majorly disrupted by the coronavirus pandemic, such as hotels, restaurants or manufacturers that needed to shut their operations, Rosengren said in the CBS interview.

"The goal is to make sure that many of these businesses are able to make it to the point where we no longer have community spread and where individuals once again feel comfortable buying goods, going out in public," Rosengren said.

Overview of the Federal Reserve's Main Street Lending Program

Loan options	New loans	Priority loans	Expanded loans
Term	4 years	4 years	4 years
Minimum loan size	$500,000	$500,000	$10,000,000
Maximum loan size	The lesser of $25 million or an amount that, when added to outstanding and undrawn available debt, does not exceed four times the adjusted 2019 EBITDA	The lesser of either $25 million or an amount that, when added to outstanding and undrawn available debt, does not exceed six times the adjusted 2019 EBITDA	The lesser of either $200 million, 35% of existing outstanding and undrawn available debt, or an amount that, when added to outstanding and undrawn available debt, does not exceed six times the adjusted 2019 EBITDA
Risk retention for lenders	5%	15%	5%
Principal payment*	33.33%, each year	Year 2 and Year 3: 15%, each Year 4: 70%	Year 2 and 3: 15%, each Year 4: 70%
Rate	Libor + 3%	Libor + 3%	Libor + 3%

Data compiled May 28, 2020.
EBITDA = earnings before interest, taxes, depreciation, and amortization
Details are based on the term sheets provided by the Federal Reserve in a press release, announcing the changes to the Main Street Lending Program on April 30, 2020.
* Principal payments are deferred for the first year.
Source: Federal Reserve

Main Street loans are far different from PPP program

One thing appears certain: The initial demand will be far less than the crush of applications the Paycheck Protection Program received. The PPP program, aimed at small businesses with less than 500 employees, depleted its initial $349 billion in funding in less than two weeks despite technical glitches and other uncertainties that initially hampered the program.

Employees at MVB Financial Corp., which has branches in West Virginia and northern Virginia, worked "through the night" to meet small businesses' demands for PPP loans, President and CEO Larry Mazza said. But so far, only two businesses have reached out to ask about Main Street loans, neither of which appear to be well-suited for the Fed's program, Mazza said.

The more limited demand is in some part due to the stark differences between the two programs.

The PPP loans, which are fully guaranteed by the Small Business Administration, can essentially turn into grants if businesses meet certain conditions. But the Fed's loans need to be paid back, a prospect that may be less appealing given some businesses' reluctance to take on new debt when the economic outlook is so uncertain.

Although the Fed program is open to small businesses, bankers say the smallest among them are better suited for the PPP program and that the total demand for Main Street loans will therefore be lower. Main Street participants will also need to borrow at least $500,000, a minimum loan size that banks say will exclude firms requiring much smaller loans.

At One United Bank, the country's largest black-owned bank, the mid-sized companies that are more likely to benefit from the Main Street program are "not within our sphere," said President and COO Teri Williams, who gave the Fed credit for developing another tool for hard-hit businesses. The bank has branches in Boston, Miami and Los Angeles but is processing PPP loans online from around the country.

Some eyeing loans as closures cause cash buffers to dry up

Some companies are considering applying for the Main Street loans when the program gets up and running.

The businesses reaching out to Webster Financial Corp. are the ones "that need it the most" given that their revenues have dried up due to the pandemic, said Chris Motl, Webster's head of commercial banking. He listed retailers, manufacturers and movie theater chains as those most interested so far.

"Depending on their size, it starts to make a lot of sense for them because had it not been for COVID, [most movie theaters] were doing just fine," Motl said.

Some well-known national companies have also eyed the Main Street program as an option, including the coffeemaker Farmer Bros. Co., The Cheesecake Factory Inc. and Dave & Buster's Entertainment Inc., according to public filings.

Regions Financial Corp., which has branches across the Southeast and parts of the Midwest, believes there is "a lot of interest" in the program, President and CEO John Turner said in an April 17 earnings call.

The Fed expanded the pool of companies eligible to participate last month, looking to reach more small businesses by halving the minimum loan size from $1 million. It also expanded the program in the other direction, allowing companies with up to 15,000 employees or up to $5 billion in revenues to take out loans; the prior thresholds were 10,000 employees and $2.5 billion in revenues. One segment of the program will now also let companies refinance their existing debts, a change that is expected to benefit some smaller oil and gas companies.

Still, some companies will find they are shut out of the program because they already had too much debt on their balance sheets, according to a review from LCD, an offering of S&P Global Market Intelligence.

The Main Street program only offers liquidity for companies that were "already in pretty good shape," said Troy Keller, a lawyer at the firm Dorsey & Whitney LLP. Banks may also decide to give potential borrowers smaller loans than they actually need, he added.

The $600 billion question

Those issues have some analysts questioning whether businesses will fully tap out the $600 billion that the Fed currently has planned for the Main Street program.

The Treasury Department received money from Congress to provide credit protection for the Fed lending program, since the central bank is limited in any losses it can absorb. Treasury Secretary Steven Mnuchin has said his agency is prepared to take losses on the full $75 billion it has invested. But Fed officials will likely continue to take a more cautious approach and therefore limit the program's potential beneficiaries, said George Selgin, a senior fellow at the Cato Institute.

The Fed, he added, has two potentially "irreconcilable" goals: helping as many businesses as it can while also avoiding losses.

"Although many, many firms might wish the Main Street program could help them, I think the actual number it will help will prove extremely disappointing," Selgin said, adding that conditional grants to businesses from Congress may have been a better alternative.

The Fed has been flexible in responding to the feedback it has received on the Main Street program, but it is unlikely to be "flexible enough" to take on more risk, said Karen Petrou, managing partner at Federal Financial Analytics.

"If the terms of the Main Street program are easy, the Fed becomes the nation's biggest business bank," she said. "I'm not sure we really want that to be a permanent [feature] of the United States financial system. It would be hard to roll back."