WALL STREET JOURNAL

Fed Had a Loan Plan for Midsize Firms Hurt by Covid. It Found Few Takers.

Nick Timiraos

January 4, 2020

In the depths of the financial panic from Covid-19 last year, the Federal Reserve offered to lend to a wide swath of businesses—something it had never done before. Yet it struggled to find takers.

The Main Street Lending Program aimed to help pandemic-hit businesses that were too small to borrow in the bond market but might need more help than a small-business loan from the popular Paycheck Protection Program.

"There was a program here that looked nice on paper, but in practicality, it has not worked," said Mike Cazaz, chief executive of Werner Aero Services, a New Jersey supplier of aircraft engines and parts that couldn't get a loan under the program.

Washington was happy to rely on the Fed because it had the chops to get a program for medium-size businesses up and running fast. Its apolitical reputation reduced concern about loans being steered to big donors. The Treasury Department became a Fed partner to absorb any loan losses.

But the experience revealed the limitations of running a relief program through the Fed and exposed gaps in the government's ability to deliver aid to companies that can't raise money on Wall Street. For months, many banks weren't interested in participating. Demand picked up only in recent weeks after word came that the program would be ending.

"There is a cost if, whenever we have [financial panics], we do programs that only help large institutions, because in the long run that makes it much riskier to be a small or medium-size firm," said Eric Rosengren, president of the Federal Reserve Bank of Boston, which has administered the Main Street program. Many such businesses could fall through the cracks, he said, accelerating a long-running consolidation in which larger companies with access to low-cost credit increase market share.

When the pandemic struck, the Fed launched a suite of emergency loan programs. It went beyond its core mission as lender of last resort to the banking system by becoming a commercial lender, a role its leaders had long resisted for fear of being pulled deeper into politics. The Fed initially saw the situation as desperate, its other tools were exhausted and it wanted to show it could help those beyond Wall Street.

Officials have been far less concerned than they were in the 2008 financial crisis about encouraging irresponsible behavior by providing broad safety nets. As the pandemic and lockdowns spread last spring, there initially was little debate or support for an approach that would allow businesses that had been healthy before the pandemic to be wiped out.

Businesses “didn’t close because of anything they did wrong,” Fed Chairman Jerome Powell said on April 9, a day when the central bank unveiled the Main Street program and announced a larger safety net for the corporate-bond market. “To the extent we have the ability to make them whole, we should be doing that as a society,” he said.

Word of a Fed plan to backstop corporate borrowing encouraged investors to buy corporate bonds, which in turn cut the need for purchases by the Fed.

So that middle-market firms wouldn’t be left out, the Fed agreed to purchase bank loans made to companies that had up to 15,000 employees or under $5 billion of revenue and that had been profitable in 2019.

Congress roped in the Treasury to absorb any losses on the loans because the central bank believes it isn’t allowed to sustain capital losses. The Treasury agreed to provide $75 billion to cover loan losses, using funds Congress provided for this purpose.

The Fed, lacking the bandwidth to underwrite thousands of loans, relied on banks to make the Main Street loans. To encourage them to do so, it agreed to purchase 95% of each loan. The Fed said its Main Street program would purchase up to $600 billion of such loans.

It bought just 646 loans totaling $6.3 billion from July through November.

The borrowers included a Brooklyn landscaping architect, a minor league baseball club in Texas and a casino in the Poconos of eastern Pennsylvania. The largest was $300 million to Fitness International LLC in Irvine, Calif., which runs LA Fitness gyms.

The root failure, say banks and borrowers, was that if the loan a borrower wanted was attractive to a bank, the lender didn’t want to sell most of it to the Fed. But if a loan looked to be a dud, the bank was reluctant to hold any of it.

Some current and former officials also said loan terms were too strict because the Treasury was concerned about not losing the money Congress authorized. It would have been better if lawmakers had been explicit about how much of that money they were willing to let the Treasury lose, in Mr. Rosengren’s view.

In past crises, Congress created special agencies to do this kind of work. In 1932, lawmakers chartered the Reconstruction Finance Corp. to stem failures of banks and railroads by taking equity stakes. In 1989, after many savings and loan associations failed, Congress created the Resolution Trust Corp. to manage the liquidation of their assets.

What the government devised this time “was a compromise program which has been like trying to administer mouth-to-mouth resuscitation through a cocktail straw,” said George Selgin, a Fed historian at the Cato Institute, a libertarian think tank.

Marc Epstein, owner of the Milk Street Café, a few blocks from the Boston Fed’s downtown headquarters, qualified for a $1.5 million Main Street loan in October. He said he would use it to help reopen when former customers return to their office jobs. Mr. Epstein said he wasn’t sure how he would be able to afford the reopening costs without the loan.

Tina Beattie, co-owner of a company that runs 36 Denny's franchises in five Midwestern states, said she too was eager to get a Main Street loan, so much so that she paid $30,000 for audited financials to satisfy one lender's loan-qualification rules.

"That was money we took out of working capital at a tenuous time. That's how much we thought the program would be of value," Ms. Beattie said. "We thought it was a super-elegant program. I loved everything about it."

Main Street loans carry a rate of 3 percentage points above short-term interbank lending rates and have five-year terms. They allow borrowers to delay principal payments for two years and interest payments for the first year.

Existing lenders to Ms. Beattie's Top Line Restaurants Inc. weren't interested in the Main Street program because it didn't allow them to refinance a portion of borrowers' existing debt. Other lenders also declined. "They said, 'We're not touching the hospitality segment,' " Ms. Beattie said.

Mr. Cazaz of Werner Aero said that if his company had received a Main Street loan, it would have been able to avoid furloughing 23 of its 30 workers. He said banks told him they passed on the program because they worried about the "government coming back two or three years down the road and saying, 'This loan was bad. You're liable for the entire 100%.'"

Reese Ryan, chairman of R Bank in Round Rock, Texas, said his bank decided not to participate because many businesses with little revenue amid the pandemic were too risky, regardless of their 2019 financials. He said if the program had allowed banks to sell 100% of Main Street loans to the Fed or to refinance a portion of existing debt, "I would have done that in a heartbeat."

Fortunately for Mr. Ryan, not all lenders were so cautious. He also served as the CEO until recently of a sports and entertainment company that obtained a $16 million Main Street loan in October. It gave the company, which owns a stadium concession business and the minor league Round Rock Express baseball team, a way to avoid going deeper into debt through more-expensive bank loans.

Fed and Treasury officials said Main Street was designed to address a grim scenario that never materialized: one where companies unable to borrow in capital markets drew down their credit lines and overwhelmed the banking sector's capacity to lend.

Another reason the program wasn't used more widely, they said, was that the Treasury's Paycheck Protection Program ended up reaching more businesses that otherwise might have been candidates for a Main Street loan. The PPP provided loans of up to $10 million that can be forgiven if they're used mainly to pay employees. The PPP has made $525 billion in loans.

Ms. Beattie's Top Line restaurants, for instance, got a PPP loan. But a Main Street loan, too, "could have given us some breathing room," she said.

Mr. Cazaz of Werner Aero said PPP loans, with forgiveness that depends on their being used mostly for payroll, were useless for companies such as his because it didn't have business to hire people to do.

Mr. Epstein reopened his Milk Street Café in September in order to meet the forgiveness requirements of his PPP loan, but he closed the Boston restaurant back down and furloughed all 72 employees on Oct. 25, the day after the money ran out. Because his business depends so heavily on corporate catering, he lost more money when it was open than when it was closed, he said. He hopes to reopen once Covid-19 vaccines are widely distributed.

Demand for the Main Street program picked up in recent weeks. Reasons included changes made to encourage broader awareness and use of the program, bankers said.

In mid-November, Treasury Secretary Steven Mnuchin said he wouldn't authorize several of the Fed's most novel emergency loan programs, including Main Street, to operate after Dec. 31.

"What you have now is a rush to get whatever you can before it closes down because there may be nothing else," said Hal Scott, a professor at Harvard Law School who has criticized the program for being too stingy..

The Main Street program ended up doing more business in December than in its first five months combined, bringing total lending to more than $17 billion.

In Mr. Mnuchin's November announcement, he said the program was no longer needed and the funds would be better spent on business grants. In the recently enacted $900 billion Covid aid bill, Congress rescinded $429 billion it had provided for the Fed programs.

The bill provided $325 billion in additional small-business aid, plus $15 billion for movie theaters and live-entertainment venues. To process a last-minute crush of Main Street loans approved in December, the Fed and Treasury extended the program's termination date to Jan. 8.

The program would have reached more borrowers if it had been extended into 2021, said John Steinmetz, chief executive of Vista Bank, a $1.3 billion community bank in Dallas that completed 79 Main Street loans. "We had to turn away several at the end that were good candidates," he said.

Sen. Pat Toomey (R., Pa.) won language in the relief bill that prevents the Fed and Treasury from restarting the Main Street program in 2021 without Congress's approval.

Mr. Toomey said the government had succeeded in restoring the flow of credit. "The goal wasn't to have the Fed lend as much money as possible," he said.