Office of the Special Inspector General for Pandemic Recovery

Office of Audits

Audit of Direct Loan Program Recipient – Mesa Airlines, Inc.

Report Number SIGPR-A-22-006
September 20, 2023

Executive Summary

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Why We Performed This Audit

We performed this audit as part of our ongoing audit work relating to Section 4003, Division A, Title IV, Subtitle A of the Coronavirus Aid, Relief, and Economic Security Act of 2020 (CARES Act). Mesa Airlines, Inc. (Mesa) received a loan under the CARES Act section 4003(b)(1) and entered into a loan agreement with the Department of the Treasury (Treasury). The audit intends to determine if Mesa is following the terms and conditions in its loan agreement with Treasury.

What We Found

We found instances where Mesa used proceeds from the loan to make payments on other existing loans, which is in violation of the terms of the loan agreement. We also found that Mesa fell below the Collateral Coverage Ratio requirement of 1.6 to 1. Rather than requiring Mesa to make loan payments or pledge additional collateral to get in compliance as the agreement dictates, Treasury granted Mesa a waiver to this requirement and reduced the ratio to 1.55 to 1. Finally, although the loan agreement requires Mesa to use all proceeds from the sale of collateral to repay the loan, Treasury entered into an agreement to allow Mesa to use only a portion of its proceeds from the sale of collateral to be applied towards the loan repayment.

What We Recommended

We recommend that Treasury officials:

1. Determine what if any corrective action(s) should be taken to address Mesa's misallocation of $944,400 in loan proceeds; and implement these action(s) as necessary.
2. Closely monitor Mesa's collateral and develop a plan on how to proceed with managing the loan if Mesa falls short of the terms established in the loan and waiver agreements.
3. Ensure that borrower disposition of collateral is handled in accordance with the terms of the loan agreement for Mesa and all other outstanding direct loans.

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Introduction

The Special Inspector General for Pandemic Recovery (SIGPR) was established by Section 4018 of the Coronavirus Aid, Relief, and Economic Security (CARES) Act. Under the CARES Act, SIGPR has the duty to conduct, supervise, and coordinate audits and investigations of the making, purchase, management, and sale of loans, loan guarantees, and other investments by the Secretary of the Treasury under any program established by the Secretary under the Coronavirus Economic Stabilization Act of 2020 (CESA), as well as the management by the Secretary of any program established under CESA. SIGPR also has the duties, responsibilities, powers, and authorities granted inspectors general under the Inspector General Act of 1978. We performed an audit of Mesa Airlines, Inc. (Mesa) to determine if Mesa complied with the provisions in the CARES Act, and if it followed the terms and conditions of their loan agreement.

The role and mission of SIGPR is to safeguard the people's tax dollars appropriated by Congress through the CARES Act. SIGPR strives to ensure that the American taxpayer gets the best return on investment by efficiently rooting out fraud, waste, and abuse. In carrying out its mission, SIGPR's goal is to treat everyone with respect, to operate with the utmost integrity, and to be fair, objective, and independent.

Purpose

The SIGPR Office of Audits has the mission to conduct audits of loans, loan guarantees, and other investments made by the U.S. Department of the Treasury (Treasury) under any program established by the Treasury under Division A of the CARES Act. Section 4003(b)(1)-(3) of the CARES Act appropriated up to $25 billion to help stabilize the airline industry. In October 2020, Treasury agreed to make a loan totaling $195 million to Mesa. The purpose of this audit is to determine if Mesa is following the terms and conditions in its loan agreement with Treasury.

Objective

The objective of SIGPR's *Audit of Direct Loan Program Recipient – Mesa Airlines, Inc.* is to determine if Mesa is following the terms and conditions of its loan agreement with Treasury.

See ***Appendix A*** – Scope and Methodology for additional details.

Background

Section 4003 of the CARES Act authorizes Treasury to make loans, loan guarantees, and other investments to provide liquidity to eligible businesses related to losses incurred because of the coronavirus pandemic. Under this program, Treasury provided approximately $2.7 billion in loans to 35 eligible businesses, including passenger air carriers, repair station operators, ticket agents, cargo air carriers, and businesses critical to maintaining national security. As of April 2023, of the 35 loans that Treasury executed, 21 businesses owe a combined $974 million. Fourteen borrowers have fully repaid their

loans. In total, borrowers have paid over $1.7 billion in principal prepayments, and more than $107 million in cash interest payments.

On October 30, 2020, Treasury made a loan to Mesa pursuant to section 4003(b)(1) of the CARES Act. Mesa elected to draw $43 million at close and $152 million on November 13, 2020, for a total value of $195 million. The loan proceeds were to be used to provide liquidity to continue the Company's operations. The loan is secured by aircraft, engines, accounts receivable, tooling inventory, simulators, and ground service equipment. The loan has an interest rate equal to LIBOR (London Interbank Offered Rate) plus 3.5% and matures on October 30, 2025. The loan agreement includes covenants by Mesa to comply with certain restrictions on employee compensation, stock repurchases, dividends, and reductions in employment levels, as required by the CARES Act. The loan agreement includes other provisions such as restrictions on the use of the loan proceeds, the sale of collateral, and requirements on maintaining a minimum value of collateral.

Mesa is a regional air carrier providing scheduled, commercial passenger service throughout the U.S., as well as to Canada, Mexico, Cuba, and The Bahamas. Mesa is headquartered in Phoenix, Arizona, and operates flights on behalf of United Airlines and DHL Express, flying planes branded as United Express, and DHL.

Status of Mesa's Treasury Loan as of 9/1/2023

Loan Amount	Date of Loan Agreement	Maturity Date	Total Outstanding Loan Amount	Total Prepaid Principal	Cash Interest Receipts
$195,000,000	10/30/2020	10/30/2025	$144,400,117	$60,546,900	$15,649,367

Results

We found instances where Mesa is not in compliance with the terms of its loan agreement with Treasury. Mesa used a portion of its direct loan proceeds to pay on other existing loans, which is in violation of the terms of the loan agreement. Furthermore, Mesa has not maintained collateral in accordance with the terms of the loan agreement. For example, Mesa has not maintained the minimum Collateral Coverage Ratio to comply with the loan terms and has sold collateral without using the full proceeds of the sale to pay down the loan as directed by the loan agreement. Treasury is aware of the non-compliance related to collateral and has granted waivers to Mesa to lower the Collateral Coverage Ratio and allow for the sale of collateral.

Finding 1 – Mesa Misallocated $944,400 of Loan Proceeds to Pay Principal on Other Indebtedness.

Mesa allocated approximately $944,400 of its loan proceeds to make payments on other loans, which is not permitted under the terms of the loan agreement. Mesa did not receive any guidance on how to account for the spending of the loan proceeds from Treasury, and Treasury was not able to detect the improper payments through its monitoring processes. By not taking measures to ensure that borrowers use loan proceeds appropriately, Treasury cannot ensure that its loans are meeting the intent of the CARES Act.

Section 6.16 of the loan agreement states that loan proceeds should not be used "for any purpose other than for general corporate purposes and operating expenses." Section 6.16 makes a specific prohibition on the use of proceeds to pay down other loans, stating that proceeds of the loan, "shall not be used for any non-operating expenses (including capital expenses, delinquent taxes and payments of principal on other Indebtedness)."

Mesa began using the proceeds of its CARES Act loan in November 2020 and had used all the proceeds by April 2021. According to Mesa officials, they did not have any formal guidance on how to account for the spending of the CARES Act money. Therefore, accounting for the use of loan proceeds involved a "learning curve" where Mesa had to develop its own system to ensure compliance with the loan agreement. As part of its system, Mesa developed a "Draw Request Tracker" spreadsheet to monitor its use of the loan proceeds. The spreadsheet tracks the amount of loan proceeds paid out through checks, wire payments, and payroll, and was used to flag payments that were not eligible to be paid with the Treasury loan proceeds.

Mesa had all of its loan proceeds deposited into a separate bank account they referred to as the "Treasury Account." Once Mesa identified payments to make with the loan proceeds, Mesa transferred the payment amounts from the Treasury Account into its "Concentration Account", which was an operating account Mesa used to send payments to vendors. Although CARES Act funds and Mesa's operating funds became mixed once Mesa made these transfers, Mesa had the Draw Request Tracker spreadsheet to track items allocated for payment with the CARES Act funds.

Although we found that Mesa flagged most payments that were not eligible to be made with CARES Act funds, our review of the Draw Request Tracker and Mesa's bank statements identified four ineligible payments that were not flagged. Mesa transferred money for these payments in November 2020 shortly after receiving the loan proceeds, during what Mesa officials described as their "learning curve". It appears Mesa transferred money for these loan principal payments unintentionally, before it had fully developed its controls to prevent such payments. In total, Mesa allocated $944,400 in CARES Act funding to pay down other existing loans, which violates the terms of the loan agreement.

Treasury's Oversight – Use of Loan Proceeds

To help ensure borrower compliance with the terms of its loan agreements, Treasury has a quarterly "Review Card" process. As part of this process, borrowers must enter responses to Treasury's monitoring questions through a Salesforce portal. Treasury developed the Review Card questions to monitor compliance in a variety of areas, including the use of the loan proceeds. However, the Review Card process relies primarily on borrower certifications. If a borrower's self-reporting is incomplete or indicates non-compliance, Treasury may initiate a more detailed review.

As part of the quarterly Review Card process, Treasury requests information from the borrower on its use of the loan proceeds. However, unless the borrower self-reports that it used direct loan proceeds for expenses other than operating expenses or general corporate purposes, the borrower will get a pass for the Direct Loan Spending portion of the Review Card. For example, in Quarter 4 of 2020, as detailed above, Mesa used $944,400 in loan proceeds to pay down existing loans. However, because Mesa did not indicate that it used the loan proceeds inappropriately, Mesa received a pass in the Direct Loan Spending Review Card section for that quarterly period.

Because Mesa received a pass in the Loan Spending Review Card section in Quarter 4, 2020, it is assumed that Treasury is unaware of Mesa's $944,400 in improper allocation of loan proceeds. Treasury should determine whether corrective action is appropriate in this instance.

Treasury provided loans to Mesa and other airlines as part of the CARES Act to provide liquidity related to losses incurred as a result of the coronavirus pandemic. By not ensuring that loan proceeds are used in accordance with the loan agreements, Treasury does not have assurance that its loans are meeting this intent. Treasury should make efforts to ensure that any future programs include enhanced monitoring and guidance to borrowers to ensure that loan proceeds are expended appropriately and consider if corrective action is appropriate to address Mesa's loan proceeds allocation error.

Finding 2 – Mesa Has Not Maintained Collateral in Accordance with the Terms of the Loan Agreement

Mesa's ratio of pledged collateral to loan value fell below the level mandated by the loan agreement. Once Mesa fell out of compliance with the ratio requirement, Treasury granted waivers to Mesa in an attempt to keep them in compliance. In addition, Mesa

sold pledged collateral and did not use 100 percent of the net proceeds from the sale to pay down the loan as required by the original loan agreement. Treasury is aware of these issues and has granted waivers to allow for Mesa to remain in non-compliance with the loan terms. Treasury must be diligent in monitoring Mesa's collateral going forward to ensure its financial interests are protected.

Mesa entered into a Pledge and Security Agreement with Treasury and the Bank of New York Mellon which details the collateral Mesa pledged for the loan. For the first $43 million draw of the loan at loan origination, Mesa pledged five aircraft (which included two engines each), nine additional engines, flight simulators, various ground support equipment, qualified receivables from United and American Airlines, and a large inventory of tooling equipment. At the second draw of the loan ($152 million), Mesa pledged an additional 44 aircraft with accompanying engines (88 engines total). Mesa's collateral was valued at over $388 million.

The original loan agreement between Mesa and Treasury has several provisions related to loan collateral. Mesa must maintain a Collateral Coverage Ratio (CCR) of at least 1.60 to 1.00, and collateral must be appraised twice per year. There are also restrictions on the disposition (sale) of its collateral. For example, if Mesa sold any collateral that was pledged to its loan with Treasury, Mesa is required to allocate 100 percent of the net proceeds of that sale toward paying back its loan. Over the past year, Mesa has fallen out of compliance with each of these terms of the loan agreement.

Collateral Coverage Ratio

Mesa has not maintained a CCR of 1.60 to 1.00 as prescribed in the loan agreement. The loan agreement defines the CCR as "the ratio of the Appraised Value of the Eligible Collateral as of the date of the Appraisal or Valuation Certificate most recently delivered with respect to such Eligible Collateral…to the aggregate principal amount of all Loans and Commitments outstanding as of such date." During the month ending March 31, 2022, Mesa's CCR fell to 1.55 to 1.00, which is below the minimum contractual ratio.

In response to Mesa falling below the required CCR, on April 15, 2022, Mesa, Treasury, and the Bank of New York Mellon entered into a Waiver Agreement (effective April 1, 2022) which modified the CCR covenant down to 1.50 to 1.00 through September 30, 2022. The agreement contained many conditions, including a requirement that Mesa produce a plan and timeline detailing the steps that Mesa would take to get back into compliance with the 1.60 to 1.00 standard by September 30, 2022.

However, Mesa was not able to get back into compliance with the CCR requirement by September 30, 2022. Subsequently, on November 7, 2022, Mesa sent a letter to Treasury detailing a plan to sell some of its pledged collateral to pay down the loan balance. Mesa planned to sell eight aircraft with associated engines by December 2022 and sell an additional 11 aircraft with associated engines by April 2023. Mesa intended to use the net proceeds from these two sales to pay down its loan by approximately $50 million. Mesa offered that it could maintain a CCR of 1.50 to 1.00 under this plan.

In response to Mesa's November 7, 2022 letter, Treasury entered into another Waiver Agreement with Mesa on December 22, 2022 (effective October 1, 2022). Under this Waiver Agreement, the CCR covenant was reduced to 1.55 to 1.00 until the loan's maturity date. In addition, the Waiver Agreement dictates that Mesa must allocate at least $32 million of the net proceeds from the sale of collateral proposed in its November 7, 2022 letter to prepay the principal balance of the loan. Furthermore, in the event Mesa sells any other collateral at any time, Mesa must use the net proceeds of those sales to pay down the loan to maintain a CCR of at least 1.55 to 1.00.

Mesa's Sale of Collateral

On January 11, 2023, Mesa sold eight aircraft and associated engines that were pledged as collateral to its Treasury loan. This sale yielded approximately $40 million in net proceeds for Mesa, $32 million of which was applied to the loan. On March 17, 2023, Mesa sold four additional collateral aircraft for $14.2 million, with all proceeds of the sale applied to the loan balance. Finally, on April 13, 2023, Mesa sold six engines previously pledged as collateral for $11.2 million, with all proceeds applied to the loan.

Section 2.06(b)(i) of the original loan agreement, dated October 30, 2022, dictates that in the event the borrower sells collateral, the borrower must prepay its loan in the amount equal to 100 percent of net proceeds from the sale. From January through April 2023, Mesa sold airframes and engines pledged as collateral to the loan and received a total of $65.4 million in proceeds. However, Mesa did not apply 100 percent of these proceeds toward the loan, paying a total of $57.4 million (88 percent) from the proceeds of the collateral sale.

Treasury is aware that Mesa did not use the full proceeds from the collateral sale to pay down the loan balance. The Modification and Waiver Agreement between Treasury and Mesa dated December 22, 2022 amends the original loan agreement and allows for Mesa to sell collateral and use the proceeds of the sale to get the CCR at a level of at least 1.55 to 1.00. Treasury documented its decision to allow for the sale of the collateral and to lower the CCR to 1.55 to 1.00 in a December 22, 2022 Action Memorandum. Treasury's financial advisor concluded that allowing for the sale of collateral and lowering the CCR increases Treasury's recovery rate on the loan by facilitating multiple prepayments, reducing the amount of collateral Treasury would have to liquidate in bankruptcy, and maintaining the value of collateral through ongoing use. Treasury believes the plan is consistent with the CARES Act's primary objective of providing liquidity to eligible businesses related to losses as a result of the coronavirus, and the allowances provided by Section 4027(c) of the Act which allows for modifying, restructuring, or otherwise amending 4003 loans, provided no extension of duration or loan forgiveness.

While Treasury conducted its due diligence in considering Mesa's waiver requests for the CCR and sale of collateral, it is important that Treasury continue to closely monitor Mesa's collateral to protect its interests. Subsequent to the waiver's approval and the three separate sales of collateral, Mesa submitted a CCR computation in April 2023 showing a

ratio of 1.51 to 1.00, which is below the lowered CCR standard in the waiver agreement.[1] Treasury must consider how to move forward managing its loan to Mesa if Mesa continues to fall short of meeting the terms of the loan agreement.

[1] Later in April 2023, Mesa made a $3.2 million payment on the loan to get the ratio back into compliance with the CCR requirement of 1.55 to 1.00 as of April 30, 2023.

Conclusion

Mesa is not in compliance with all the terms and conditions of the loan agreement. Mesa used $944,400 in loan proceeds to make payments on other existing loans, which is in violation of the loan agreement. In addition, Mesa has not been able to remain in compliance with the loan agreement's Collateral Coverage Ratio requirement. Finally, Treasury allowed Mesa to dispose of collateral without collecting the full proceeds of the sale as directed by the loan agreement. Treasury needs to ensure loan proceeds are used as intended to help establish that its loans are meeting the intent of the CARES Act. Furthermore, it is important that Treasury monitors Mesa's collateral and should enforce the existing terms of its loan agreements to protect its investments in its CARES Act loans.

Recommendations

We recommend that Treasury officials:

1. Determine what if any corrective action(s) should be taken to address Mesa's misallocation of $944,400 in loan proceeds; and implement these action(s) as necessary.
2. Closely monitor Mesa's collateral and develop a plan on how to proceed with managing the loan if Mesa falls short of terms established in the loan agreement and waiver agreements.
3. Ensure that borrower disposition of collateral is handled in accordance with the terms of the loan agreement for the loan to Mesa and all other outstanding direct loans.

Mesa Airlines, Inc. Comments

In its response to the draft report (**Appendix B**), Mesa expressed disagreement with Finding 1 of the report. Mesa brought forth four points in its rebuttal to Finding 1 of the report:

1) It had sufficient funding to cover the $944,400 payment without using CARES Act funds;
2) The Draw Request Tracker provided only a sampling of upcoming approximate payables, and did not have a connection to actual payments or payments listed in the tracker;
3) It had other eligible payments that could have been made with the loan proceeds, but were not; and
4) It has been an exemplary borrower, complying with the CARES Act and loan agreement.

SIGPR Response

While we agree that some aspects of this argument have merit, we stand by the facts communicated in Finding 1. Mesa allocated $944,400 of CARES Act funds to make a principal payment on another loan, which was not an allowable use of loan proceeds according to its loan agreement with Treasury.

In its first point of the response to the draft report, Mesa argues that it had “more than sufficient funds in its bank accounts to pay for all of the payables due during this time frame without using any funds from the Treasury”. We agree with this statement. The balance of Mesa’s Concentration Account on October 31, 2020 was approximately $23.7 million. This was prior to any deposits or transfers from its CARES Act loan.

Although Mesa had enough funding in its operating account to cover the $944,400 in loan payments mentioned in Finding 1 of this report, Mesa’s Draw Request Tracker and bank statements show that Mesa allocated loan proceeds from its Treasury Account to make the loan payments. During the month of November 2020, Mesa made four separate transfers from its Treasury Account, which contained the CARES Act loan proceeds, into its operating account (Concentration Account). Mesa’s Draw Request Tracker listed the payments to be made and the amounts of the payments. Included in the $8.5 million transferred from the Treasury Account to the Concentration Account on November 24, 2020 was money allocated to four loan payments. The principal amount of these four loan payments totaled $944,400.

In the second point of its response to the draft report, Mesa argued that its Draw Request Tracker provided only a sampling of approximate payables, and that there was no connection between the amounts drawn from the loan proceeds and payments listed in the tracker. We do not agree with this statement. Our review found that amounts allocated for payments in the Draw Request Tracker match amounts transferred from the Treasury Account to the Concentration Account down to the penny. In other words, items identified for payment in the Draw Request Tracker did not represent approximate payables, but in fact represented actual amounts to be paid through loan proceeds transferred into the Concentration Account. Therefore, although loan proceeds from the Treasury Account and Mesa’s Concentration Account funds were mixed once the Treasury funds were transferred, the Draw Request Tracker effectively identified payments made with the loan proceeds.

Furthermore, our review of the Draw Request Tracker showed that the tracker was used to help identify payments that were not eligible to be paid with the loan proceeds. We observed several instances where this process was effective in flagging ineligible uses of loan proceeds, similar to the $944,400 payment identified in this report. When Mesa flagged ineligible uses through the Draw Request Tracker, Mesa removed the corresponding dollar amounts from the Treasury Account transfer request. Therefore, it is apparent that Mesa did regard the Draw Request Tracker as a method of identifying actual payments to be made with loan proceeds, rather than a sampling of approximate payables.

In the third point of its response to the draft report, Mesa argued that it had other eligible payments that could have been made with loan proceeds but were not. We agree with the statement. There were in fact other payments Mesa could have made with the loan proceeds that would have been eligible. Our review indicates that the $944,400 loan payment was made by Mesa in error, and that Mesa did not knowingly use the loan proceeds inappropriately. Had Mesa caught the error, it is likely those funds would have been used for other eligible payments.

In its last point of its response to the draft report, Mesa mentions that it has been an exemplary borrower, complying with the CARES Act and loan agreement. Other than a misallocation of $944,400 in loan proceeds for an ineligible payment, we have seen no reason to contradict this statement. Again, our review indicates that Mesa's ineligible use of loan proceeds was unintentional. We agree that Mesa had other eligible payments that could have been made with the loan proceeds had they identified the $944,400 payment as ineligible. Mesa officials were very cooperative with the audit and provided all requested records and information in a timely manner.

Mesa's response to the draft report is provided in its entirety in **Appendix B**.

Treasury's Comments

In its response to the draft report, Treasury did not express any disagreement with the report's findings or recommendations. Treasury's response to the draft report is provided in its entirety in **Appendix C**.

Audit Team

This audit was managed and conducted by the individuals listed below:

Kevin Gallagher	Audit Manager
Victor Martinez	Auditor-In-Charge

Appendix A – Scope and Methodology

Scope and Methodology

Our objective was to determine if Mesa is in compliance with the terms of its loan agreement with Treasury.

To accomplish our objective, we:

- Interviewed Treasury's program officials charged to handle Mesa's loan;
- Reviewed the CARES Act Section 4003(b) requirements;
- Reviewed the Loan and Guarantee Agreement and Pledge and Security Agreement between Mesa, Treasury, and the Bank of New York Mellon;
- Reviewed Treasury's process for monitoring the loan through Salesforce Review Cards; and
- Conducted a site visit to Mesa to interview Mesa officials and review financial information related to the loan.

We conducted this performance audit between July 2022 and April 2023 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Internal Control

We assessed internal control and compliance relating to the context of our audit against *Standards for Internal Control in the Federal Government* (GAO-14-704G) and with laws and regulations necessary to satisfy the audit objective. The methodology above describes the scope of our assessment, and the report findings include any internal control deficiencies we identified. Our assessment is not intended to provide assurance on Treasury's internal control structure as a whole. Treasury management is responsible for establishing and maintaining an effective system of internal control.

July 13, 2023

Office of the Special Inspector General for Pandemic Recovery
Office of Audits
2051 Jamieson Ave, Alexandria, VA 22314

RE:Audit of Direct Loan Program Recipient – Mesa Airlines, Inc. (the "Company" or "Mesa") – Report Number SIGPR-A-22-006, June 16, 2023 (the "Audit Report") by the Office of the Special Inspector General for Pandemic Recovery ("SIGPR") Office of Audits (the "Auditor")

Ladies & Gentlemen:

This letter responds to and addresses certain findings set forth in the draft Audit Report regarding the alleged improper use of $944,400 in loan proceeds in November 2020 in violation of the Company's loan agreement (the "Loan Agreement") with the U.S. Treasury (the "Treasury"). For the reasons discussed below, the Company respectfully disagrees with the Auditor's findings as related to Mesa and, accordingly, requests that these findings be removed from the Audit Report. Specifically, for the reasons outlined below, Mesa disputes that it: (a) ever engaged in "improper use of loan proceeds" (to which the Report refers on four occasions); and (b) was "non-complian[t]" with or "in violation of" the terms of the loan (phrases that the report uses on five occasions each). Mesa therefore respectfully requests that the report refrain from referring to the Company's actions as "improper", a "violation" of or "non-compliant with" the relevant loan agreement. If SIGPR, nonetheless determines that it will not remove such findings from the Audit Report, we respectfully request that it clarifies in the Report that (as discussed more fully below) the Company had sufficient funds in its operating account as of the timeframe at issue to make the payments in question without the need for or use of the loan proceeds, and, accordingly, that Mesa complied with the intent of the CARES Act and the Loan Agreement and at no time put Treasury or taxpayer funds at risk.

First, at the time frame in question, Mesa had more than sufficient funds in its bank accounts to pay for all of the payables due during this time frame without using any funds from the Treasury. Mesa's account balance on November 19, 2023, the day immediately prior to the transfer of $ 8,529,895.36 from the account where Treasury funds were held, was $ 29,975,335.06. See Exhibit A below. Mesa asserts that it

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made the Willington Trust principal payments totaling $944,400 from the funds already deposited in this account by the Company's customers -American Airlines and United Airlines. Again, please see Exhibit A below. Moreover, Treasury funds were not the only funds available to the Company for its use throughout the month of November when this draw in question transpired

Exhibit A

Daily Ledger Statement Summary

Date	Amount	Date	Amount	Date	Amount
10/31	$23,672,411.08	11/10	$52,769,503.35	11/20	$28,841,736.17
11/02	$16,168,677.71	11/12	$43,582,015.38	11/23	$30,147,541.71
11/03	$16,054,636.76	11/13	$39,751,920.40	11/24	$38,136,116.20
11/04	$32,420,730.82	11/16	$37,379,973.06	11/25	$39,923,444.42
11/05	$31,669,648.84	11/17	$32,519,606.90	11/27	$39,722,761.56
11/06	$30,725,847.93	11/18	$32,912,339.49	11/30	$42,347,829.55
11/09	$116,426,504.22	11/19	$29,975,335.06		

Average Collected Balance

$37,530,868.68

Cash is an inherently fungible asset, meaning it does not have unique identifiers and can be freely exchanged for goods, services, or other forms of cash. In the case of the Company, the funds received from draws under the Loan Agreement were eventually transferred to and deposited in the Company's operating account, merging with existing cash reserves, and becoming part of the general pool of funds available to the organization. As reflected in in Exhibit A, the Company's operating account contained more than sufficient funds throughout the month to cover the Loan Payments without taking into account the $944,400 drawn (or other amounts drawn at that time) under the Loan Agreement. Indeed, since the Company's operating account had existing funds in the timeframe in question, there is no plausible way to conclude that funds drawn under the Loan Agreement and transferred to such account were the funds used to make the $944,400 of payments in question. Thus, we strongly believe that the fungibility of funds should be acknowledged when assessing whether the payment of the principal of a separate loan constitutes a violation of the Loan Agreement. Once loan proceeds and other available funds entered our operating account it would be impossible to determine (by Mesa or the Auditor) which specific funds were used to make the Loan Payments or to unequivocally conclude that specific funds in the operating account were attributable to funds drawn under the Loan Agreement.

Second, although the Company's "Draw Request Tracker" (the "Tracker") referenced certain principal payments on loans payable to Wilmington Trust Company (the "Loan Payments"), the draft Audit Report fails to provide important context involving the tracker. Specifically, the Company used the Tracker to provide *a sampling* of upcoming payables to approximate possible uses of funds to be drawn under the Loan Agreement for qualifying purposes thereunder for each week and to transfer estimated funds to the appropriate Mesa accounts to accommodate such use of proceeds. Critically, the inclusion of the referenced $944,400 in the Tracker (along with other expenses) was not in any way tied to nor does it reflect the Company's formal accounts payable payment process. It does not—and should not be interpreted to—mean—that there was any connection between the amounts drawn under the Loan Agreement and payment of the items listed in the Tracker. At no time did the Company use or distribute any funds drawn under the Loan Agreement to pay any debt service obligations.

The Company has had and continues to have in place established banking, payable, and business processes to conduct its daily operations. It is through these processes and from these operating accounts that the Company processed its payables. In short, the fact that the Loan Payments were set forth in the Tracker does not translate to the conclusion that proceeds from the Loan Agreement were used to pay the Loan Payments or any other payments not otherwise permitted under the Loan Agreement. It was simply one of the tools the Company employed to manage its business at that time.

Third, we note that the Company had Eligible Expenses in excess of $9,551,301 following the period where funds were fully drawn under the Loan Agreement. While such expenses were eligible to be paid from the proceeds under the Loan Agreement, they were not. They were paid out of the Company's funds in its operating account. As such, we believe the foregoing should be a key factor in looking at the Company's actions in November 2020.

Finally, we note that Mesa has been an exemplary borrower complying with both the letter and the spirit of the CARES Act and the Loan Agreement. As the Audit Report acknowledges, Mesa worked with Treasury in an open and productive manner, seeking and obtaining a waiver when warranted and even received a passing grade in the "Direct Loan Spending" portion of its quarterly Review Card during the period in question. (*See* Report at pp. 3-4). Characterizing Mesa's conduct as "improper", "in

violation", or "non-compliant", is not only inaccurate, but it has the potential to tarnish the reputation of a publicly traded company that—with the help of the CARES Act—and through its own responsible management and stewardship, retained approximately 3,000 employees during the pandemic.

In light of the foregoing factors, we kindly request that you consider the existence of adequate funds in the Company's operating account to cover all expenses without using Treasury funds and Mesa's unequivocal statement that it used existing funds to pay the Willington Trust Principal Payments, the fungibility of cash, the purpose for which the Company used the Tracker (i.e. an estimator of funds to be transferred only), and the payment by the Company of Eligible Expenses without use of proceeds from the Loan Agreement. We further request that you consider Mesa's track record as an exemplary borrower and corporate citizen, honoring the purpose and spirit of the CARES Act. We believe the totality of the facts existing at the time of the Loan Payments should result in the conclusion that the Company did not violate the Loan Agreement.

Lastly, we understand SIGPR's mission is to "efficiently root[] out fraud, waste and abuse" in the programs it oversees and to carry out its mission with the goal to "treat everyone with respect, … and to be fair, objective, and independent." For all the foregoing reasons, any "fair" and "objective" evaluation of the record would conclude that all funds drawn under the Loan Agreement were used appropriately. Mesa's reputation as an outstanding corporate citizen—one that did an exemplary job of working with Treasury and managing the loan facility—should not be called into question and the findings in the Audit Report involving Mesa should be removed.

Very truly yours,

Torque Zubeck

D. Torque Zubeck
Chief Financial Officer
Mesa Airlines, Inc.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

September 8, 2023

Kevin Gallagher
Audit Manager
Special Inspector General for Pandemic Recovery
2051 Jamieson Avenue
Alexandria, Virginia 22314

Dear Mr. Gallagher:

I write regarding the Special Inspector General for Pandemic Recovery's (SIGPR) Revised Draft Report: *Audit of Direct Loan Program Recipient – Mesa Airlines, Inc.* (Draft Report), dated August 9, 2023. The U.S. Department of the Treasury (Treasury) appreciates SIGPR's efforts.

Background on Treasury's Direct Loan Program

The Coronavirus Aid, Relief, and Economic Security Act (CARES Act) was enacted on March 27, 2020, to provide assistance in response to the unprecedented challenges presented by the COVID-19 public health emergency. Section 4003 of the CARES Act authorized Treasury to make loans and loan guarantees to eligible businesses, including passenger air carriers and related businesses, cargo air carriers, and businesses critical to maintaining national security. Under the Section 4003 loan program, Treasury provided an emergency credit line for large and small businesses that were unable to obtain credit elsewhere during the height of the pandemic, thereby reducing COVID-19-driven bankruptcies, protecting pensions, and, together with the Payroll Support Program (PSP) that was also authorized by the CARES Act, avoiding long-term reductions in aviation capacity.

Section 4003 of the CARES Act required borrowers to agree to specific terms designed to protect taxpayer interests and ensure that the borrower used loan proceeds in a manner consistent with the loan's purpose. Treasury also imposed additional requirements on borrowers through the terms of the loan and guarantee agreements. Among those terms were requirements that a borrower use loan proceeds only for the borrower's operating costs, maintain a specific collateral coverage ratio, and maintain accurate books and records. Additionally, borrowers agreed to deliver certain financial statements, certificates attesting to compliance with agreement terms, and other reporting on a regular basis. Treasury reviews borrower reporting, and where a borrower self-reports noncompliance or Treasury identifies a potential concern, Treasury follows up on such matters consistent with approved procedures.

Under the Section 4003 loan program, Treasury authorized up to $21.9 billion in loans, ultimately disbursing approximately $2.7 billion in loans to 35 eligible businesses. The majority of these funds have already been repaid, and a combined $976 million remains outstanding to 20 borrowers.

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On October 30, 2020, Treasury made a loan of $195 million to Mesa Airlines, Inc. (Mesa) to provide liquidity to allow the company to continue operations during the COVID-19 pandemic.

Draft Report

The Draft Report states that Treasury employs a "Review Card" portal in Salesforce to capture borrowers' responses to questions aimed at monitoring borrowers' compliance with the terms of the loan and guarantee agreements. Each quarter, Treasury requires borrowers to respond to a compliance questionnaire that is administered through Treasury's award management system. Treasury further requires borrowers to submit certain documents, including collateral coverage ratio certificates, to Treasury's financial agent and collateral agent responsible for managing assets pledged under the secured loan and guarantee agreements. Treasury's financial agent also collects principal and interest payments on the loans, with all such amounts being reconciled by Treasury. In addition, Treasury communicates regularly with borrowers, reviews borrowers' financial statements, and for publicly traded companies, reviews borrowers' reports filed with the Securities and Exchange Commission.

The Draft Report contains three recommendations related to Mesa's Section 4003 loan. SIGPR's first recommendation calls for Treasury to determine what, if any, corrective action should be taken to address SIGPR's finding that Mesa misallocated $944,400 in loan proceeds in November 2020. As detailed in the Draft Report, although Mesa had deposited the entire Section 4003 loan amount into a separate bank account referred to as the "Treasury Account," Mesa would transfer funds for payments to be made with the Treasury loan proceeds to its "Concentration Account," which was an operating fund that Mesa used to send payments to vendors generally. Thus, in November 2020, Mesa commingled a portion of its Section 4003 loan proceeds with its general operating funds.

The Draft Report explains that Mesa developed an internal tracking system that was intended to track the amount of Section 4003 loan proceeds the company used to make payments through checks, wire payments, and payroll, and to flag any payments that were not eligible to be paid with the Section 4003 loan proceeds. According to the Draft Report, while Mesa identified most payments that were not eligible to be paid with the Section 4003 loan proceeds, Mesa did not flag four payments from its Concentration Account totaling $944,400 that were used to pay down Mesa's other indebtedness. The Draft Report states that these payments were made in error and that Mesa did not knowingly use the loan proceeds inappropriately. The Draft Report further states that, at the time of these payments, Mesa had sufficient funds in its Concentration Account to cover its payments without using any of the Section 4003 loan proceeds, and further that had Mesa caught the error in time, it likely would have used the Section 4003 funds to make other eligible payments. With respect to SIGPR's recommendation, Treasury notes that Mesa has already corrected its tracker, and Treasury is considering what additional steps, if any, should be taken in response to these findings.

SIGPR's second recommendation calls for Treasury to closely monitor Mesa's collateral and develop a plan on how to proceed if Mesa falls short of the terms of the Modification and Waiver Agreement dated December 22, 2022. As noted in the Draft Report, Mesa's ratio of pledged collateral to loan value fell below the level initially mandated by the loan and guarantee

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agreement. Treasury issued two waivers to Mesa. The first waiver, issued on April 15, 2022, temporarily modified the collateral coverage ratio (CCR) from 1.60:1.00, as set forth in the loan and guarantee agreement, to 1.50:1.00, and required Mesa to provide a plan detailing the steps that the company would take to get back into compliance with the 1.60:1.00 CCR by September 30, 2022. Mesa was unable to come into compliance with the CCR by that time, and sent a letter to Treasury on November 7, 2022, detailing its plan to sell some of the collateral pledged to Treasury to pay down the outstanding loan balance. Treasury considered Mesa's plan and issued a second waiver on December 22, 2022, which modified the minimum CCR to 1.55:1.00 until the loan's maturity date, in exchange for a requirement that Mesa use the net proceeds of any future sales of pledged collateral to pay down the outstanding loan balance to maintain a minimum CCR of 1.55:1.00 until maturity. Although Mesa initially submitted a CCR computation in April 2023 showing a CCR of 1.51:1.00, Mesa made a $3.2 million payment on the loan to bring the CCR back into compliance. As of April 30, 2023, Mesa was in compliance with the 1.55:1.00 CCR. With respect to SIGPR's recommendation, Treasury continues to monitor Mesa's financial position and collateral closely and will take additional actions as appropriate.

SIGPR's third recommendation calls for Treasury to ensure that any borrower disposition of pledged collateral is handled in accordance with the terms of the Section 4003 loan and guarantee agreements for all outstanding loans, including Mesa's. While Treasury shares SIGPR's focus on borrower compliance with applicable requirements under the loan and guarantee agreements, in appropriate circumstances Treasury will agree to modify or waive certain of those requirements, when permitted by the CARES Act, in order to protect taxpayer interests and to fulfill the statutory purposes of the Section 4003 loan program. With respect to Mesa's sale of certain collateral as described in the Draft Report, Treasury's financial agent recommended approving the Modification and Waiver Agreement to increase Treasury's recovery rate on the Mesa loan by facilitating immediate prepayments while maintaining the value of the collateral through ongoing use. Treasury concluded that the modification of the loan terms was appropriate.

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Treasury appreciates SIGPR's work regarding the loan made to Mesa, and we appreciate the opportunity to review the Draft Report.

Sincerely,

Jessica Milano
Chief Program Officer
Office of Recovery Programs

Appendix D – Report Distribution

Chief Program Officer – U.S. Department of the Treasury

Office of General Counsel – U.S. Department of the Treasury

Chief Financial Officer – Mesa Airlines, Inc.

Inspector General – Special Inspector General for Pandemic Recovery

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