

# Banks Take Aim at Revolvers

**With lenders shrinking the length and size of their commitments to companies and charging more, liquidity risk is rising.**

**Vincent Ryan - CFO.com | US**

Companies are finding themselves in a liquidity squeeze. At a time when financial markets and counterparties are scanning companies' liquidity with a sharpening eye, a large swathe of lenders is tightening access to revolving lines of credit, recent data shows.

Indeed, banks are "universally adjusting" the terms on revolving lines of credit, according to a June report from CreditSights.

Banks are cutting the size of revolvers, upping interest rates, shortening maturities, and enhancing their collateral positions, regardless of where companies fall on the credit-quality spectrum, says the report, written by analyst Chris Taggart.

Revolving lines of credit are a critical capital source for payroll, buying raw materials, and paying rents, as well as a liquidity backstop for commercial paper. Higher rates and reduced capacity on such debt can mean companies have to consume more of their cash on hand in daily operations.

Data from banks backs up CreditSights' findings. Unused commercial-credit commitments at large banks shrank in the first quarter, according to a review of call reports by CFO.com. Citigroup's unused commercial credit commitments dropped to \$262 billion in the first quarter of 2009, down from \$405 billion a year earlier; JPMorgan Chase's obligations fell to \$247 billion, from \$311 billion; and Bank of America's dipped to \$269 billion, from \$305 billion.

What's more, new issuance of corporate revolvers continues to plunge. In the first half of 2009, banks issued \$163 billion in new revolving lines of credit, down from \$292 billion the first half of 2008, according to new data from Reuters Loan Pricing Corp. Total issuance for 2008 was \$455 billion, while in the prior three years prior it had exceeded \$1 trillion.

"Revolvers represent contingent liabilities for the banks," says Richard Speer, chief executive at bank consultancy Speer & Associates. "They're trying to reduce their risk levels and focus on managing their exposure. It's typical right now for them to tighten."

Speer says another trend is driving the lower numbers: the highest quality corporate credits aren't borrowing, choosing to fund business through working capital improvements or other forms of credit. "The companies that are borrowing are those that don't have a choice," he says. "That's why banks have to be that much more careful."

Spreads, generally, are three times higher for companies refinancing their revolvers. And maturities are shortening. Five-year revolvers, for example, are being eliminated entirely or

"split" between a 364-day maturity and one that goes out to three years. The percentage of revolvers with 364-day maturities reached 50% in the first half of 2009, according to Reuters Loan Pricing. As late as 2007, less than 20% of new issuances had maturities as short as 364 days.

The pain is not being spread evenly, however. Highly leveraged borrowers are feeling more of the brunt of banks' new prudence. But some upper-tier borrowers in that group are taking an active stance and not waiting for banks to come to them. They are offering lenders "amend and extend" deals, notes CreditSights. Lenders can opt-in to extend a revolver's maturity, in return for a sizable rate increase (200 to 400 basis points). But not all lenders want to renew their commitment, so the revolver can be split into two tranches, old and new.

That can result in diminished revolver capacity later on, when the commitment of the old lenders ceases. Graham Packaging, for example, obtained \$122.8 million in extension, but that was only half the size of its existing revolver. CreditSights calls such deals "a de facto collateral enhancement" for the lenders that agree to re-up.

In most cases, companies will take it, as they view locking-in credit of any size as key. They are anticipating what CreditSights calls the "heavy maturity years" of 2011 to 2015. During that period, \$936 billion of institutional loan and high-yield bond debt comes due.

There are other disadvantageous terms seeping into revolver agreements. Tying revolver spreads to spreads on the company's credit-default swaps or a credit-default swap index like CDX is one. (This happened to Rockwell Automation, a "mid single-A" rate firm.) Concerns about rating agencies are giving this pricing method a boost. "The loan market is starting to see [CDS margins] as a more accurate reflection of credit risk," says Vanessa Spiro, a partner at Jones Day. "But borrowers are not enamored of it."

"Springing maturity" provisions are another tweak that undercuts the stability of revolvers. These provisions exist to keep a lid on a company's total outstanding debt. In one example, if senior secured leverage exceeds a certain percentage on a future test date, the revolver matures earlier.

There is one positive change for borrowers, however. New terms give them the ability to claw back value from a defaulting lender, says CreditSights, in effect applying loan payments to cover credit advances that have gone un-honored. CreditSights says that change is in part being driven by the collapse of Lehman Brothers.

Why are changes to revolvers so important? The refinancing issues with revolvers affect more than just banking relationships, says Pam Krank, president of The Credit Department. For one thing, when a bank reduces or revokes a line of credit, "it's a trigger" for aggressive action on the part of unsecured trade creditors, Krank says. "If bank availability goes down, it makes the unsecureds very nervous." As a result, they cut the amount of trade credit granted a customer or put the customer on hold altogether, she says. "It has a huge impact."