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More on Revolving Credits

THE LEAD | July 14, 2015

Who knew such a mundane topic as revolving credits could stir up such passions? Based on our TLL mail bag, readers have very definite opinions about how banks (and borrowers) are coping with the shifting regulatory climate related to these otherwise innocuous financing mechanisms.

As we discussed last week, the crack-down on “risky loans” has caused banks to cut back on their funded debt obligations to many highly leveraged borrowers. Less-regulated entities are rushing in to fill that vacuum. But a casualty of regulation is that *unfunded* obligations are being impacted as well. These are tougher shoes for non-banks to fill.

First, as one banker noted to us, even if funded leverage falls below the six times Ebitda mark set by regulators for a criticized loan, the guidelines state that unfunded RC availability must be included in the debt calculation as well.

Also throw into the mix any committed debt allowable under the credit agreement, including baskets and accordions. Regulators assume they are all drawn Day One, with no benefit to cash flow. As our friend wrote sadly, “It’s harder and harder to be a bank.”

One counterintuitive solution banks are trying (another correspondent revealed) is to make revolvers larger and shrink the amount of the corresponding term loan. Since more of the funded portion is placed under the RC, it improves the return on capital for that facility. It also has the side benefits of both relieving amortization pressure for the borrower and ameliorating regulators’ concerns about banks issuing back-ended term loan B tranches.

But as is the case with many things related to bank regulation since the credit crisis, there are unintended consequences to be considered. By shifting away institutional term loans, where 1% amortization in the first several years is commonplace, banks are putting more debt into revolvers. Where there’s no amortization.

It also takes out of play another debt repayment feature of term loan B’s; namely, excess cash flow recaptures. While the integrity of these sweeps has certainly been watered down of late, it gives lenders another tool in their pay down arsenal.

Revolvers are notoriously difficult to control from a lender’s perspective. Talk to work-out and restructuring pros. In troubled credit situations the first thing banks do is look to restrict RC usage. And the first thing that borrowers do when they know liquidity may be cut off, is draw down under the revolver. It makes for some unhappy relationships.

Finally, one buy-side manager called to tell us how much revolver exposure he had in his entire multi-billion-dollar loan portfolio. “Five million bucks,” he said proudly. “And I’m not even sure why we have that much.”