CORPORATE LAW UPDATE

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WORTH THE HASSLE? – CONSIDERATIONS IN DEBT REFINANCING

In today's low interest rate environment, creditworthy businesses may wish to consider refinancing some or all of their debt. The potential benefits are many: reduced interest rates; relaxation of covenants to allow for greater M&A activity, capital expenditures and shareholder payments; elimination of blocked accounts and customer lockboxes; and release of collateral or personal guaranties of company principals.

If real estate comprises a material portion of a company's collateral, appreciation in the value of such real estate may permit borrowing increased amounts. With respect to "borrowing base" loans, changes in the creditworthiness or nature of the company's customers or in inventory composition may allow for additional receivables or inventory be considered eligible so as to support larger advances than under the existing "borrowing base" definition. Recent past upgrades to machinery and equipment may also entice new lenders to extend more credit.

Several factors should be considered in determining the advisability of a potential refinancing. The existing loan documents should be reviewed to ensure that prepayment is permitted. Assuming that prepayment of the current loan is permitted, there will be legal and other fees associated with payoff of the existing loan and negotiation of the new loan documents. A new lender may also require a due diligence fee prior to making a lending commitment. Depending on the language of the old loan documents, there may also be substantial prepayment or similar fees associated with the loan payoff. Such fees are not necessarily enforceable, but their existence and significance must be addressed as part of the decision process. The savings from the refinancing must be sufficient to justify the incurrence of these costs.

A company should also consult its tax specialists for guidance on whether any income (or expense from accelerated recognition of fees incurred at loan origination) would be recognized in the refinancing and the current or amortized deductibility of any fees or costs associated with the transaction.

Before approaching lenders, a company may also wish to do some housekeeping. It should conduct lien searches and address any tax, judgment or unexpected liens that are found. A company should confirm that it is current on all franchise and other taxes necessary to remain in good standing where necessary. Finally, if a company is, or is threatened to become, a defendant in a material litigation, the company should consider resolving such litigation or claims prior to commencing negotiations with lenders.

While lenders typically desire to retain business, and existing lenders should be contacted first if refinancing is explored, improved circumstances or market conditions may cause interest from other lenders who may offer improved pricing and/or terms. Nonetheless, companies may wish to consider the value of maintaining establishing relationships with loan officers who intimately know their business. Keeping that familiarity may be more cost-effective in the long run than saving a few dollars with a new lender.

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If a decision is made to move forward with a refinancing, it is essential to obtain a written commitment from the pertinent lender that sets forth the amount of loan commitment, interest rate, maturity date, collateral, credit support such as guarantees from major shareholders and affiliated companies and other major provisions that have been mutually agreed. If a new lender will be providing the financing, the writing needs to specify what will be required from the old lender in terms of release or transfer of collateral and other matters. At the least, there will need to be a "payoff letter" indicating the funds required of the new lender to fulfill the existing obligation. In such payoff letter, the lender being replaced may require a borrower to release all claims against such lender as a condition of the lender's signing the payoff letter, releasing collateral and returning old notes. Conversely, the borrower should obtain the possession of the original notes being paid off and a written release of all claims from the old lender.

It is at this stage that any prepayment fees will be requested. Such fees may range from simple reimbursement for professional and filing fees from the original deal to 'make-whole' amounts covering reductions in interest rates or costs of reversing swap or other derivative arrangements obtained by the lender to support the deal, to acceleration of facility or commitment fees which would have been paid had the loan remained outstanding for the originally contemplated term.

FisherBroyles corporate partners can assist you with consideration of the merits of refinancing, as well as with the manner of its execution.

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