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Bankruptcy financing gets pricier and more elusive

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By Caroline Humer

NEW YORK (Reuters) - Financing is getting pricier and more elusive for companies that file for bankruptcy.

Debtor-in-possession - or DIP - financing is the fuel that keeps companies going through bankruptcy, allowing them to continue paying their suppliers and their employees as they try to become profitable again.

It has been a popular and lucrative form of financing for much of the last decade, as the DIP lender is usually the first to be paid back when the company emerges from bankruptcy or liquidates.

But now, as companies head into bankruptcy, they are finding they have few assets that have not already been promised as collateral to lenders, making it difficult to secure DIP financing. In addition, the tight credit markets that may have helped drive them into bankruptcy are limiting the availability of loans after they file.

"I think the fact that DIP financing is more difficult to get is an absolute truism," said Lisa Donahue, a co-head of restructuring firm AlixPartners' Turnaround and Restructuring practice.

Companies are heading into bankruptcy with few assets to use as collateral because they have so much other debt tied to assets, she said.

"Unencumbered assets to actually put a DIP on top of are very difficult to get," she said.

In addition, the lack of liquidity and competition make DIP loans harder to get, she said, pushing rates and fees to unprecedented levels.

HIGHER FEES

Interest rates and fees have doubled to 5 to 7 percent from 2.5 percent while loan terms have decreased to 6 to 12 months from 2 years, she said.

That is making it a bit harder to emerge from bankruptcy. "In a successful restructuring you need a little bit of a runway," she said.

Consolidation on Wall Street has not helped build competition. This year, JPMorgan (JPM.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) bought Bear Stearns, much of failed investment bank Lehman Brothers was absorbed by Barclays (BARC.L: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)), and Merrill Lynch (MER.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) brokered a deal to be bought by Bank of America (BAC.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)).

Hedge funds and private equity firms have also stepped back from lending, said Bill Wexler, head of the national corporate advisory group at business advisory firm BBK.

"That is changing the dynamic on courthouse steps and as a result, our sense is that the (bankrupt company's) existing lender is going to be able to negotiate and lever a much more attractive, and a much more expensive, DIP

loan because it doesn't have competition at the moment," Wexler said.

The decline in lenders has occurred even as the need for DIP loans in the United States have risen. Rob McMahon, managing director for General Electric Co's (GE.N: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) corporate lending arm, told Reuters last month he expects U.S. demand for DIP loans to be about \$10 to \$12 billion in 2008, up from \$2 billion last year.

GE itself expects to provide \$2 billion to \$3 billion of that financing, he said.

LEHMAN, INTERSTATE PAY UP

Two companies that have paid the higher price of the restrictions on DIP financing in the last month are Lehman Brothers Holdings Inc (LEHMQ.PK: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) and Interstate Bakeries (IBCIQ.PK: [Quote](#), [Profile](#), [Research](#), [Stock Buzz](#)) - the maker of Wonder Bread.

Lehman is paying the Libor rate - or the London interbank offered rate - plus 6 percent to 7 percent on \$450 million in DIP financing. Interstate Bakeries, which has been in bankruptcy for more than four years, last month paid 4.5 percent on a financing tranche of \$75 million.

Companies that can manage to hold off on filing for bankruptcy may benefit as long as banks begin lending more freely again, one expert said.

Bob Carbonell, executive vice president of retail credit rating service Bernard Sands, said that retailers such as Goody's Family Clothing, Mervyns LLC, Linens & Things and Boscov's Inc. had filed for bankruptcy before DIP rates rose significantly. And other large retailers are not expected to file before the end of the holiday shopping season, their busiest time of year.

"I don't see any of our major apparel or accessory retailers filing before Christmas. And interest rates will be resolved by the end of the year, hopefully," Carbonell said.

(Editing by Tim Dobbyn)

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