

Do Economic Conditions Drive DIP Lending?: Evidence from the Financial Crisis

FRED TUNG BOSTON UNIVERSITY SCHOOL OF LAW

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Indira Gandhi Institute of Development Research
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Economic Conditions and DIP Lending

I. DIP Loan Terms:

Pricing

Loan Covenants

Extraordinary Provisions

Roll-ups

Milestones

→ All-in-Spread (AIS)

Reporting

Periodic updates to lender

Two most common:

Cash reporting

Budget reporting

Economic Conditions and DIP Lending

I. DIP Loan Terms:

Pricing

Loan Covenants

Extraordinary Provisions

Roll-ups

Milestones

Deadlines
achievements

➤ filing

➤ court approval or completion of major asset sale

Use DIP Loan to pay off DIP lender's pre-bkr claim

- Ordinarily, claims get paid only at end of case,
 - And not in cash, but in promises.
- Roll-up cashes out pre-bkr claim with sure-to-be-repaid DIP loan
- Potentially bad consequences:
 1. Eliminates reorg risk for DIP lender's pre-bkr claim
 2. Can't pay with promises
 3. Larger exit financing burden
 4. May take value from junior claimants

Economic Conditions and DIP Lending

II. DIP Loans Terms:

Pricing

Increased during Credit Crunch

Loan Covenants

More stringent reporting (frequency) with credit scarcity,
for both budget and cash reporting

Extraordinary Provisions

Roll-ups

Milestones

Use of extraordinary provisions bore no relation to credit availability.

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III. Data and Sample

A. Sample Cases: Lopucki BRD (2004-12)

B. Case files: PACER

C. Coding DIP loan arrangements for
covenants/ other loan terms
roll-ups

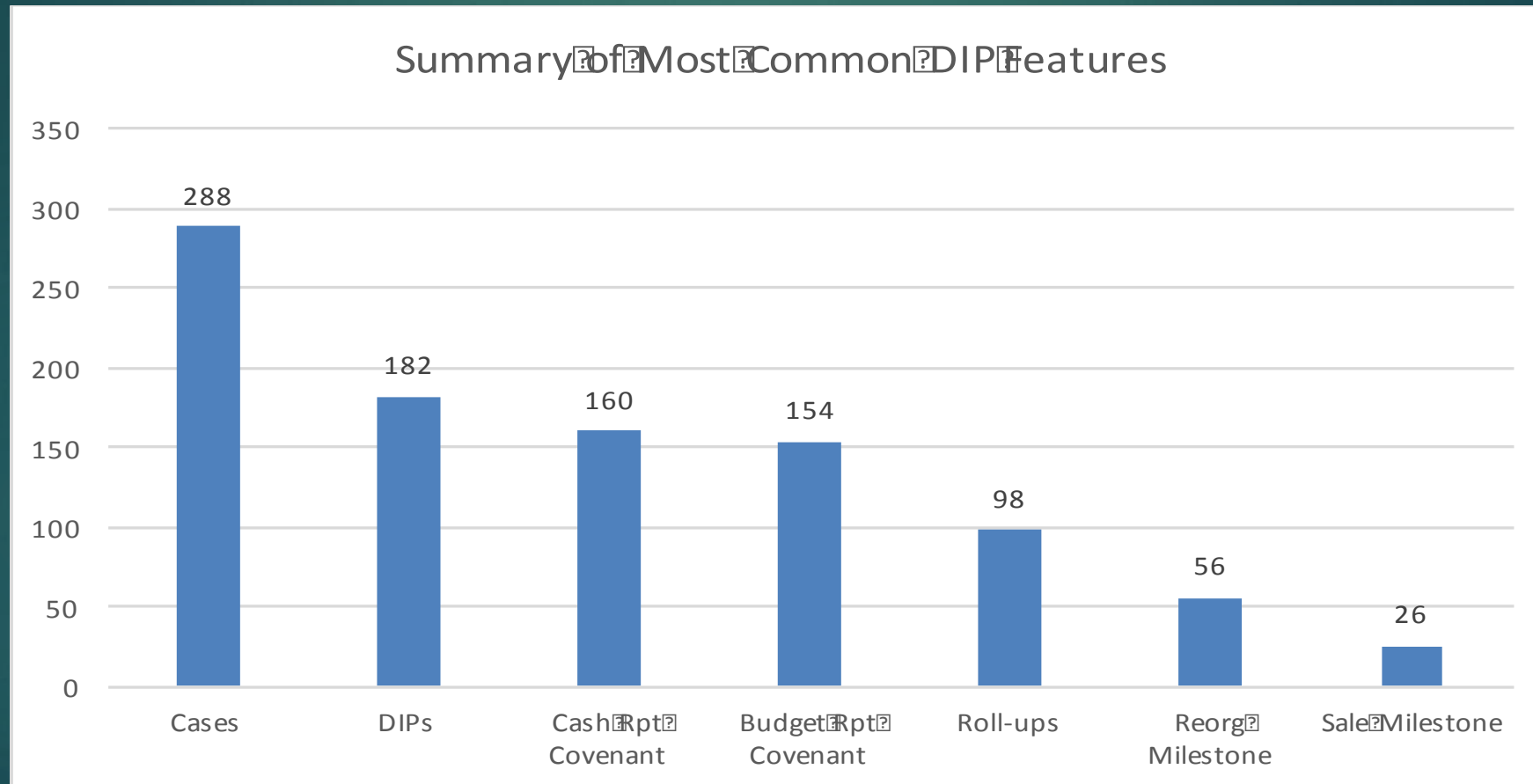
D. All-in-spread: Thomson Reuters DealScan

E. Domestic credit level: BIS, CHY

Total DIP amount
Case milestones

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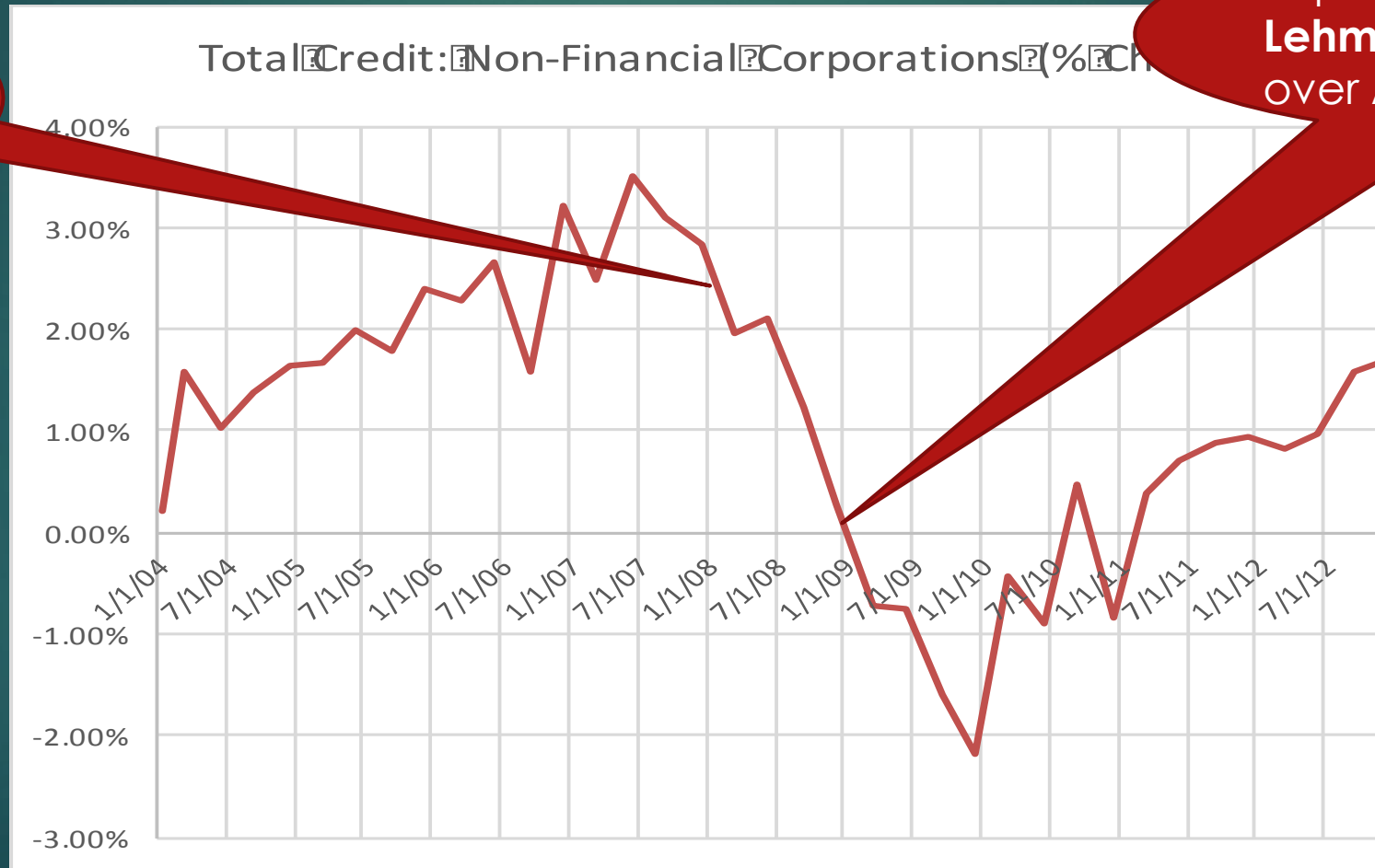
IV. Empirical Analysis: Background



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IV. Empirical Analysis: Credit Market Effects

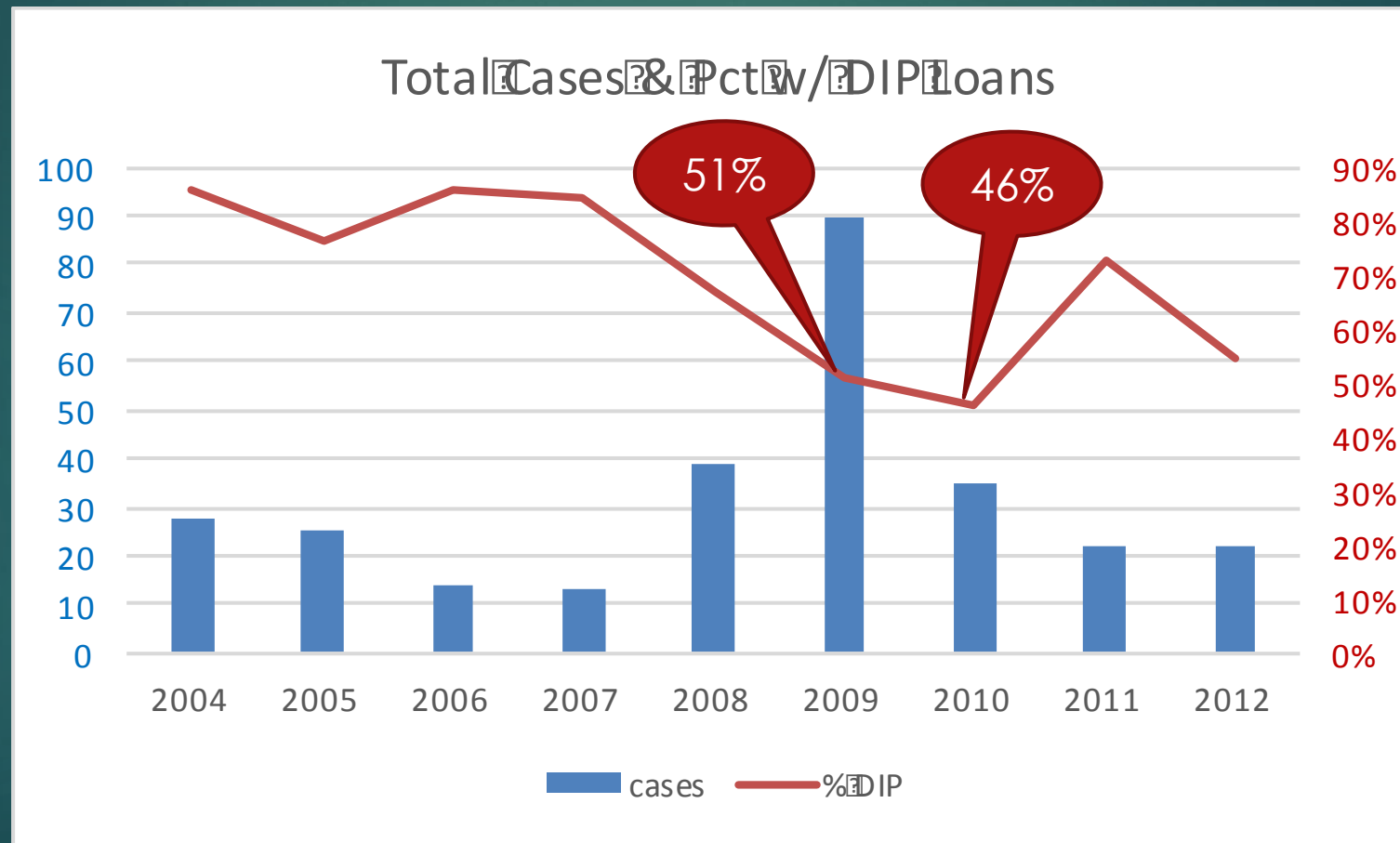
Early '08:
Bear Stearns
sold to JPMC



Sep '08:
Lehman files; Fed takes
over **AIG, FM, FM**

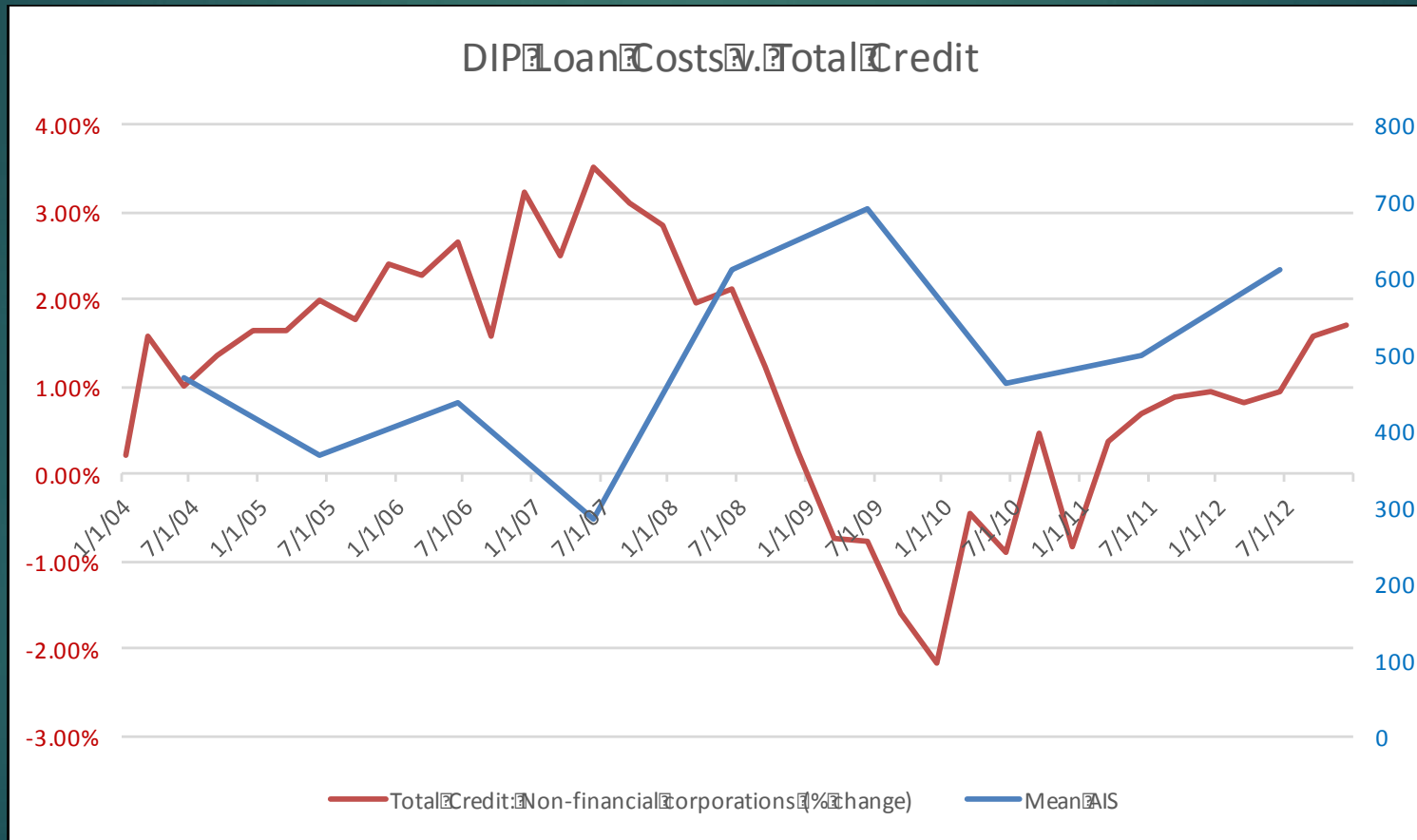
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IV. Empirical Analysis: Credit Market Effects



Economic Conditions and DIP Lending

IV. Empirical Analysis: DIP Loan Pricing



Economic Conditions and DIP Lending

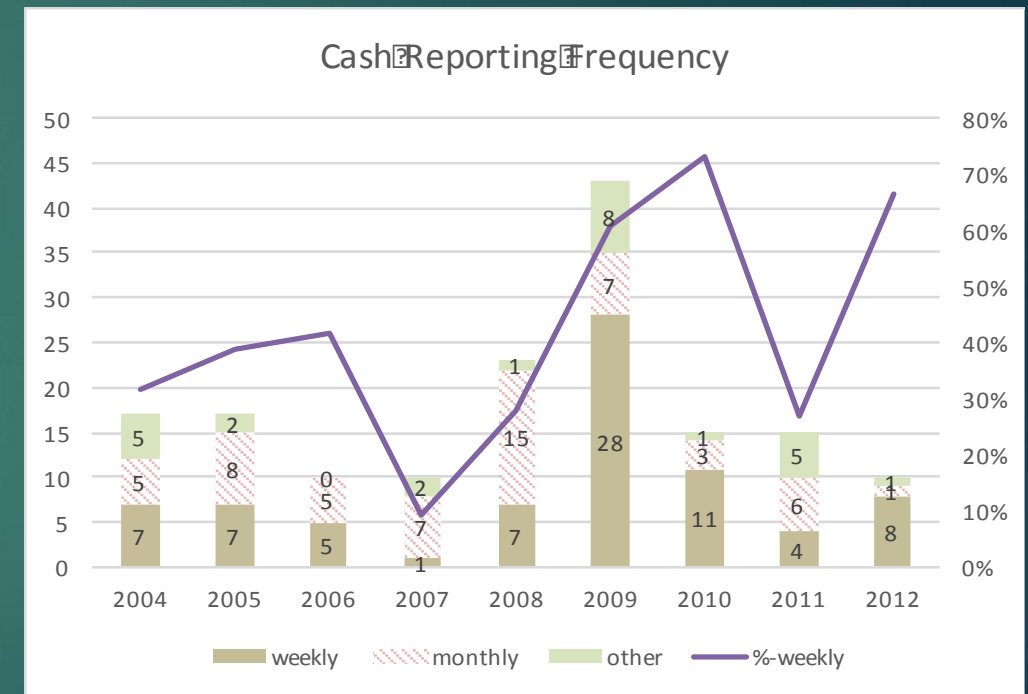
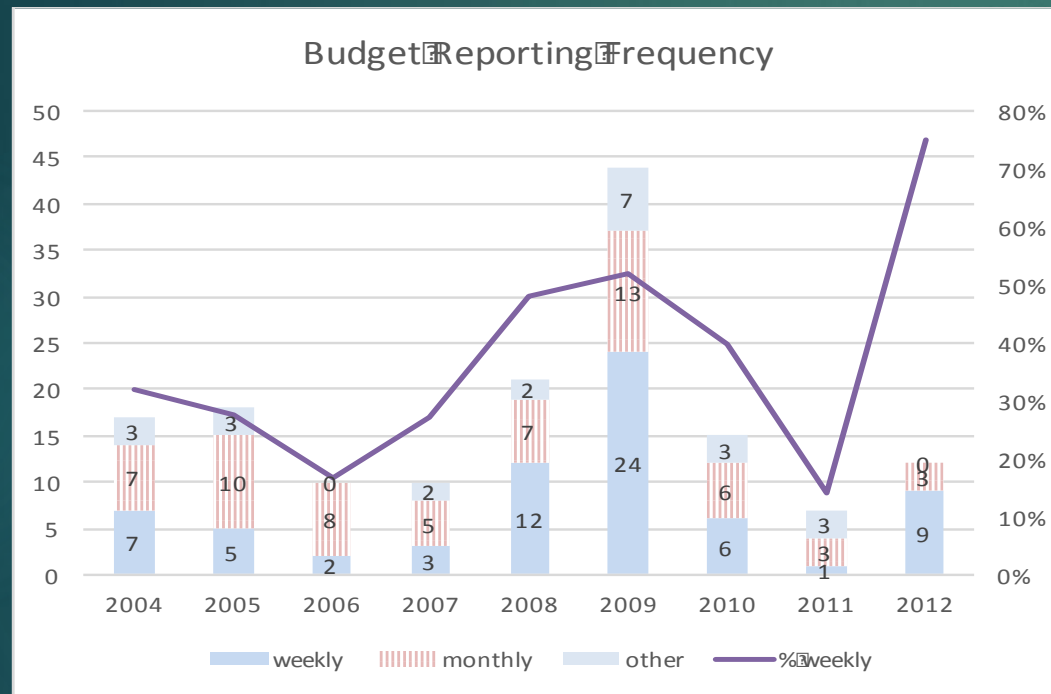
IV. Empirical Analysis: DIP Loan Pricing

TABLE 2
DIP LOAN PRICING AND AVAILABLE CREDIT

	(1) All-in-Spread Above LIBOR	(2) All-in-Spread Above LIBOR
Credit (%)	-70.66*** (1,874)	-52.16*** (1,911)
Prepack	-42.79 (66.41)	-53.65 (69.39)
363 Sale	38.50 (62.93)	71.11 (97.60)
Ln(Assets)	2.044 (22.05)	-11.92 (29.30)
Leverage	302.8 (451.4)	327.7 (438.6)
Num. Covenants		2.892 (18.00)
Disc. St. Milestone		100.9 (124.1)
Plan Milestone		24.42 (124.0)
Sale Milestone		3.262 (117.7)
Rollup/Claim		-0.886 (0.694)
Constant	191.6 (485.6)	294.8 (491.2)
Industry FE	Yes	Yes
Observations	100	90
R-squared	0.199	0.275

Economic Conditions and DIP Lending

IV. Empirical Analysis: Reporting Covenants



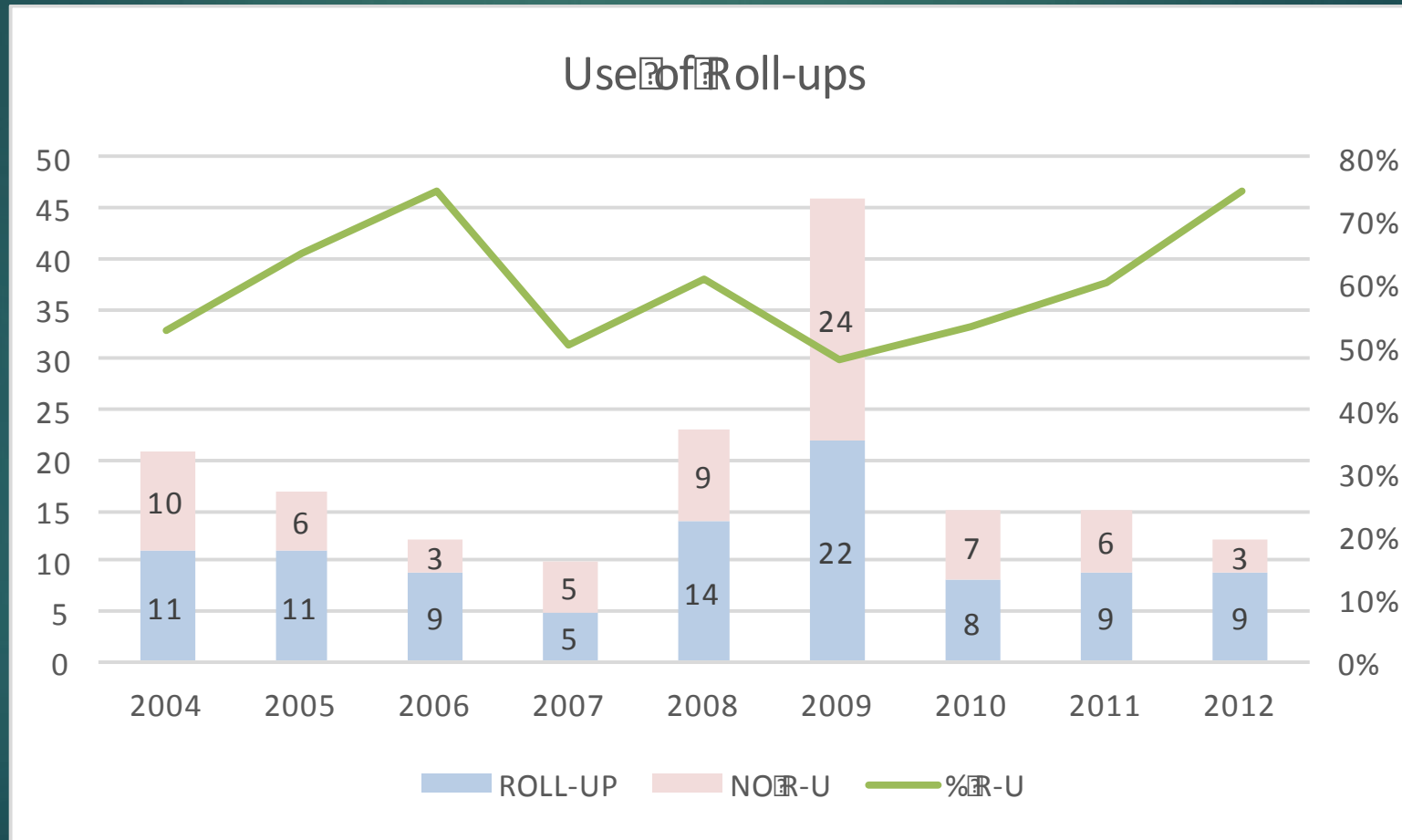
Economic Conditions and DIP Lending

IV. Empirical Analysis: Reporting Covenants

REPORTING FREQUENCY AND AVAILABLE CREDIT		
	(1) Budget Reporting Frequency	(2) Cash Reporting Frequency
Credit (%)	8.69* (4.96)	9.22* (5.37)
Prepack	0.57* (0.19)	0.10 (0.20)
363 Sale	-0.24 (0.19)	-0.03 (0.21)
Ln(Assets)	0.11 (0.07)	0.12 (0.10)
Leverage	-0.78 (1.30)	0.48 (1.31)
Num. Fin. Covenants	-0.03 (0.07)	-0.09 (0.08)
Disc. St. Milestone	-0.26 (0.28)	-0.17 (0.36)
Plan Milestone	0.42* (0.23)	-0.04 (0.33)
Sale Milestone	-0.06 (0.2)	0.01 (0.20)
Rollup/Claim	0.00 (0.00)	0.00* (0.00)
Constant	2.45 (1.55)	1.29 (1.51)
Industry FE	Yes	Yes
Observations	149	145
R-squared	0.171	0.141

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IV. Empirical Analysis: Roll-ups (Chart)



Economic Conditions and DIP Lending

IV. Empirical Analysis: Roll-ups (Regression)

ROLL-UPS AND AVAILABLE CREDIT: REGRESSION

	(1) Roll-up Dummy	(2) Roll-up Value	(3) Roll-up/ Claim	(4) Roll-up/ DIP
Credit (%)	2.48 (2.52)	1,445 (946.5)	365.6 (242.6)	2.54 (1.64)
Prepack	0.05 (0.10)	-45.61 (33.30)	4.40 (9.25)	-0.00 (0.06)
363 Sale	-0.02 (0.11)	34.33 (50.07)	-9.71 (9.74)	-0.05 (0.07)
Ln(Assets)	-0.02 (0.04)	123.6** (58.17)	-4.63 (3.38)	-0.03 (0.02)
Leverage	0.38 (0.67)	-332.8* (198.2)	-2.78 (71.62)	0.46 (0.46)
Num. Covenants	0.05* (0.03)	17.89 (11.05)	5.20* (3.13)	0.035* (0.02)
Disc. St. Milestone	0.10 (0.13)	75.74 (67.02)	-8.52 (13.97)	0.07 (0.09)
Plan Milestone	-0.09 (0.11)	1.538 (44.81)	5.38 (11.28)	-0.02 (0.08)
Sale Milestone	0.25** (0.12)	-20.21 (42.98)	23.76** (10.61)	0.21*** (0.08)
Constant	0.25 (0.78)	-425.8 (430.9)	76.10 (78.08)	0.03 (0.53)
Industry FE	Yes	Yes	Yes	Yes
Observations	158	158	155	155
R-squared	0.20	0.23	0.23	0.23

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IV. Empirical Analysis: Extraordinary Provisions--Milestones

MILESTONES AND AVAILABLE CREDIT

	Available Credit (%)	Disclosure Statement Milestone	Plan Milestone	Sale Milestone	Any Milestone
Available Credit (%)	1				
<u>Discl Stmt</u> Milestone	-0.05 (p<.50)	1			
Plan Milestone	-0.07 (p<.36)	0.70*** (p<.00)	1		
Sale Milestone	0.09 (p<.28)	-0.04 (p<.59)	-0.09 (p<.27)	1	
Any Milestone	-0.01 (p<0.87)	0.59 (p<.00)	0.74 (p<.00)	0.47 (p<.00)	1

Economic Conditions and DIP Lending

V. Conclusion

Ordinary loan terms respond to economic conditions.

- DIP loan pricing and reporting frequencies increase with credit scarcity.

Re extraordinary provisions:

- Incidence of roll-ups and milestones showed no relation to credit market changes.
- So no evidence to support the credit market rationale for use of extraordinary provisions.
- **Conjecture that roll-ups and milestones became part of the status quo pre-Crisis.**
 - **Merely continued through the Crisis.**
- **Ongoing research:**
 - Focus on term loan rollups (working capital rollups may be harmless).