Credit Crisis

Revolver At Their Heads

Liz Moyer, 10.08.08, 6:00 AM ET

It's not just banks hoarding cash these days.

Corporate titans, including those with stellar ratings, are drawing on revolving bank-credit lines to secure rainy day funds until the credit markets calm down.

In recent weeks, Duke Energy, Gannett, FairPoint Communications and General Motors drew existing credit lines in a defensive move. Some, including newspaper publisher Gannett, requested the funds to help cover short-term debt coming due. Others, including Duke and General Motors, took the loans because of uncertainty over the effectiveness of the Treasury Department's $700 billion plan to break the logjam in the credit markets.

Corporate treasurers fear bank credit will dry up if banks continue to be mired in their own financial difficulties. That makes companies more cautious in planning for the near term, with the unhappy consequence of slower growth hitting an already stressed economy.

It also presents a vexing problem for banks. Revolving credit lines are part of a typical financing plan for most banks' corporate customers. But it is expected that the lines, though offered, will not be used, the analogy being that flood insurance is cheaper and more widely available for those who live at the very top of a mountain.

Now bankers are scrambling to limit how much money they will have to lend through these pre-existing credit lines, which they are obligated to do, just as their own balance sheets are stressed by limited ability to borrow from fellow banks.

The trend could also produce future losses for banks. "Higher credit risk borrowers will be the most compelled to draw down on their revolver availability now, versus take the risk the commitments fail to be funded in the future," says Chris Taggert, an analyst at CreditSights. "This could be tantamount to a funding blitzkrieg by high-yield borrowers upon bank lenders."

The stress is so severe that some lenders are trying to exit the exposures. GMAC, the financing affiliate of General Motors, tried to sell a $2.3 billion package of credit lines earlier this month but pulled that auction last week because of market conditions. The bundle of loans, of which $830 million has already been drawn down, included credit lines for Rite Aid, Sears Holdings, Goodyear Tire and AK Steel, among other companies.

"The bid levels were too low and for only a fraction of the portfolio," says Taggert.

Trouble in the short-term lending markets is the culprit. Corporations sell commercial paper, a short-term IOU, to fund day-to-day activities like payroll. But because of the fear in the credit markets, including concern that debts won't be repaid, the commercial paper market has all but frozen. Issuance fell $95 billion for the week through Oct. 1, according to data from the Federal Reserve. That brings the three-week decline to $218 billion.

Last month, AT&T Chairman Randall Stephenson said his company was having difficulty selling anything other than overnight commercial paper, rather than the more typical three-month term. "It's day-to-day right now," he was quoted saying. "I mean literally it's day-to-day in terms of what our access to the capital markets looks like."

The problems aren't limited to public companies. Last week, California Treasurer Bill Lockyer said the state had been locked out of the credit markets for 10 days and might have to ask the federal government for a $7 billion loan to cover its short-term cash needs.

The drop-off can be traced to the mid-September weekend Lehman Brothers collapsed. Lehman was one of the biggest commercial paper dealers, and its collapse sent shock waves through the short-term debt markets, limiting the ability of companies to raise short-term cash.

Even solid borrowers that still are able to sell commercial paper and otherwise raise cash are preparing for the worst. Duke Energy, for one, explained recently it was taking $1 billion from its $3.2 billion credit line "to increase our liquidity and cash position and to bridge our access to the debt capital markets."

General Motors last month said that drawing $3.5 billion off its $4.5 billion secured credit line "improves our liquidity position at a time when the capital markets have become more challenging."

The Federal Reserve and the Treasury has been battling this trend on two fronts. Earlier, the Treasury agreed to insure money market funds, the main buyers of commercial paper, from losses up to $50 billion. The Fed offered to expand its emergency lending program to help commercial banks finance the purchase of asset-backed securities from the funds.

Money funds hold $3.4 trillion of investor money.

Then on Tuesday the Fed said it would create a special entity to buy commercial paper directly from eligible issuers. The program targets commercial paper with three-month terms, favored by corporate treasurers. The credit market issues have forced companies still issuing commercial paper to issue it overnight or in terms shorter than 90 days.

"The Treasury believes this facility is necessary to prevent substantial disruptions to the financial markets and the economy," the Fed said Tuesday. "A large share of outstanding commercial paper is issued or sponsored by financial intermediaries, and their difficulties placing commercial paper have made it more difficult for those intermediaries to play their vital role in meeting the credit needs of businesses and households."

The Fed may really be buying banks time to get their acts together. Buying up commercial paper straight from issuers basically puts the Fed in the commercial lending business.

Tim Ryan, president of the Securities Industry and Financial Markets Association, Wall Street's lobbying group, said Tuesday the program "will help make credit available directly to American businesses so they, in turn, can continue to meet the needs of everyday citizens."