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RESTRUCTURING A LOAN
A Four Step Guide to Success

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The COVID-19 pandemic affects the health of not only the population but businesses as well. Quarantine restrictions have led to production downtime, causing changes in cash inflows. In this situation, access to new funding has become even more difficult.

Debt restructuring can help businesses to fulfill their contractual obligations and continue operations. This booklet provides key recommendations for successful negotiations with the creditor to restructure a loan.

01 STEP

First, review the terms and conditions of your current loan agreement. Specifically:

- Review your obligations under the agreement, especially payment terms and the costs and consequences of late payments.
- Assess realistically the financial capacity of your company to honor the terms of the existing agreement.
- Identify terms of the loan agreement that discuss any additional requirements or fees for changing the terms of the agreement
- Assess your possibilities to provide additional security for the loan (e.g., additional collateral, a guarantee of the owner or other companies).

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Familiarize yourself with the **types of restructuring:**

Loan currency (foreign or domestic). Changing from a foreign currency loan to one denominated in national currency can help avoid currency risks, but loan servicing may become more expensive. Conversely, if a company has foreign currency revenues, a foreign currency loan might significantly reduce the costs under the loan agreement (bear in mind that a foreign currency loan should be taken out if you have foreign currency revenues sufficient to pay off both principal and interest).

Interest rate reduction. Reducing an interest rate will allow you to have additional liquidity. For example, if your company has lost several major regular customers, which resulted in a revenue decrease, but your fixed costs remain unchanged, an interest rate reduction will help increase your liquidity and allow you to settle your obligations in a timely manner.

Loan term extension. Extending the loan for a certain period of time may help you keep going or re-start operations. For example, the major debtor of your company notified you that it would be able to settle its debt 3 to 4 months later than due. Thus, your cash flow does not allow you to make loan payments in a timely manner. A loan term extension will help resume operations, manage your cash flow, service the loan when it falls due and avoid penalties.

Loan refinancing. It is advisable to choose the most convenient and affordable type of loan (e.g., a loan secured by a bank deposit) to resume business.

Debt reduction (such as late payment penalties / fines). This type of restructuring is most often available to companies that have a good long-term relationship with the lender. In order to keep such a customer, the lender may be willing to give up some profits and support the partner in financial difficulty.

Loan repayment holiday, i.e. obtaining temporary relief from the obligation to make loan payments in general, or on payments of principal and/or interest, deferring them to future periods. For example, some of your harvest is destroyed by unfavorable weather or the price for your harvested crop is low but, according to some trusted sources, can significantly go up in a certain period of time. A repayment holiday for this period will solve the settlement issue.

Additional funds provided by the lender to complete/resume a certain project, which will help improve the financial condition

The method of restructuring may depend on the type of loan as well:

Overdraft. Because you have insufficient funds in your current account, t**he limit of available overdraft is either reduced or set to zero**. If debt is overdue, the overdraft may be **refinanced/restructured into a secured time loan**.

Loan secured by a bank deposit. If loan payments are overdue, the bank may debit the deposit account securing the loan in accordance with the contract. However, if the borrower applied to the bank for restructuring before the payments become overdue, **the bank may restructure such type of loan into another type by taking new collateral**.

Time Loan, Investment Loan, Credit Line. For all these types of loans, **any of the above types of restructuring or any combination thereof** can be used, depending on company needs/possibilities.

02 STEP

Forecast the **company's financial capacity:**

Develop a financial plan/forecast of your company that projects cash flows for the period (length of time) you expect problems in business , and for the subsequent recovery.

In the forecast, separately describe the scenario in the event of restructuring. To do this, choose the expected type of restructuring.

The forecast should include detailed information about: the problem that led to the need for restructuring (e.g., production difficulties, market changes, source of sales/revenue, collection of accounts receivable, changes in the product line, etc.) and about costs associated with such solutions (additional jobs, etc.).

03 STEP

If after the first two steps you are convinced that restructuring is a good option for you, then it is time to prepare documents to apply to the lender. Generally, it is necessary to prepare the following package of documents:

- **An application for restructuring** that should include the restructuring proposal and its justification.
- **Financial statements** (balance sheet, income statement) of the borrower and the consolidated statements of the group of companies (if such a group exists) as of the most recent reporting date, with a detailed breakdown of some line items of the financial statements (at the lender's request).
- **Management/consolidated statements.**
- Documents that confirm the borrower's **financial forecasts** regarding debt repayment.
- For an investment project, **changes in the production start-up schedule, changes in the design documentation**, etc.
- **Bank statements from all the servicing banks for the last three months** and information about the existence or absence of overdue debt on loans and the debt servicing.

IT IS IMPORTANT TO UNDERSTAND HOW THE LENDER WILL ASSESS THE POSSIBILITY OF RESTRUCTURING:

A. LOAN SECURITY

1. Collateral appraisal

The lender will assess the current value of existing collateral.

Collateral is appraised according to the bank's internal rules. Banks predominantly rely on reports of independent appraisers accredited by the bank. The appraisal report is valid for a term of 1 to 6 months.

In addition, **the lender can ask for a personal guarantee of business owners**.

In the event that the existing collateral becomes impaired and not adequate to cover the loan, **the lender may require additional collateral**.

The lender generally checks the availability of collateral before deciding on restructuring and prior to signing changes to the loan agreement. Depending on the type of collateral, such checks can be on a quarterly, semi-annual or annual basis.

To document additional collateral, you will need:

- *Documents of title to the collateral*
- *The resolution of an authorized body on pledging collateral as security.*
- *Technical passport and/or other documents in accordance with the lender's list.*

2. Collateral acceptability and adequacy criteria

2.1. 1. Banks are interested in **liquid collateral**. *Liquid collateral is a collateral that is in demand in the market and can be easily sold. All the collateral items must have duly executed documents of title.*

2.2. What types of collateral are generally not acceptable to banks

Computers and office equipment over 3 years old. Cars with significant mileage and that have been in use for over 10 years.

Specialized equipment.

Property located on land owned by someone else or that has utility systems dependent on other owners.

Property without a duly documented plot of land.

Other non-standard types of collateral the list of which may vary from bank to bank.

3. Collateral insurance

In general, collateral should be insured for the entire term of the agreement by an insurance company accredited by the bank and listed on their web site.

** Some collateral agreements require notarization by law or at the request of the lender.*

B. BORROWER BUSINESS REPUTATION ASSESSMENT CRITERIA

The lender will assess the reputation, credit history of you and your company

1. Credit history of the company / its owners

It is recommended to keep a good credit history and pay off the overdue debts under other obligations. The borrower should check the owner's and the company's credit history at several credit history bureaus (this can be done by any individual for a fee or once a year – free of charge); the most active credit history bureaus in Ukraine are: ПВБКІ, УБКІ, МБКІ).

2. Criminal/court cases, facts of dishonest participation in the bidding process, facts of fraud, application of criminal liability, failure to pay taxes

It is advisable to have clean records and not be involved in lots of litigation. Check the Comprehensive State Register of Court Decisions (by the EDRPOU code of the company / group of companies); if there are litigations, explanations regarding their history and prospects should be prepared.

Taxes payable can be checked on the website of the State Tax Service of Ukraine.

3. Distortion of information in financial documents (inconsistencies in the financial statements, discrepancies between breakdowns and official records for which the client cannot give a clear explanation)

Make sure that your financial statements are accurate and verifiable. Statements provided to the lender should be consistent with reports filed with the statistics authorities and/or the tax service. Breakdowns of line items in the financial statements should be consistent with the final data in the reports.

C. FINANCIAL CAPACITY ASSESSMENT CRITERIA

1. Requested restructuring terms should be consistent with the forecast sales volume

Lenders are generally willing to make changes to the agreement for the purpose of restructuring if it is justified and there is no other way to pay off the loan in a timely manner. It is important to channel some forecast revenue not only into current operations but to pay off debts as well.

2. Loan debt burden of the company: the operating income + depreciation (ebitda) to total debt (with guarantees and letters of credit received) ratio

Most lenders will allow this ratio to be no more than 4. This means that the operating income generated by the company can be used to pay off all its debts within 4 years. It should be noted that this indicator can be higher for some companies if itsr loan portfolio consists of long-term (over 3 years) loans.

3. Adequate business capitalization

The equity to total assets ratio shows the resilience of the company, its ability to withstand adverse unforeseen conditions in business. A company is considered adequately capitalized if its equity level is over 20%. But there are certain exceptions – e.g., for trading companies, this number can be lower, given the specific nature of their business.

04

STEP

FINAL STEP

1. Read the entire agreement on making changes (on restructuring) before signing, as well as all the documents referred to in the agreement.
2. Before signing the changes to the loan agreement, check the following terms and conditions:
   - A new loan term.
   - A new repayment schedule.
   - A new interest rate and conditions of reviewing it.
   - Fees for the revision of terms and use of the loan.
   - Rights and obligations of the parties. Pay attention to the borrower's obligations (reporting requirements and other obligations) and liability in the event of a delay in payments.

Restructuring is a temporary solution for short-term financial problems to ensure business rehabilitation in the long term.

This information is not intended as specific legal or financial advice. Any company or individual considering restructuring a loan should decide whether to seek professional assistance. This publication was prepared with the support of the American people provided through the United States Agency for International Development (USAID). The content is the sole responsibility of the Financial Sector Transformation Project implemented by DAI Global, LLC. The views expressed in this publication do not necessarily reflect those of the USAID or the U.S. Government.