



Fiscal First Aid Quick Reference

Restructuring Debt

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Introduction

Debt restructuring is the process of reducing, renegotiating, or reworking debt with the goal of improving or restoring liquidity and rehabilitating the government so it can continue in the long term. Debt restructuring, which can be a critical step in creating breathing room in the near term, can include lower interest rates and changes in payment schedules, which may include stretching out the term of a loan or modifying the terms of the loan, which may include adding a period of interest-only payments, flexible payments, and partial loan forgiveness, or taking new money out from the loan.

Debt restructuring does not take place in a vacuum. Often, other fiscal first aid tactics are required in conjunction with the restructuring for it to work. These other tactics can include ways to enhance revenues, reduce expenses, prioritize capital projects, and make the debt load manageable. Depending on the tactic, it might precede, follow, or be implemented along with a debt restructuring. At the same time, restructuring debt allows for interim budgetary relief to allow time for cost-saving initiatives to be implemented and the full savings value of the initiatives to be realized.

Restructuring debt is another form of deficit borrowing. This is generally frowned on, but it can be acceptable when implemented as part of a comprehensive recovery strategy as a measure, as a way of buying time to allow recurring cost savings initiatives and revenue initiatives to be implemented.

Restructuring debt can be a critical part of emerging from fiscal distress, but during periods of general economic malaise or when a government is in dire straits, the opportunities available for taking advantage of debt restructuring may be limited. When a government finds itself in fiscal distress, lower interest rates might not be a practical option. Stretching out repayment terms might come at a disadvantageous interest cost. An ill-considered debt restructuring may prove very costly in terms of interest rate cost, onerous up-front issuance costs, and other costs.

When considering debt restructuring, governments should be aware of creating inter-generational inequity problems by stretching debt out past the life of the asset it funds. Also, governments should keep in mind the operating impacts of debt restructuring on future budgets, especially when evaluating more creative structures such as interest-only, flexible payments, and other shifts in payments over time. Back loading a debt issue with higher principal payments can be hazardous to the condition of the budget in future years.



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Key Points to Consider

- **Review and update debt policy.** Governments considering a debt restructuring should review their debt policy to confirm that the strategy won't put you in violation of debt limits.
- **Evaluate proportion of the budget devoted to debt service payment.** See how a restructuring would change that proportion over time and how that compares to your debt policy.
- **Consider the length of the extension.** Be cautious about extending the obligation past the useful life of the asset being financed and about creating an unmanageable repayment burden in later years.
- **Get the rating agency involved.** Keep the rating agencies apprised of your strategy, including how the restructuring will buy time to pursue other strategies to improve financial position.

Example from the City of Danville, Virginia

The City of Danville, Virginia, restructured its debt. Over the course of the repayment extension, the city was able to forge inter-government alliances to develop the local economy and create new sources of revenue, and it was able to contain its expenses without resorting to lay-offs. No interest rate savings were realized; instead, the city ultimately paid more in interest on the debt. However, by modifying its payment terms, stretching out its debt, and combining its restructuring with other retrenchment tactics (like a wage and hiring freeze), the city was able to relieve its budgetary discomfort.