Market Intersection:

A Quarterly Look at the U.S. Credit Markets

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US syndicated lending reached US$2.9trn record in 2021

Ioana Barza

US syndicated lending reached a US$2.9trn record in 2021, nearly doubling 2020's activity levels and surpassing 2018's US$2.6trn high.

"I was surprised there was not more volatility in the loan market given all the noise but that is because at the end of the day default rates remained very low, lower than anyone predicted they would be, and credit is key; everything else is less important," said one underwriter.

In addition to rapid growth, the market continued to undergo big changes.

"2020 was going to be the year for sustainability-linked facilities and it didn't happen because borrowers were focused on liquidity and not anything else," said a second underwriter.

In 2021, US ESG loan volume jumped to US$237.8bn, from 2020's US$18.4bn and 2019's US$15bn.

US new money lending reached US$1.1trn in 2021 and included US$619bn in M&A-related financings, which ranked second only behind 2018's US$648bn.

"Going into year-end, we thought we would see more issuance to lock in Libor but we started to see a steady drumbeat of SOFR so that didn't seem to come to fruition as we thought it might," said one investment grade underwriter. "2022 will be all SOFR: does the market figure out what the right convention should be when pricing these loans?"

2017's US$1.69trn record was surpassed in leveraged finance, which also reached a record US$1.77trn in combined leveraged loans and high yield bond issuance in 2021. High yield bond issuance made up US$463bn which beat 2020's prior record by 14%. Leveraged loan issuance reached US$1.3trn, nearing 2017's US$1.4trn record.

Leveraged pro rata lending reached a record US$537bn, surpassing 2018's US$514bn record. Institutional loan issuance, at US$769bn, nearly doubled 2020's levels and ranked second only to 2017's US$919bn record.

"These trends from 2021 are likely to continue: Strong CLO formation and inflows to retail (loan funds)," said one asset manager. "It feels like the (visible) demand side as well as Separate Managed Account (SMA) and other money is looking for 4%-plus return. All the demand factors will be in place and supply will come to meet it."

New issue CLOs surpassed US$182bn, far outpacing 2014's US$125bn record in addition to CLOs refinancing at record pace. In an expected rising rate environment, the CLO investor base will continue to diversify and, with large players in the market, triple-A spreads are expected to tighten.

"It feels like it was a banner year in the sense that it was a banner year yet we still saw 4.5% returns to the investor in the (loan) asset class," said one leveraged bank underwriter. "A banner year often is just a lot more unbalanced to the issuer side, meaning more repricings. But this year, we saw a good balance across all kinds of uses (of proceeds) which is a little unusual."

LBO-related loan financings jumped to US$196bn in 2021, approaching 2007's US$206bn record. Direct lenders also increased market share by providing mega unitranches in the broadly syndicated market.

"The market is growing enough and default cycles are benign enough where the syndicated market and direct lending market can co-exist without pain right now," said one leveraged underwriter. "If either variable changes – growth slows down or the credit cycle gets more negative – the two markets would be more in conflict. But I don't see why the private debt market would shrink. All sponsor firms and traditional asset managers are dipping their toes further into that space."

Another added, "There is no magic bullet that anybody has to fight this disintermediation or offset it because every investor is getting involved especially as yields in traditional places investors go from public equities to investment grade debt are so compressed."

However, loan yields could come down as well given a manageable forward calendar.

"This means we will see opportunistic issuance, refis, repricings or dividend deals," said one underwriter. "I have to believe throughout the year, with all the dry powder in PE hands, we will see more LBO activity announced. I don't know if it will hit a record, or if we see a couple of mega deals, but I feel confident we will have a steady diet of US$3bn to US$5bn enterprise value LBOs."

Fig. 1 Institutional loan issuance

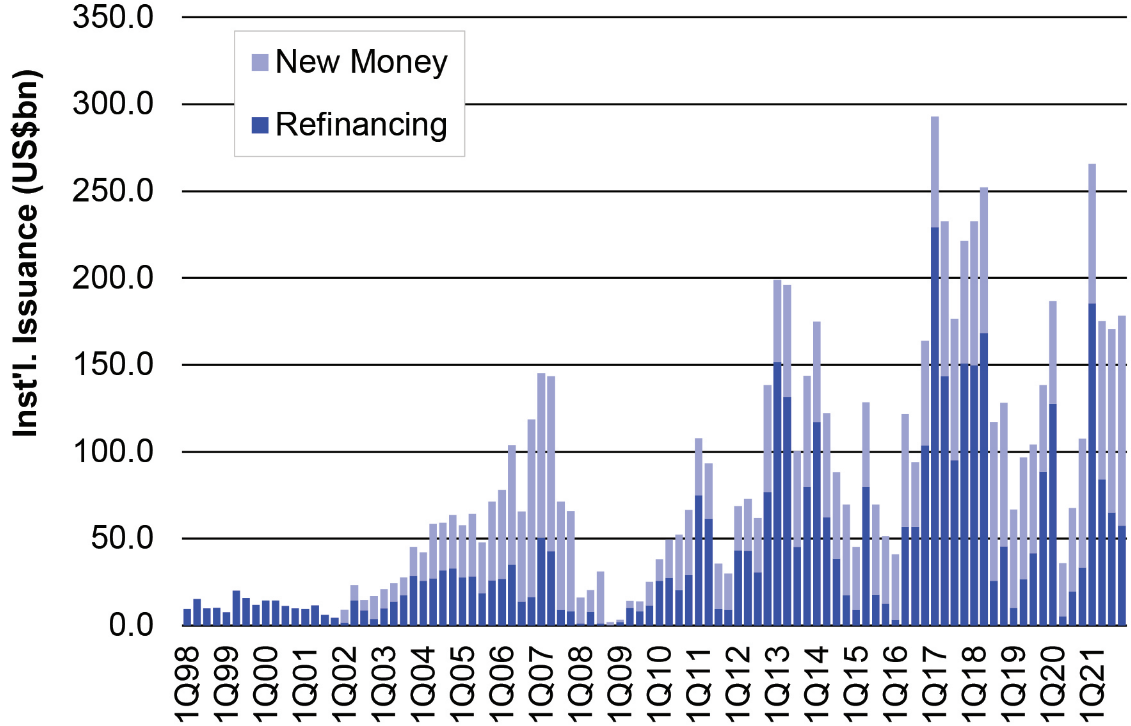
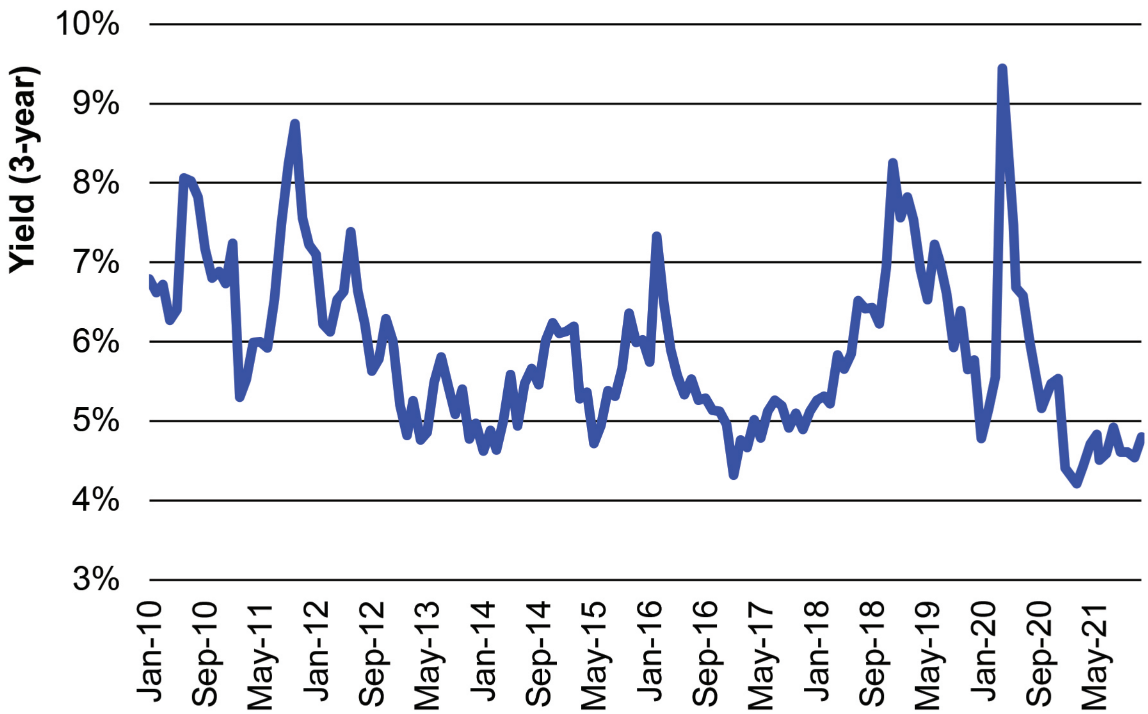


Fig. 2 Primary market yields stayed steady in the 4.5% range



Source: Refinitiv LPC

Middle market lending soars in 2021

Diana Diquez

The middle market staged a comeback in 2021 with syndicated loan volume reaching its third highest annual level on record at US$188bn. This was 86% above 2020's US$101bn and easily surpassed pre-pandemic issuance of US$144bn in 2019.

The year began at a slow pace but then picked up in the second quarter and there was no pause through year-end.

Syndicated middle market loan issuance topped US$50bn for three quarters in a row, a feat not accomplished since 2013, the year that holds the record high. By the fourth quarter, some lenders took a step back and were not pursuing new opportunities as they had already deployed enough capital through the first nine months of the year. For the first time in a long time, the supply of loans outstripped demand and lenders were able to be more selective. Some lenders said that they had to pass on some opportunities as their capacity was restricted.

A whopping 79% of lenders that responded to Refinitiv LPCs Quarterly Survey said they were able to lend as much as they wanted to in 4Q21. And for the year, most lenders said that they met or exceeded their budgets as there was plenty of new money deals in the market. While overall volume was below prior highs, new money syndicated lending broke the record that was set prior to the great financial crisis in 2007 with volume of US$108bn in 2021. This was more than double 2020's numbers and represented 58% of total middle market lending. Despite the healthy level of activity, competition was intense throughout the year and terms loosened and pricing tightened.

The role of direct lenders continued to expand in the middle market as record amounts of money flowed into the asset class.

Middle market fundraising crashed 2020's record, soaring to US$180bn in 2021. With so much money coming into the asset class, the role of direct lenders transcended the middle market as evidenced by the many plus US$1bn unitranches that were executed in 2021. Unitranche volume skyrocketed, setting new highs US$65bn in the middle market and US$86bn in the large corporate market.

While direct lenders continued to take away market share from the syndicated market, middle market syndicated sponsored lending also recovered from 2020's depressed level. At US$65bn, syndicated sponsored lending almost doubled 2020's volume and was up 16% from 2019's total. Moreover, 78% of syndicated sponsored lending or US$50bn came from new money issuance. Private equity sponsors had a lot of money to put to work and LBO and portfolio add-on acquisition activity was very robust. While the majority was financed in the direct lending market, US$19bn of LBO and US$17bn of sponsored add-on acquisitions made it through the syndicated loan market in 2021.

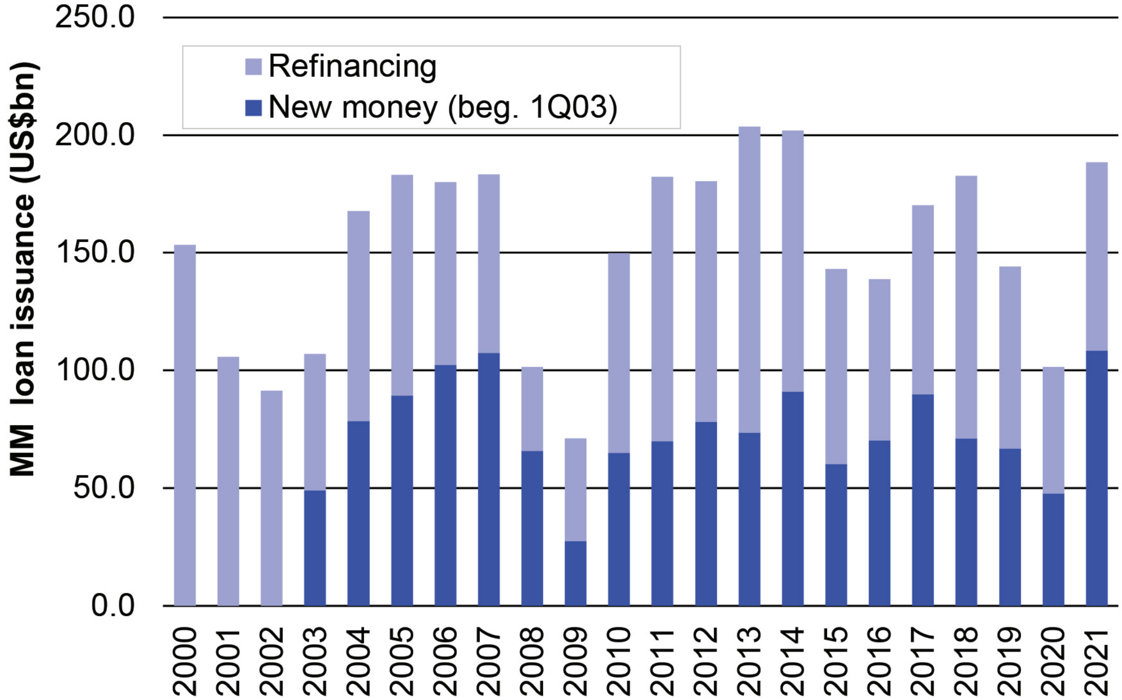
"The market is as aggressive as ever, even us regulated folks are getting comfortable with loan to value ratios, if a sponsor is putting 7 times, on a 12 times deal, we get comfortable, but the reality is that we are still at a very high 5 times leverage," said one banker.

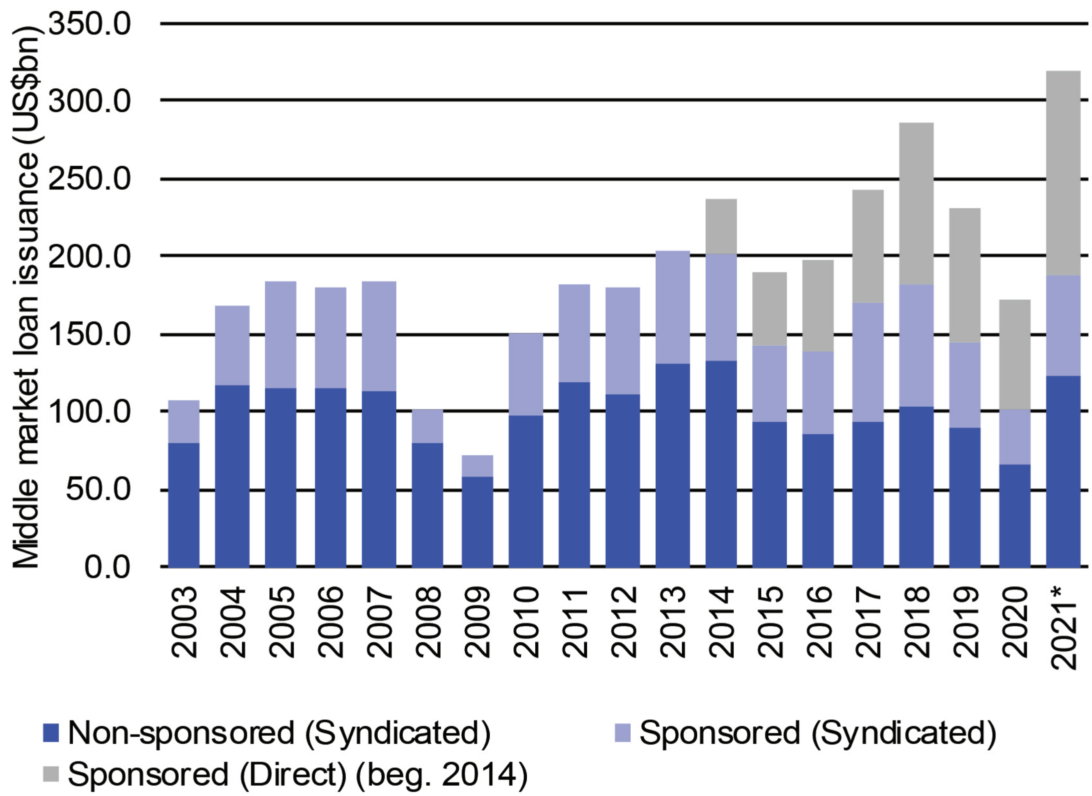
Non-sponsored syndicated loan volume surged to its highest level since 2014 at US$124bn. While overall volume was shy of the prior record, new money lending exploded to US$58bn, a new high in this market.

Despite intense competition from sponsors, high valuations and cautious business owners, M&A activity in the non-sponsored market recorded a 14 year-high of US$14bn.

Looking ahead into 2022, many middle market lenders said that they expect strong M&A activity to continue, however, some see activity tempering as volatility returns because of the effects of inflation, labor shortages and supply chain disruptions, among other variables.

Syndicated middle market new money lending sets a record in 2021





Source: Refinitiv LPC

The Legal Corner by Paul Hastings

The private credit market wrapped up a frenetic 2021 with a dazzling array of record-breaking numbers. Now that a year defined by its feverish demand for capital deployment is in the rearview mirror, it can be productive to pause and take stock of some key factors that will define 2022.

Inflation and Rising Rates

Broad market expectation is that interest rates will rise as early as March 2022. Projections of a rise in interest rates coupled with persistent inflation across the global community have put the spotlight back on the market effects of macroeconomic conditions. We will likely see a shift in the sectors that outperform in 2022, with the leaders turning away from industries that traditionally excel in a fast-growing economy. As portfolio investments are revisited throughout the year, it may be worthwhile to review the financial covenants and reporting requirements in light of the sector's projected ability to perform if inflation were not to moderate.

Retirement of LIBOR

Upon LIBOR's effective retirement at the end of 2021, a new level of uncertainty has crept into deal making. Amidst the backdrop of general unease with rising interest rates, dealmakers find themselves adapting to SOFR terms in deals accustomed to LIBOR conventions. While it has not hampered deal flow or affected pricing, there is general uncertainty around how to reconcile a potentially volatile prime rate with the phase-out of LIBOR and an unsettled market standard on SOFR spread adjustments. Clarity will require testing SOFR against a volatile interest rate environment as we move further ahead into 2022.

Bottomless Barrel of Dry Powder

Notwithstanding the global macroeconomic conditions, there is still a seemingly bottomless barrel of dry powder in the private credit market. The ongoing need to deploy capital will not be stifled merely by rising rates or uncertainty, and this year promises ongoing steady deal flow. Sectors that historically have survived market volatility and companies with strong financials will likely be particularly attractive this year. With potentially volatile market conditions on the horizon, it is even more vital for lenders to focus on financial covenants, negative covenants and events of default in financing transactions. While the last several years have seen a rise in borrower flexibility and the erosion of stringent covenant terms, lender protections will become important once again to ensure early intervention in risky credits.

At this time, early in 2022, looking into the future is no clearer than looking into a crystal ball. High capital deployment demands will likely drive the market for several months to come, continuing the familiar theme of tolerating and adapting to uncertainty as needed, the same theme that has driven the private credit market to record-breaking highs in recent quarters and ensuring that 2022 will be another year of market defying growth.

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About Refinitiv LPC

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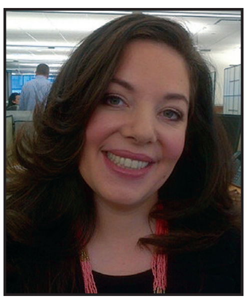

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