Market Intersection:

A Quarterly Look at the U.S. Credit Markets

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US syndicated lending fell to US$1.5trn in 2020, a 10-year low

Ioana Barza

While high yield and corporate bond issuance reached record levels, US syndicated lending activity shrank by one third in 2020 to US$1.5trn, leaving lenders primed for a dramatic pick-up in 2021. US leveraged lending was down 12% year over year, falling to an eight-year low of US$711bn, while high yield bond issuance was up 50% to US$400bn.

“The Fed took months to do in 2008-2009 what it did in a matter of weeks in 2020 and the market took comfort in that, believing that although this is really bad, it’s not permanent and there will be a solution by way of vaccine,” said one leveraged underwriter. “This was the hope at the beginning and has come to fruition. We saw a massive rally and rates that are unbelievable by historical standards. It was a Fed induced technical creating a wave of cash looking for spread assets that benefits high yield and will keep benefiting the high yield market.”

“The loan market traded down precipitously and it was heightened by the CLO buyer which went into hibernation,” said one arranger. “We always knew the loan market was very dependent on the CLO buyer base, which was dependent on the triple-A buyer base. Initially in the pandemic, spreads gapped out, it was hard to finance CLOs, a lot that had been issued went into static mode and were unable to buy new issues so the loan market had its own set of problems.” A jump in secured high yield bond issuance bought some time for the loan market to repair itself as investors built up cash given a lack of new issue or a major overhang to work through. The pause on new issue helped boost the secondary market. Lenders across the spectrum said they were way off on their recovery expectations with the secondary rallying faster and stronger and defaults lower than projected given the ongoing challenges around the spread of Covid. Similarly, the fourth quarter defied expectations with a broader pick-up in new activity and issuer-friendly terms supported by confidence that there is enough liquidity given pent-up investor demand, year-end budget goals, and the emergence of a vaccine. In fact, of the 36 deals with structural and/or price flexes tracked by Refinitiv LPC in December, 35 were issuer friendly. By the end of 2020, lenders concluded that access to affordable capital was prevalent across the spectrum. Institutional loan issuance was down 3% to US$387bn while leveraged pro rata lending saw a 20% drop to US$324bn. “Issuers teetering on the edge did what they had to do in order to shore themselves up,” said a lender. “Now we all take a breath and hope they survive. The expectations we all had at the end of 1Q and beginning of 2Q were very dire, given the amendment cycle we all went through, how much cushion we filled in.” Looking ahead, US M&A-related lending jumped to US$85bn in the fourth quarter, the highest since 3Q19’s US$120bn. This pick-up is expected to continue. M&A will really take off in 2021,” said one leveraged underwriter. “We are not alone in that; this is very much a market consensus view.”

Fig. 1 Institutional loan issuance

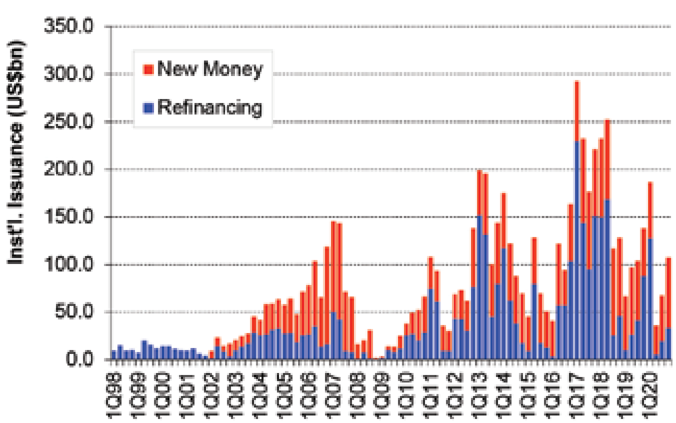
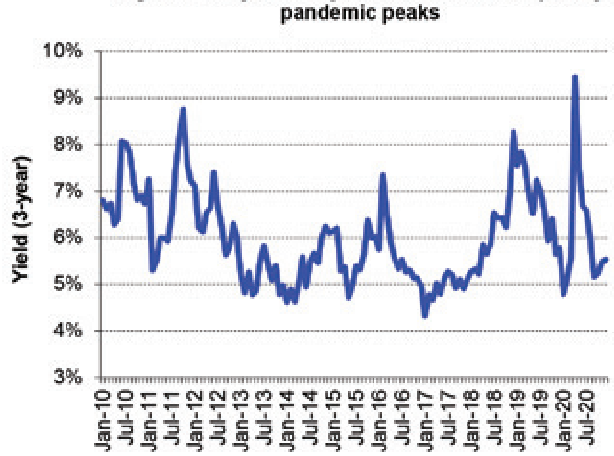


Fig. 2 Primary market yields recover from Apr/May pandemic peaks



Source: Refinitiv LPC

Middle market syndicated lending at 11 year low

Diana Diquez

The middle market ended 2020 on a high note with lending snapping back to log its highest quarterly level of the year in 4Q20. Middle market syndicated volume soared 75% quarter-over-quarter to US$33.7bn in 4Q20. But the effects of the pandemic left a toll on the numbers and at US$101.5bn, syndicated middle market lending was at an 11-year low. Many respondents to Refinitiv LPC's middle market investor survey said the resiliency of the loan market was one of the biggest takeaways of a very challenging year, and the middle market was no exception. While syndicated middle market lending collapsed in 2Q20 and remained at low levels in 3Q20, it soared back to life in 4Q20; a much faster recovery than in the financial crisis. Most surprisingly, new money lending in 4Q20 of US$18bn overtook refinancings, providing opportunities for lenders that were eager to put money back to work after having focused mostly inward in the prior two quarters. But the increase in dealflow did not meet pent up demand and lenders said that competition was back, and aggressiveness was one of the key themes across both the sponsored and non-sponsored markets in 4Q20. However, while many lenders said that portfolios have performed better than expected at the height of the crisis, and the vaccine has brought optimism, many sectors might be permanently affected. In the non-sponsored middle market, syndicated loan volume bounced back to total US$19.7bn in 4Q20, the highest quarterly level since 4Q19. In the last couple of years, the non-sponsored middle market had been chugging along, as corporate issuers were cautious about undertaking any expansion plans. However, in the months leading to the pandemic, bankers that focused in the space had seen their pipelines building, but then COVID-19 hit, and issuers retrenched. New money lending reached its highest level since 2Q19 at US$8bn, but only US$1.7bn of this total backed M&A activity; an improvement to dire levels in the prior two quarters but still at low levels.

Despite higher volumes, the market snapped back to the same pre-COVID dynamic, too much liquidity and limited opportunities especially on the M&A front. In turn, competition was back and terms loosened once again. Libor floors, which made a comeback as an already contracting Libor fell precipitously when the pandemic hit, were fewer and far between in the last quarter. Heading into 1Q21, only 11% of bank respondents to Refinitiv LPC's quarterly survey said they are requiring 1% floors on non-sponsored deals; 6 months earlier, 64% were asking for 1% floors. Moreover, more than half of banks' minimum spread requirement for non-sponsored loans was in the 100-175bp range heading into 1Q21. Six months before, only 25% would lend at that range, with the majority of bankers requiring spreads above 200bp at that range.

In the sponsored market, a spike in lending also took place in 4Q20. Middle market sponsored syndicated loan volume of US$14bn in 4Q20 almost doubled the US$7.2bn logged in 3Q20 and was at its highest quarterly level since 3Q19. Despite the year-end boost, syndicated lending of US$36bn for the year was at its lowest since 2009. After two depressed quarters, syndicated LBOs make a comeback in 4Q20.

Syndicated LBO issuance of US$4.6bn, while lower than 1Q20s levels, more than doubled 3Q20's US$2.2bn. Lenders said that December was particularly busy compared to prior years, "there was a lot of auction activity in 4Q20 and everyone was racing to get deals done by year-end," said one lender. The direct lending market faced its first real big test in 2020, and for the most part, proved its resiliency. Direct lending fundraising topped US$107bn in 2020, surpassing 2018's robust levels. 62% of the total took place in the second half of 2020. Looking at the year ahead, lenders are optimistic about the vaccine and expect 2021 to be a year of growth and a lot more M&A activity. But there are also concerns that the market might be getting ahead of itself and terms will get too aggressive, with still a long and uncertain road to recovery.

Fig. 3: Middle market syndicated volume jumped in 4Q20 to US$33.7bn

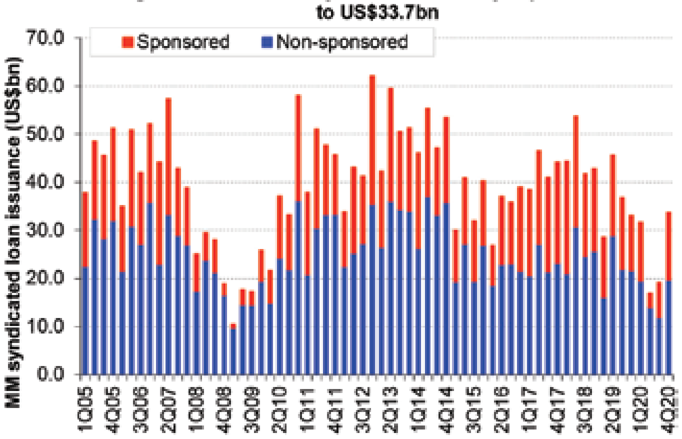
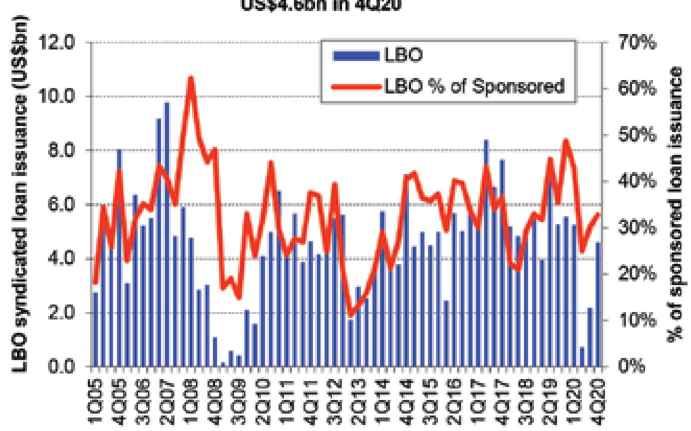


Fig. 4: LBO activity picked up meaningfully, totaling US$4.6bn in 4Q20



Source: Refinitiv LPC

The Legal Corner by Paul Hastings

The credit markets experienced a flurry of activity in the fourth quarter of 2020 amidst a low interest rate environment, the likelihood of further government stimulus under the new administration, the promise of widespread vaccination, and optimism for a large-scale economic rebound. While borrowers and lenders focused their energy and capital in the second and third quarters on the stabilization of investments in their existing portfolios and shied away from new platform acquisition financing, pent-up demand led to a robust financing environment in the fourth quarter. Large pools of untapped capital, both at banks and private credit lenders, resulted in fierce competition to finance the most attractive credits and industries (e.g. technology and life sciences). Notwithstanding the ongoing economic uncertainty, recent vintage loan documentation is notable for borrower-favorable terms that remain consistent with pre-pandemic market conditions, including with respect to EBITDA adjustments and negative covenant flexibility.

Market participants have addressed head-on potential COVID-related ambiguities in loan documentation, such as carve-outs to “Material Adverse Effect” definitions, providing specificity around EBITDA addbacks for lost profits, and clarifying the financial impact of PPP loan forgiveness. Recent liability management transactions in financings for sponsor-backed companies such as Serta, Boardriders and TriMark, has renewed sensitivity from lenders around debt-layering, covenant stripping, and the transfer of assets into unrestricted subsidiary structures.

Although the momentum of a strong M&A pipeline and resilient investor demand for yield has carried into 2021, there are still substantial challenges ahead given the uncertain duration of the pandemic and ongoing restrictions on businesses. Restructuring professionals are active and lenders continue to closely monitor the liquidity of their borrowers. Many industries remain under stress and financial covenant holidays provided in the early stages of the pandemic will result in many borrowers seeking another round of covenant amendments in the coming quarters. It remains to be seen whether lenders who agreed to “kick the can” in hope of a gradual and steady recovery will continue to demonstrate patience with their borrowers and whether equity holders will continue to finance the most troubled companies.

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A leading global law firm, Paul Hastings provides innovative legal solutions to many of the world's top financial institutions and Fortune 500 companies in markets across the United States, Europe, Asia, and Latin America. Our leading Finance practice supports clients with a deep global bench of legal experts to address various financing challenges with strategic thinking and flawless execution. We work with clients in every key financial center on an exceptional array of both domestic and international finance matters. Our lawyers represent financial institutions and servicers as lenders, and public and private companies as borrowers, in working capital and acquisition financings across a broad range of business sectors and industries. We also have particular experience in guiding clients through complex restructurings and turnarounds and are recognized market authorities on intercreditor arrangements across all lending structures.

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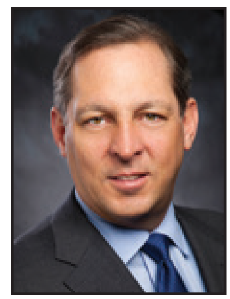

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About Refinitiv LPC

Refinitiv LPC is the premier global provider of information on the syndicated loan and high yield bond markets. Our first-to-the-market news, comprehensive real-time and historic data helps industry players stay informed about market trends and facilitate trading and investment decisions.

From offices in New York, London, Hong Kong, Sydney and Tokyo we are the one source for comprehensive coverage of the syndicated loan markets worldwide.

Our publications, online news, analysis, valuation services and interactive databases are used every day by banks, asset managers, law firms, regulators, corporations and others to drive valuation, syndication, trading, and research and portfolio management activities.

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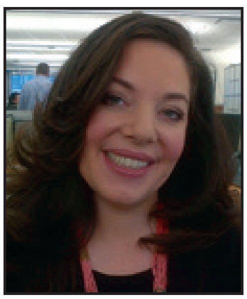

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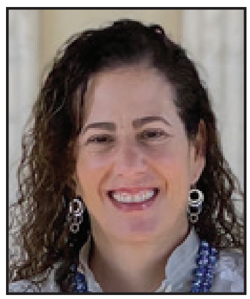

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