Syndications Update[1]

By Kayla Culver, Isabella Shaw and Ellen G. McGinnis

The focus of this panel was the current state of the syndication market for subscription line facilities and anticipated trends for the coming year. What follows is a high-level summary of some key points discussed by the panelists.

2022 Recap

2022 proved to be a dynamic year for syndications across the fund finance market, with record deal volume and increased deal sizes. Many deals were oversubscribed as a number of new participants entered the fund finance space. In the first half of the year, pricing remained relatively stable.

However, the second half of the year brought more instability due to a number of externalities – the global economy, the war in Ukraine, fears of a recession, revisions to capital requirements, the strength of the US Dollar (making it more expensive for non-US banks to lend in Dollars), and inflation and rising interest rates.

Factors specific to the fund finance market also had an impact in the second half of 2022. Longer deal tenors for facilities closed in prior years had a compounding effect - in 2022 many lenders had significant capital allocated to older facilities, which contributed to the capital constraint and supply side issues experienced by several lenders. Additionally, the robust market in the first half of the year meant lenders reached capital allocations earlier in 2022 than in prior years. To navigate these allocation issues, the second half of the year saw new trends arise such as shorter deal tenors (typically limited to one year), higher pricing, and smaller lender commitments. Several panelists noted that it is also taking longer to close facilities. All of these factors have led to a strong focus on relationship lending over opportunistic book-building.

As many lenders are unwilling or unable to take the sole underwriting risk for the large facility sizes being requested, syndication remains a strong focus in the industry. However, the turbulent conditions in 2022 spurred lenders and sponsors to search for creative solutions during the syndication process. Bridge structures and temporary increase provisions have been used to meet funding needs while agenting lenders seek syndicate partners. These types of structures will often come with increased pricing as well as automatic reductions if not syndicated within a set period of time. New lenders have also entered the space – smaller banks and non-bank lenders who might previously have been overlooked for syndicate groups have been increasingly able to participate.

Looking Ahead to 2023

The consensus was that the syndication market will likely remain "choppy" in 2023. Panelists expect funds to continue to see longer fundraising timelines and a slower pace of fund investments, which may lead to delays in closing and syndicating transactions as well as challenges in attracting syndicate lenders. Additionally, with lender balance sheet constraints, it is taking longer to find lenders to participate in a syndicate group. Panelists noted

[1] Panelists include Nancy Becker (Managing Director and Head of Loan Syndications for the Fund Finance Group at Wells Fargo), Dipti Goel (Managing Director within Loan Syndications at City National Bank), Stanley Likver (Principal Global Solutions Group at Ares Management), Cecilia Luk (Head of Fund Finance Syndication at Sumitomo Mitsui Trust Bank), and Tom Nowak (Managing Director - Syndicated Finance Group at BofA Securities, Inc.). The panel was moderated by Shana Ramirez (Partner at Katten Muchin Rosenman LLP).

that despite increasing fund sizes, they expect deal sizes to remain fairly constant as lenders may not have sufficient capital to offer larger funding commitments.

Shorter tenors are also anticipated to remain for the time being. Longer deals are harder and more expensive for banks to offer, so sponsors need to be mindful of their true financing needs. Three- or four-year facilities may be available with the right group of lenders, but they will be expensive and harder to arrange.

Lenders will also have to continue making the case internally for capital deployment to subscription lines and chosen sponsors. Therefore, relationship development remains extremely important for sponsors. If participation in a facility is unlikely to yield more business for a syndicate lender, that lender may be less willing to extend or increase their commitment, especially if facility usage is low. Exiting a facility frees up capital for other opportunities, so staying in a deal needs to provide sufficient value to syndicate lenders.

Additional Lender Considerations When Determining Whether to Join a Syndicate

Pricing and utilization remain key considerations when evaluating new transactions, but syndicate lenders will also focus on other factors such as the investor pool, proposed advance rates, AUM (assets under management) and other indicators of fund financial health, and opportunities for ancillary banking products (including asset-level loans and deposit accounts).

While sponsors and agents are interested in partnering with lenders that are new to the fund finance space, new participants often present an intensive undertaking for syndication desks. New entrants require significant education on the product and the diligence and documentation process. Additionally, new entrants are typically only comfortable with smaller commitment amounts initially. Ultimately, sponsors and agents are focused on relationships and in finding lending partners who are committed to the relationship for the long term.

Key Takeaways for Syndicating Deals

With the above factors in mind, it is essential that sponsors focus on what they really need in terms of facility size and tenor. A smaller, highly-utilized line with a one-year tenor will be easier to sell to lenders as it will take up less capital and present less risk on rate movements given the shorter maturity. Sponsors should take the time to assess their financing needs and how they intend to use the facility early on so they can be best positioned to attract desired lenders.

Panelists also noted that the days of sponsors sitting back and waiting for the agent to syndicate the deal are over – it is vital for sponsors to have good relationships with banks and have a good understanding of what syndicate lenders need and expect. Additionally, sponsors should be aware that as supply tightens, lenders may start to roll back some of the more borrower friendly provisions from the past few years. These include provisions such as alternative currencies, multiple jurisdictions and complex structures, and large letter of credit sublimits. Over-negotiated documents that are very borrower-friendly may impair or delay syndication, as lenders are being more selective in which deals to join. A credit agreement that is more in line with market terms will be easier to syndicate and lenders may be more willing to provide larger commitments.

Sponsors should also be prepared for larger syndicates with smaller commitment sizes. A large syndicate has benefits and drawbacks – though harder to manage from an agent and fund perspective, it is also easier to replace capital if a lender departs.

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Perhaps the most important takeaway is that sponsors should start the syndication process early. Finding the right lenders will take time; bank committees are more involved than they were previously, and the syndication process is taking longer. This is particularly important if syndicate lenders are new entrants into the space. New subscription lenders will typically take longer to complete their review processes and their policies may change regularly. While new market entrants present great opportunity for syndicate growth it will come with some growing pains.

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