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Refi Madness

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If sheer volume means anything, total syndicated loan activity in the US for the first half of the year was singular. According to Thomson Reuters LPC, more than $1.2 trillion of paper – both investment and non-investment grade – was distributed through June 30. That was a bigger number than any other half-year on record.

Digging into the data, however, indicated that (as usual) quality didn't necessarily follow quantity. Indeed, almost 75% of transactions involved recycled money. Loans related to M&A deals for the first half amounted to $196 billion, the *lowest* such figure in four years.

At a glance, leveraged loans also came on strong. So far this year, more than $730 billion hit the market, also a half-time record. But again, more than 70% came from existing lenders for either refinancings or repricings.

In the middle market a similar story emerges. First half volume for all middle market loans was a hair under $79 billion. Because of their less liquid nature, repricings tend to be less frequent for smaller deals (less than 50% of deal flow) than for large institutional credits. Still, the lack of new money opportunities hurt.

The urge to reduce borrowing costs is as natural to issuers as sand to bathing suits. What's adding insult to injury is what else borrowers are looking for besides lower spreads. In particular, sponsors want to loosen covenants, or dispense with them altogether. They are also raising debt baskets and altering asset sales requirements.

From the investor's perspective, lowering overall spreads typically doesn't elicit allergic reactions. It is, after all, part of the game. When the market swings to the sell-side, companies take advantage if they can. When conditions revert in favor of lenders, they will extract whatever they can to push pricing back to more salutary levels.

It's been almost two years since any significant correction. There is a growing sense among lenders that market technicals – low interest and default rates with a reasonable economy – will keep things issuer-friendly as far as the eye can see. The longer this period of effervescence, the more widespread sell-side changes will be.

As we've noted previously, middle market yields have generally remained range-bound over the past four years. What has shifted is the degree of leverage borrowers are achieving for a given all-in spread.

Issuers have extracted more debt/ebitda over the past consecutive quarters. As our *Chart of the Week* highlights, leverage hasn't quite reached the lofty levels seen in the second half of 2015. But unlike that period, over the past eighteen months lenders are going deeper in the capital structure and doing so at increasingly cheaper costs.

Where will this end? Impossible to tell. What experienced direct lenders tell us is they are willing to go along with "deeper and cheaper" for the better credits. "If you want to be in the loan business," one top manager told us, "you just have to do some of this stuff."