How Big is the Middle Market? (Second of a Series)

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To get a better handle on the total universe of middle market loans, let's define what we mean by the middle market.

Should we include, for example, both non-sponsored as well as sponsored loan volume? Thomson Reuters LPC estimates there's been an average of $100 billion in annual non-sponsored activity since 2000. But these financings tend to be working capital driven with more than 70% comprised of revolving credit capacity. That results in the relatively modest $30 billion of yearly funded debt.

Also, many non-sponsored loans fall under the heading of C&I loans by commercial banks. To accurately assess the extent of these holdings would involve reviewing things like Shared National Credit reports – an effort beyond the scope of this exercise. For simplicity's sake, let's confine our study to PE-backed leveraged loans.

As our *Chart of the Week* shows, annual sponsored volume according to LPC generally hovers around the $100 billlion mark, though now at a $140 billion pace for 2017. This includes both syndicated ("league table credit") and clubbed/sole lender transactions from arrangers who report to LPC's Private Deal Analysis survey.

One way to guesstimate total middle market outstandings is to multiply the average sponsored issuance by the average life of these middle market loans. As with last week's installment, we recruited LPC's middle market data guru, Fran Beyers, to walk us through some numbers.

"You can look at the average four years of sponsored activity, annualizing for the first half of this year," Fran told us. "That gives you $113 billion. It's reasonable to think we aren't capturing every deal being done out there, so let's also assume we're missing 25% of volume. That brings you up to $141 billion."

What kind of average life do you assume for middle market loans? "Cliffwater Research recently put out an excellent study [link] that reports a 2.91 year life for their direct loan index," Fran said. "That's close to the experience of most lenders.

"So if you multiply $141 billion by 2.91, that totals $410 billion," she concluded. "If your average life pushes out to four years, that number is higher. You also need to account for run-off and refinancings, which vary depending on spreads and market conditions."

How should we think about the levels of refis versus new money in deals today? "You can use 75% as a gauge for middle market sponsored new money," Fran said. "For syndicated deals that percent is 70%, and for the private/club market it's closer to 80%. So if you average the two and go with 75%, that is probably pretty accurate."

Using 75% of issuance for new money, then, we end up back at $113 billion for annual sponsored volume, excluding refinancings, with outstandings around $340 billion.

Next week we take a look at the refinancing cliff of middle market loans