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BDC leverage on the rise, one tool to combat falling Libor

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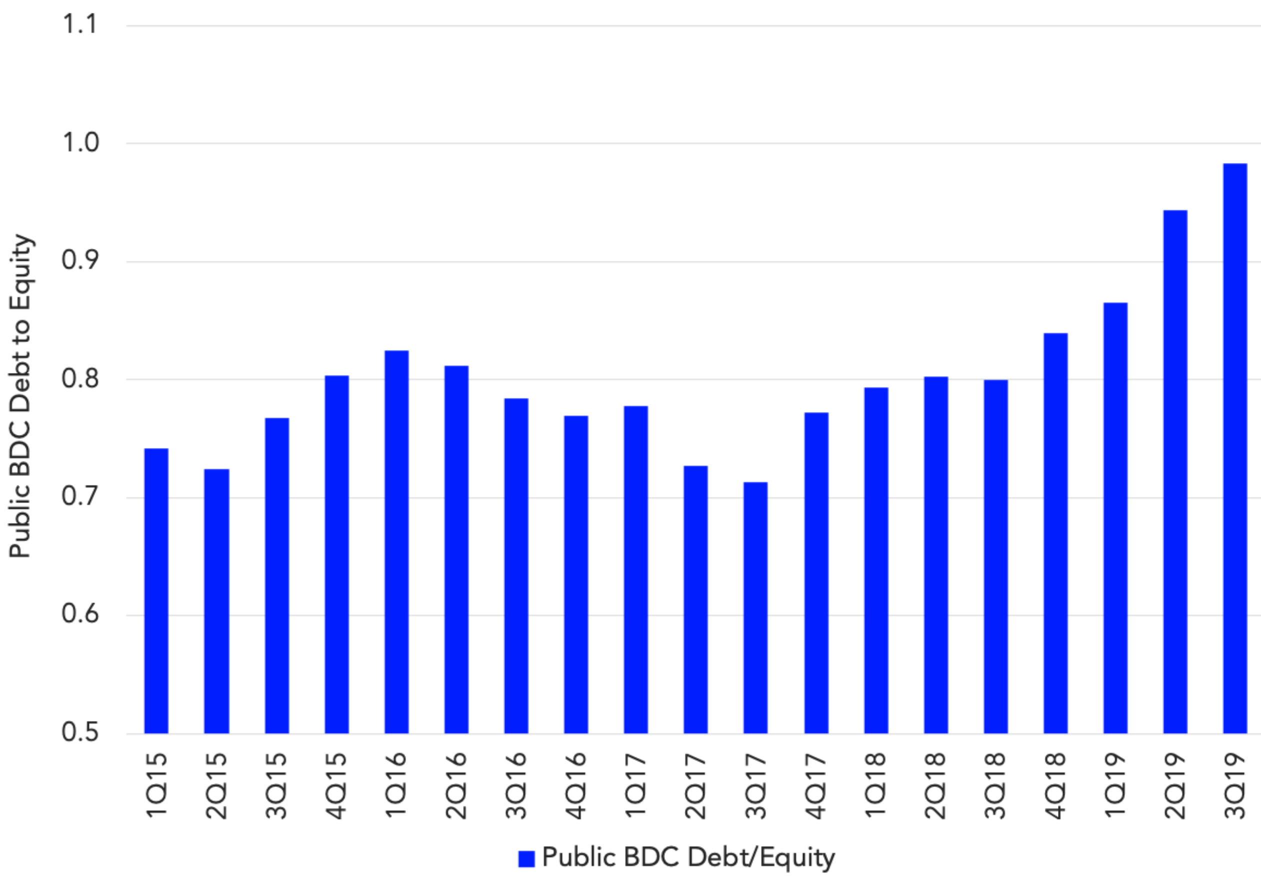

After peaking in December 2018 at over 2.8%, 3-month Libor has since fallen to 1.9% and BDCs are reporting lower weighted average yields in 3Q19 as a result. Following this steep decline, BDCs are taking advantage of their flexibility to increase leverage under the 2:1 Legislation to help boost returns. “Recently, the uptick in leverage has been swift which is contrary to how slowly things started. This is partially attributed to market forces, including lower benchmark rates and late-cycle positioning,” said Finian O’Shea at Wells Fargo Securities. Based on 33 public BDCs that reported so far, 73% reported a rise in debt to equity levels. Balance sheet debt to equity for that BDC universe rose to 0.98x at 3Q19, up from 0.94x at 2Q19 and 0.87x at 1Q19 according to BDC Collateral. “Leverage is going up due to both ‘willingness and ability’ – managers have mostly sorted out their leverage policy with the bank and debt communities, and are opting for lower risk paper at higher rates of leverage to solve for the top line,” added Finian O’Shea. But an increase in leverage can only help so much, BDCs mentioned additional strategies to increase returns in light of falling Libor including rotating into higher spread assets such as unitranche and second lien loans as well as capitalizing on the 30%

non-qualifying bucket to tap higher yielding assets such as specialty finance, aviation finance, structured products, special situations or European investments.