The Unitranche – What it is, and Why it Matters (First of a Series)

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As with all great capital market innovations – price flex, CLOs, and second-lien term loans – the unitranche seems obvious in hindsight. Having one lender provide a senior secured tranche that mimics a combined senior and subordinated debt structure solves a number of borrower issues. Yet its development was hardly a foregone conclusion.

A decade ago the notion of one debt provider bridging the divide between a secured and unsecured obligation was far-fetched. Banks still dominated the senior debt space, and private funds ruled the mezzanine class. But then two things happened.

In late 2007 GE Antares and Allied Capital (later acquired by Ares) developed the first unitranche fund – the Senior Secured Loan Program. The $3.6 billion SSLP fund offered one tranche to borrowers by synthetically blending pricing for a first-out tranche (provided by GE) with a second-out tranche (Allied's contribution).

Then came the Great Recession. In the face of uncertain liquidity and a derailed loan syndication market, the unitranche offered certainty of execution. Private equity sponsors are typically reluctant to put all their financing eggs into one provider basket. But the unitranche became an increasingly attractive one-stop credit solution for a number of concerns raised by disruption in the capital markets.

First, it avoided syndication risk – arrangers unable to execute due to market conditions. Second, there was no worry about market flex; unitranche providers guaranty their pricing and terms because they can hold the entire tranche. Finally, with only one tranche, inter-lender issues are often managed behind the scenes.

The popularity of the unitranche grew even when liquidity returned to the markets. The overhang of volatility – prompted by Greek exits and US debt rating downgrades – compelled sponsors to continue seeking the safe haven of the one-stop. Also with the advent of Leveraged Lending Guidance, banks struggled to compete effectively with their syndicated product.

Over the past few years, the unitranche has grown in importance. Thanks to the success of SSLP, and now its competitors, sponsors now have a wide range of one-stop options.

William P. Brady, a partner at Proskauer and noted expert on multi-tranche financings, told us how things have changed. "Pre-crisis, the unitranche was a single product with a simple five-page Agreement Among Lenders," he said. "Today the unitranche has evolved from a single product to a platform that replicates an increasingly complex variety of debt structures."

Over the next several weeks we'll examine all aspects of the unitranche phenomenon, including:

- Who are the players?
- How do these players structure their unitranche funds?

- What are the loan document issues?
- Where is pricing and terms today for unitranche debt?

Next week we continue our series by looking at the different types of unitranche structures.