Opportunistic refinancings drove U.S. lending to US$535bn in 1Q17

– *Ioana Barza*

March 31, 2017 – Record refinancing activity in the institutional market drove U.S. syndicated lending up 50% year over year. At US$535bn, lending in the first quarter was down 8% from the prior quarter but refinancing activity was up 7% to US$409bn.

"The typical things that you want for the asset class are all there: low default rates, high historical returns over the last 12-24 months and increasing interest rates," said one arranger. "Those three things do not happen at the same time that often and could mean a huge boom in issuance. But, the product is just not there."

In the absence of sufficient new money supply, refinancings took center stage and were met with strong investor demand. In a rising rate environment, inflows into loan retail funds have been positive for 20 weeks while roughly US$16bn in new CLOs have been issued so far this year. Pension funds, sovereign wealth funds, insurance companies, endowments and family offices have been allocating to the asset class through various avenues including Separately Managed Accounts. Some are first time investors while others are growing their current exposure to the floating rate, cash coupon, steady return asset.

As a result, issuers pursued opportunistic refinancings to the tune of US$261bn in the leveraged market, surpassing 2Q13's prior record of US$246bn. Pro rata refinancings reached US$66bn. Meanwhile, the US$195bn logged in the institutional market in 1Q17 beat out all prior full year refinancing activity in the institutional market and ranks only behind 2013, 2014, and 2016's full year record levels of US$409bn, US$235bn, and US$221bn respectively. In 2013, US$283bn was completed in the first half of the year.

Conversely, new money made up just one quarter of leveraged lending's US$345bn total in 1Q17 and M&A financings just 15%. While new money in the institutional market was only US$31bn, total institutional loan issuance jumped 55% over the prior quarter to US$248bn boosted by refinancing activity. Conversely, leveraged pro rata lending fell 15% to US$97bn and registered only US$31bn in new money lending.

Is it 2013 yet?

It is not just refinancing volume that has exceeded 2013's quarterly record, as spreads are also at post-crisis lows. The average first-lien institutional term loan spread (not including Libor or floor or OID) fell to 343bp this quarter, while in 2013 the quarterly low was 376bp. These levels remain above the 273bp low in the spring of 2007.

However, all-in yields tell a different story (including Libor or Libor floor and OID). Averaging 4.61% in the first quarter, they are at lows not seen since 2004. Yields on single-B credits averaged 5% while yields on BBs fell to 3.67% on average.

Lenders and arrangers surveyed by Thomson Reuters LPC at quarter-end say that in the absence of a growing pipeline of new M&A financings (see Issuer Optimism Tempered by Uncertainty in last week's *Gold Sheets* weekly issue) the refinancing wave could continue.

“It seems there could be a lot more downside than upside on the M&A front if you look at the leveraged market,” said another arranger. “New money deals mainly came from corporations selling divisions to sponsors. We are seeing pruning going on, spinning off from larger entities but not transformative transactions.”

The story was similar in the U.S. investment grade market where M&A financings fell to US$11bn in the first quarter, down 83% from the prior quarter’s US$66.3bn that was the third-highest on record. Roughly US$6bn of the US$25bn in investment grade term loan volume issued in the quarter supported M&A financings and completed bridge loan issuance was under US$2bn.

“It’s what we live for, the M&A. While doing a revolver keeps you busy, we live for the M&A,” said one lender.

While lenders commented on a general optimism from their issuers, it was tempered by uncertainty around the new administration’s policies (see last week’s *Gold Sheets* weekly).

“If you’re a big pharma or tech company with billions of dollars overseas, you don’t know if or when you will have access to it,” said another lender. “Is it next year, is it 2019? How does that impact your financing plans now? If you will get the money back, do you really want to issue 10-year or 20-year bonds? And if you might lose net interest deductibility, are existing obligations going to be grandfathered, in which case maybe you issue 30-year bonds?”

“Overnight or as long as possible: when those are your two options it is really hard to plan,” said the lender.

“Debt is still affordable, companies have access, and are performing generally well,” another lender said. “At some point they have to pull the trigger but in the meantime it is impossible to know how long they will wait. As long as they see that there is at least discussion going on and it is leaning in the right direction, they will remain optimistic.”

Meanwhile, investment grade refinancing activity was US$117bn, roughly in line with first quarter activity over the past few years and down from 4Q16’s US$171bn. Lenders surveyed expect activity to stay slow and steady and maintain its seasonality as issuers extend five-year facilities by a year and renew 364-day facilities. In some cases, borrowers issued 364-day facilities for additional back-up to the commercial paper market as they try to anticipate future funding needs.

Given the lack of new dealflow, “it feels like banks are getting more aggressive; nothing materially changed, it is a glacial shift, a slow slide on the margin as covenants are getting more aggressive and pricing may become more aggressive,” said a third lender.

While the majority of lenders expect terms and conditions to remain unchanged in the coming months, including tenors and pricing, some did report a change in their appetite for funded assets, preferring to lend the unfunded revolver especially if it had become more difficult to demonstrate ancillary business upfront rather than projected down the road.

Half of those surveyed said the impact of Basel requirements on lending had worked through the system until the next iteration, while 36% said capital requirements are still being taken into account by some banks which is leading to changes in appetite on the margin.

When asked about the long term effect, however, 79% said capital requirements will continue to have a big impact on lending decisions. But for now, the lack of supply remained the biggest concern heading into the second quarter.

For the full report, see the April 3 issue of *Gold Sheets*.

	1Q16 Issuance	**1Q17 Issuance**	**% change**
U.S. Total Issuance			
Overall	356.53	534.62	50%
Investment Grade	164.17	140.15	-15%
Leveraged	133.32	344.84	159%
Institutional	40.89	249.51	510%
LBO*	17.93	22.09	23%
LBO Leverage	4.68x / 6.02x	4.62x / 5.61x	
U.S. New Money Issuance**			
Overall	160.62	125.49	-22%
Investment Grade	52.38	22.95	-56%
Leveraged	83.39	83.69	0%
Institutional	37.56	53.72	43%

* Excludes bridge loans
**Includes only new financings, such as M&A, LBO, dividend payments, and incremental fund raising

1Q17 U.S. Bookrunner

Rank	**Bank Holding Co**	**Bookrunner Volume**	**# of Deals**	**Market Share**
1	BAML	78,919,100,832	306	14%
2	JP Morgan	59,652,592,990	238	11%
3	Citi	39,504,270,198	148	7%
4	Wells Fargo	39,263,551,694	222	7%
5	Barclays	36,418,496,656	139	7%
6	Goldman Sachs	26,843,970,568	105	5%
7	Deutsche Bank	24,570,992,176	104	4%
8	Morgan Stanley	24,086,568,269	84	4%
9	Credit Suisse	23,241,475,243	97	4%
10	RBC Capital Markets	19,116,810,943	84	3%

1Q17 U.S. Leveraged Bookrunner

Rank	**Bank Holding Co**	**Bookrunner Volume**	**# of Deals**	**Market Share**
1	BAML	38,102,760,811	195	11%
2	JP Morgan	29,784,329,441	138	9%
3	Barclays	28,365,715,877	104	8%
4	Goldman Sachs	23,123,831,668	93	7%
5	Morgan Stanley	21,905,123,824	76	6%
6	Deutsche Bank	21,892,966,535	96	6%
7	Citi	21,765,059,358	93	6%
8	Credit Suisse	21,040,306,677	88	6%
9	Wells Fargo	20,972,019,615	133	6%
10	RBC Capital Markets	15,218,230,064	70	4%

1Q17 U.S. Investment Grade Bookrunner

Rank	Bank Holding Co	Bookrunner Volume	# of Deals	Market Share
1	BAML	36,080,536,355	91	21%
2	JP Morgan	26,589,957,983	88	16%
3	Citi	17,102,335,840	51	10%
4	Wells Fargo	15,955,362,746	72	9%
5	Mitsubishi UFJ	9,383,314,134	43	5%
6	BNP Paribas SA	8,004,690,475	16	5%
7	Mizuho Financial	6,755,260,876	27	4%
8	Barclays	5,869,704,213	26	3%
9	U.S. Bancorp	4,809,619,295	29	3%
10	PNC Bank	4,766,743,900	30	3%

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