ACG® New York Association for Corporate Growth

Where Private Capital Meets The World

On 15th November 2017, we attended the ACG New York's 'Middle Market Lending' event. Here are the five of our top takeaways from the panel, which focuses on the private lending and the reforms concerning the debt markets in the US. *Prepared by TresVista Financial Services.*

5 THINGS YOU MISSED

ACG NEW YORK: Insights From the Debt Markets

1 **Political Impact on the Private Debt Market:** Uncertainty in the political, economic, trade and other areas affect any company borrowing money, investment decisions and middle market private capital as well as bank lending and credit and underwriting decisions. Relaxations in regulations of private lending will increase universal competition as banks with deposits are the players with lowest cost of funding. There have been speculations about reforms in taxation structure concerning carried interests and deductibility of interest.

2 **Reforms in the Debt Market:** Uncertainty about the BDC leverage changing from 1.0x to 2.0x affects the investors yield without affecting the yield of the underlying asset. The Congressional Review Act reviews that state policies. The Government Accounting office (GAO) prevented banks from highly leveraged transactions which, if reviewed by the CRA will no longer be followed. On risk retention, CLO and structured paper issuers need to have 5.0% equity in the issued tranche. This move is being criticized by the Loan Syndications & Trading Association (LSTA) as they believe that CLOs had nothing to do with the recession.

3 **Managing the Risk Dynamics Associated With Business Development:** Shift from sponsored deals to non-sponsored deals comes with a false sense of security of the sponsors supporting the company in the downturn. A lot of independent sponsors do not have sufficient capital to keep the company going. BDCs are looking for niche business with growth potential and stable recurring revenues from a diversified customer base. The dynamic environment demands the businesses to be responsive. The lower middle markets have not found huge losses on non-sponsored deals. However, to address challenges the business must have capacity and resources for problem solving and reducing their exposure to risk.

4 **Challenges Faced by Funds to Grow the Asset Base:** Funds need to have smart underwriters who bring experience to the table. There is a lot of cash chasing a few number of deals today due to the floating rates and low volatility of the underlying assets due to lack of secondary markets for re-trade. In a capital inflationary environment, the spreads and yields are going down, prices are rising and the quality is decreasing. Focus on growth with good assets in the business is more important than growth in assets on the books.

5 **Latest Trends in the Lending Business:** There is no demand-supply bubble in the real markets with the capital availability terms and this is leading to a higher yield category of credit with ~11.0% vs. 6.0% yield. There is a bubble in terms of documentation and applying a metrics to the performance. Add backs and proforma adjustments present a very different picture than the reality. This is attracting lawyer's attention. Potential business pipelines with baseless financial figures and management's vision for the business should not attract lenders.