

FUND FINANCE FRIDAY

Syndication Considerations: Elements, Issues and Hot Topics for Bringing New Lenders into Deals

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As interest rates rise and a potential recession looms, we've seen a flight to quality as new entrants seek to participate in our fund finance market. While most deals on our books have just one lender and one fund as borrower, multi-lender facilities have historically provided outsized loan commitments. To wit: of the nearly 900 new deals and rebooking amendments our U.S. fund finance team did last year, only 8% were syndicated on initial close. Yet of the almost \$200 billion of lender commitments in our U.S. portfolio during that time, almost two-thirds came from syndicated credit facilities. A significant part of that disparity comes from new lenders joining deals after origination. We expect that trend to continue. This article assesses the elements, issues and hot topics for bringing new lenders into a transaction from the perspective of the borrower, the administrative agent and the incoming lenders.

Borrower's Viewpoint: Increased Access to Capital

Before we dive into the three ways new lenders can join credit facilities, the challenges they face and the current hot-button issues for when they do, we briefly evaluate the motivations of the parties to engage in a syndication. We start with borrowers.

The primary driver of new lenders coming into a deal is a borrower's aim to access additional liquidity. As fund size increases and with it expanded investment capabilities, a borrower may look to bridge the gap between calling capital from investors and making investments by boosting its borrowing power. But a single lender will only be willing to commit so much capital to any given financing, based on its credit analysis of the credit parties and its desire to diversify its loan holdings. Hence a borrower's interest in bringing in more lenders to up its aggregate loan capacity.

Borrowers may also hope to grow their relationships with additional lenders. By seeking syndication, borrowers can diversify their potential sources of funding for their future needs. In times of economic downturn, having multiple potential sources of financing can improve a

borrower's overall outlook. When certain lenders are retracting from the market, others may be opportunistically expanding their book of business.

When considering whether to increase a facility's size via syndication, a borrower should analyze several factors. Time, energy and cost are real factors. Although there would be the operational and legal costs of bringing new lenders into a deal, those costs are often far outweighed by the additional capital provided by the facility upsize. As with any increase, the borrower should confirm that any leverage limitations listed in its constituent documents won't be exceeded if the borrower fully draws on the increased line of credit. The borrower will also want to determine the amount of debt it intends to utilize under the larger deal size. That will help the borrower avoid unwanted unused fees – the fees charged by the lenders to the borrower for not fully borrowing the maximum permitted loan amount.

Administrative Agent's Perspective: Value-Added Service, Enhanced Fees and Setting Its Terms

The benefits of a syndication for the administrative agent similarly fall into several categories. By organizing and accomplishing a lender joinder for its client, the admin agent is providing a major value-added service: direct access to more cash. That might help the admin agent win a new deal initially and to garner more return customers. The reputational benefits are also real. An admin agent that establishes itself as capable of consummating syndications may win future transactions, whether multi-bank or bilateral.

The admin agent can expect enhanced fees when putting together a syndication. It is common for admin agents to charge borrowers an arrangement fee on the commitments of the lenders in a facility. While an arrangement fee might be single digits or low double digits in basis points, that small amount can add up to a lot when aggregating lender commitments in sizable deals. Providing the ability to upsize may also permit the admin agent to write larger checks itself, whether on initial closing or in connection with the facility increase.

On a deal-by-deal basis, perhaps the biggest benefit for the admin agent is that it can drive the terms it wants. When a transaction closes bilaterally and then subsequently syndicates, the admin agent generally will negotiate the entirety of the loan documents with the borrower before another lender weighs in. Even if other lenders join at initial closing, the admin agent typically gets the credit agreement in agreed form with the borrower before the other lenders comment on it.

A financial institution will consider the time, energy and operational costs of donning an admin agent role before taking on such a task. The admin agent needs to ensure its loan ops team can coordinate and facilitate cash flows arriving from a multitude of lenders and providing them to the borrower with each borrowing request. The admin agent also must properly organize the process of bringing new lenders into a transaction, managing the timeline and expectations of the borrower and lenders throughout. While these are no small feats, admin agents that do so effectively will be rewarded accordingly.

Syndicate Lender's Mindset: Upside Profits with Less Upfront Cost

For lenders looking to join an established credit facility, the benefits are clear. The lender can quickly access an active borrower and the profits associated with lending to it. Just like how a

borrower may want to diversify its financing providers, the syndicate lender can grow its relationship with a new or existing borrower client.

The ease with which a lender can join an existing deal relative to the effort involved to negotiate a new deal from scratch can be a double-edged sword. It depends on the lender's predilection for dictating terms. While lenders joining a credit facility can certainly request changes to existing provisions, they'll mostly need to live with whatever has already been agreed to between the admin agent and the borrower. Lenders with a penchant for prescribing business points may prefer to be the sole lender in a deal to retain their bargaining power.

An incoming lender should make sure it understands how the admin agent vetted the deal. The lender's policies and credit/risk analysis of collateral should generally align with the admin agent's procedures for collateral diligence. A lender will also want to make sure the admin agent's and borrower's processes can timely facilitate the lender's "know your customer" requirements. If the joining lender can play well with others, it'll go a long way to having the lender be invited to participate in future financings.

Joinder vs. Assignment vs. Amendment

Now that we've highlighted the main considerations for borrowers, administrative agents and joining lenders, we'll provide a quick summary of how a syndication can be implemented before turning to current trends impacting our syndication transactions.

New lenders might become parties to a credit facility in one of three ways: joinder, assignment or amendment. The first two are relatively similar. In a joinder, a new lender provides an entirely new commitment to the facility. In an assignment, the new lender takes part or all of an existing lender's hold. Each is completed by the new lender executing a short agreement under which it becomes party to the deal. For the latter, the existing lender also signs the short agreement to assign its interest to the incoming lender. Otherwise there are no changes to the loan documents.

That's why credit agreements frequently contain provisions to permit facility increases. By submitting a two-page form and meeting customary conditions precedent (such as no defaults existing on the credit line and the borrower's initial representations and warranties remaining true and correct in all material respects), a borrower can request to increase the maximum amount it can borrow under the facility. New lenders may join to provide the additional lending capacity, or it can be offered by existing lenders to the deal.

If the loan agreement doesn't include such provisions, then the parties will need to amend the document to effect the increase. The parties may choose to amend in certain circumstances even if the loan documentation expressly permits facility increases. This is typically the case when the admin agent's or the lender's internal policies require form updates to approve an amendment. If the parties aren't amending the credit agreement, then the joinder or assignment agreement will typically be all that's needed for the new lenders to become parties to the credit facility.

Current Hot Topics in Upsize Amendments

We'd be remiss if we didn't start any discussion of facility increase amendments with an acknowledgement that "SOFR-flip" amendments are in full swing. Last year, the global fund finance market replaced LIBOR with the new interest rate benchmarks for non-Dollar LIBOR-quoted currencies in our facilities because LIBOR ceased for those currencies after December 31. This year we're doing the same for Dollars.

Regulators in the United States have strongly signaled to the loan market here that despite LIBOR for Dollars not ending until the end of June 2023, no "new loans" based on U.S. Dollar LIBOR should be entered into as of January 1 of this year. That includes brand-new deals and any transactions that would be deemed a rebooking of a loan, which includes upsize amendments.

As we previously detailed [here](#), LIBOR succession amendments can cause a real strain on resources and the parties' relationships. They tend to take more time and legal spend than expected. If the admin agent closely follows LSTA form language, this can reduce comments from the borrower and lenders. But many admin agents have internally approved language that to some extent varies from the LSTA model approach. And while U.S. lenders tend to be simpatico with LSTA language, Europe- and UK-based lenders may prefer provisions that align with the LMA-recommended approach. Admin agents generally have little wiggle room to change from their authorized verbiage. The admin agent will do well to inform the other parties where that's the case or where the admin agent can accept variations on its standard benchmark formulation.

Sanctions is another current hot topic in syndications. We thought (hoped) that negotiations on sanctions provisions in our deals were largely put to bed two to three years ago. With the war in Ukraine, these issues have reared their head once again. We've now seen investors in our deals with ties to Russia who are sanctioned by the United States.

This has led to increased sensitivity of many lenders to sanctions provisions, as banks are required to ensure their compliance with sanctions regulations. We've seen a recent uptick in comments regarding sanctions provisions from incoming lenders. On the other hand, borrowers want to avoid increases to the sanctions compliance requirements they've been willing to agree to in fund finance deals over the last several years.

In general, the interests of fund finance market participants are aligned on this point. No lender wants to lend against the capital commitment of a sanctioned entity. No borrower wants sanctioned investors in its fund. Both should consider how tightly the borrower is able to maintain control and monitoring over its sanctions risk. Ideally, a borrower's partnership agreement would permit it to quickly force out a sanctioned investor, but that may not be practically achievable.

Another hot-button issue in facility increase amendments isn't a new trend but instead is a classic one: tensions over assignment and participation provisions. Lenders tend to prefer as much flexibility as they can garner to assign their commitments or bring in participants. Borrowers, on the other hand, want a say in who will be providing them financing. Admin agents also want to determine which lenders are let into a deal in order to ensure the lenders are equipped to provide loans when required. These competing desires can lead to heightened discussions among the syndication parties about what consents are required for lender assignments and participations.

If a lender has internal policies that require it to have general assignability of its loans, it may need to obtain internal approval for any limitations in the credit agreement that are greater than its policy permits. A borrower may reasonably want to restrict assignments and participations to its competitors. The borrower, the admin agent and the lenders should fully confer on their particular preferences related to these provisions to ensure they are satisfied with any future parties that may join the facility.

Conclusion

Despite the challenges and effort to bring new lenders into a deal, the benefits generally far outweigh the costs. With deliberate planning and open communication about goals, timelines and constraints, the parties to a syndication can secure a successful outcome.