

Fund Finance Friday



Market Observations & Thanksgiving Wishes

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As we head into the Thanksgiving Holiday in the U.S. next week and try to take a breather from the breakneck pace of the market over the last 18 months, it is a good time to reflect on where we have been, where activity levels stand and the trends we expect to continue into 2023.

2021:

This was record year for our market, almost beyond belief. A surge in private fundraising, accelerating capital velocity, and ample bank lending capacity translated into unprecedented growth in the fund finance market. The numbers say it all:

- Deal volume (inclusive of new deal originations and facility increases and extensions) were up 56%. This is exclusive of the more than 800 other amendments (i.e., SOFR transitions) that were also processed by our team.
- Lender commitments by dollar value were up more than 70% over 2020, and with the addition of more than 7 new lenders entering the market since the inception of the pandemic.
- We saw sponsor mix also increase by 78% during this period.
- We saw at least 12 lenders active on more than 40 NAV financings.
- ESG entered the limelight. We represented five lenders as lead bank on nine ESG-linked facilities, totaling more than \$8.5 billion in lender commitments.
- The final three months of 2021 were the busiest on record in our practice group's history.

Our predictions coming into 2022, were (1) LIBOR transition work will continue and dwarf 2021 volume but over a smoother time horizon (vs. the volume we saw in Q4 2021); (2) Bespoke non-subscription deals will have a breakout year in the U.S. market as lenders seek higher yield and more loan growth; (3) ESG-linked facilities will continue to blossom and take a step more toward the mainstream; and (4) mega deals (those of more than \$1 billion in commitment size) will have a record year as the average fund size ticks up across the large sponsors following a year of unprecedented fundraising success. So, nearly 11 months in and now with data from the first three quarters available to assess, how did we do?

2022:

The first half of the year, with no surprise looked very much like a continuation of 2021. We have in recent months seen some headwinds creep into our market in terms of rising interest rates and regulatory capital concerns. You can't go anywhere these days without somebody dropping an "RWA" reference or use the term "selective" in terms of describing growth. Despite all the noise, we have all been really fortunate to see overall continued growth in our market, continued clean credit performance, and a year that for many may end up as good as or better than 2021.

- Large sponsors made their mark (as we predicted), increasing average deal size on the whole and leading to some of the largest syndicated facilities the market has ever seen. We have closed 12 facilities of more than \$3 billion this year. Just wow.

- Origination activity, while certainly robust by any measure (first three quarters were up 11%), are moderating from peak 2021 levels, and we project deal count to end the year down about 14% and overall lender commitments to end the year down about 5% from these all-time highs.
- We have seen the number of new entrants accelerate with lender count up more than 16% this year. This was really needed given the number of large syndicates to fill out.
- 70% of lender commitments this year have been allocated to syndicated deals (despite the number of syndicated deals accounting for only 9% of overall deal count). This reflects the trend of capital gravitating to the large platforms.
- We have seen a robust level of continued LIBOR transition activity (as predicted) but it seems much more manageable than last year, with many amendments getting baked into to naturally occurring extensions and other portfolio maintenance amendments.
- ESG activity has moderated some from the peak 2021 levels, but could end the year at least flat. We have closed five ESG-linked transactions this year vs. eight last year, and with some still in progress. Even if down, the sustainability trend is not going anywhere as this market continues to mature and evolve.
- Deal pricing has been a key differentiator this year. Prices started to tighten in 2021 and remained relatively stable until recent interest rate hikes. Our data collection will not have a full picture of rising pricing until end of year, and this is also harder to measure given varied treatments in the market of SOFR spread adjustments, but we do think pricing on new deals has widened by a significant margin and will end the year up perhaps 15-25 bps on average.
- We are also seeing more of a shift to shorter tenors – particularly one year deals with uncommitted extension options as a way for lenders to manage capital and also to provide borrowers with flexibility on future pricing shifts.
- The NAV market has accelerated (as we predicted). We have seen 17 active lenders this year on more than 40 deals through September (as compared to the same number for all of 2021).
- We have made significant investments in our practice – expanding our roster of fund finance attorneys to more than 80 this year, including a partner and a number of counsel additions on the NAV side.

So what does end of year and 2023 hold for us? We expect year to date private markets fundraising to end the year in great shape around \$1.3 trillion (slightly down from the \$1.4 trillion raised last year), but decelerating deal and exit values are posing a headwind to continued levels for 2023. Bank balance sheets on the whole have become more selective as loan growth in some cases has toggled depending on the segment of the market. We still see a positive trend heading into 2023, but at levels that are significantly more modest that we had become accustomed to over the last 18 months. We anticipate utilization levels to drop in light of higher pricing and a tempered fundraising environment. This will likely lead to a trend of smaller facility sizes on average for at least the near term. This is all supported by our recent survey of market lenders: 64% of respondents expect some level of commitment growth at their institution, 33% of respondents expect lower utilization levels across facilities, and 57% of respondents expect further widening in pricing.

The good news is that plenty of market opportunity remains, and we are seeing more players than ever. Structural evolution and smart solutions to some of today's problems will fuel the way for future growth. When we have dinner next Thursday, let's all be extremely thankful for our market, our teams and all the great friends and colleagues we have in this industry. I know I will.

No *FFF* next week. We hope everyone gets a well-deserved break, and Happy Thanksgiving to all of our friends and readers!