

# The US Institutional Corporate Loan Market: Overview, Current Trends and Expectations for 2018

**Moderator:**

Michael Friedman, Chapman and Cutler

**Panelists:**

Jeff Bakalar, Voya Investment Management

Mark Gold, Hillmark Capital Management/Newmark Capital

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# Topics for Today

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- Introduction to the U.S. Institutional Corporate Loan Market
- Current Trends in the Loan Market

# What are Institutional Corporate Loans?

- Extensions of credit to **non-investment grade corporate borrowers** originated by major banks
  - A global market in excess of \$1 trillion
- Issued by mid- to large-sized companies to **finance acquisitions and other growth initiatives**
- **Senior** in the capital structure; **secured** by a lien on borrower's assets
  - Repaid before other creditors/equity upon a credit event
  - Collateral typically provides substantially higher recoveries
- **Floating rate** with coupon return comprised of a nominal credit spread over LIBOR
  - Rates reset every 45 - 60 days on average`

- Large, syndicated loans to non-investment grade companies
- Secured by the borrower's assets
- Rank highest in a borrower's capital structure
- Floating rates of interest



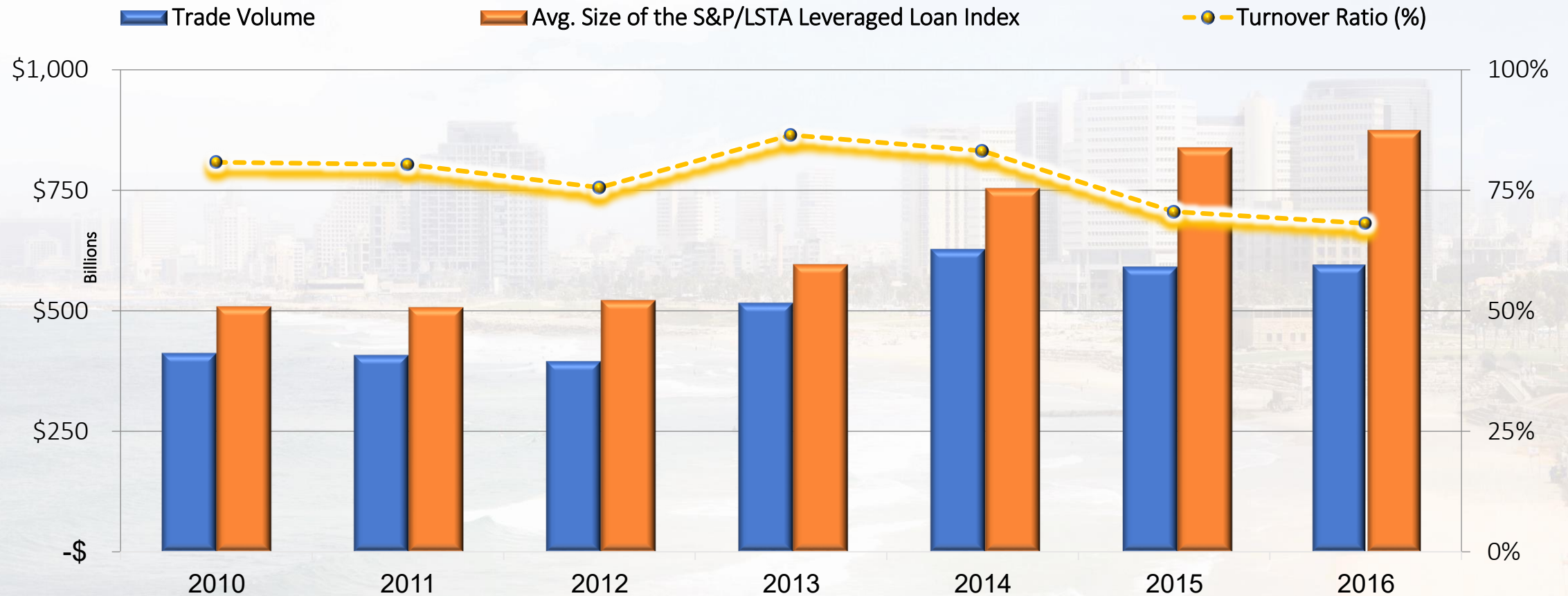
# What are Institutional Corporate Loans?

- Loans are rated
- Loans are actively traded in an established secondary market (subject to longer settlement times)
- Current bid/ask prices for each loan are readily available through multiple pricing services
- Average trade volumes in excess of \$500 billion annually over the past 5 years

# Senior in the Capital Structure with Floating Charge on Borrower's Assets

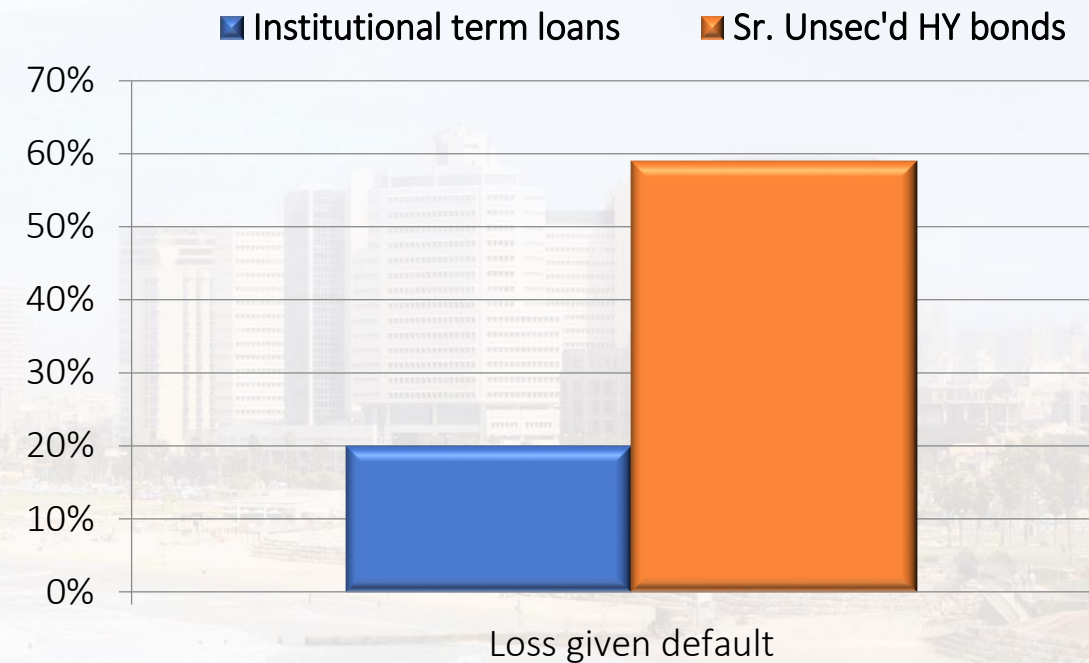
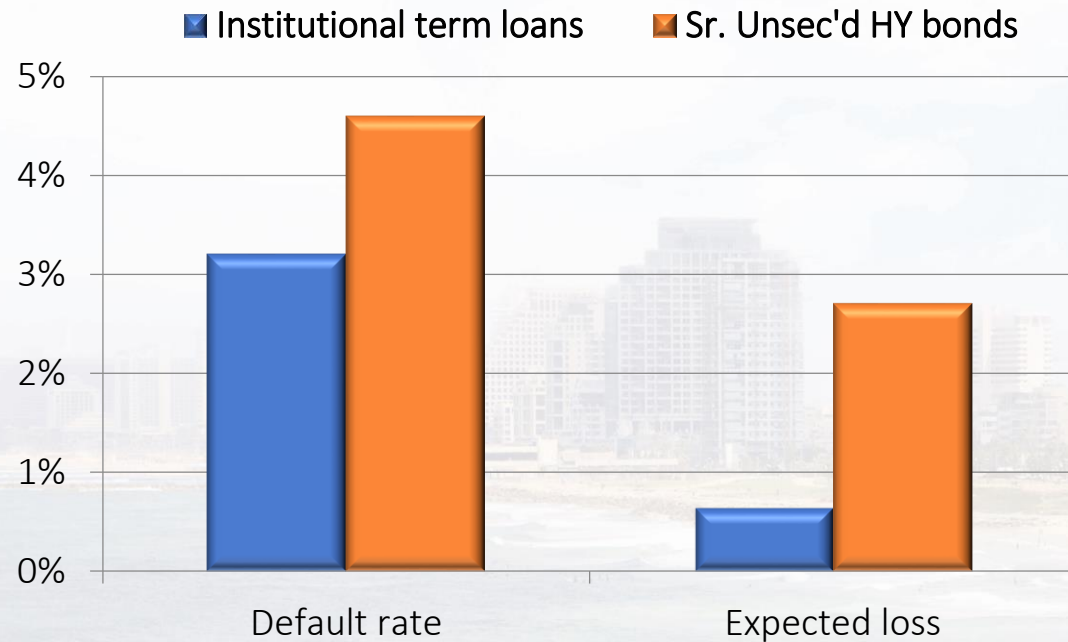
- Floating charge on Borrower Assets
  - Cash (in certain cases)
  - Receivables
  - Inventory
  - Plant & Equipment
  - Property (including real estate)
  - Intangible Assets (patents, trademarks)
  - Downstream guarantees from a holding co.
  - Upstream guarantees from subsidiaries
- Senior in Priority to:
  - Senior unsecured notes
  - High yield bonds
  - Mezzanine loans
  - Preferred / common equity

# The U.S. Corporate Loan Market Provides Substantial Trading Liquidity



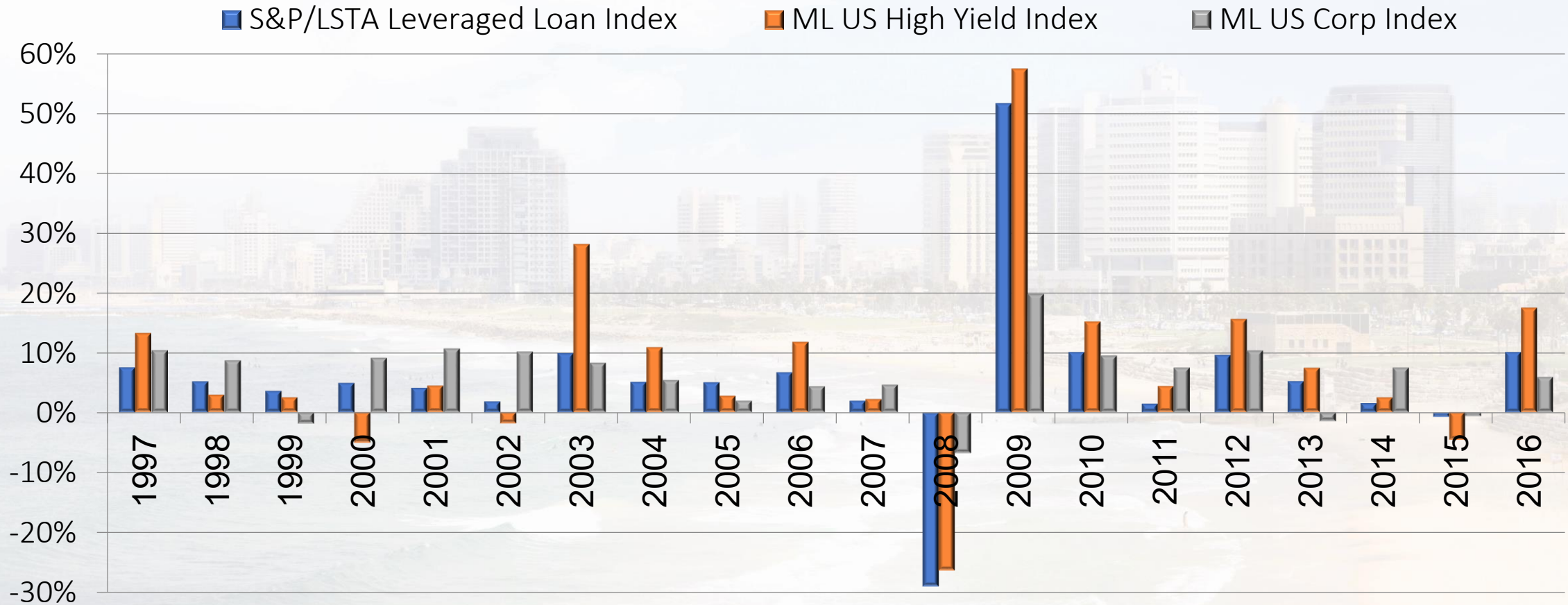


## U.S. Institutional Corporate Loans Have Relatively Low Losses as Compared to High Yield Bonds



- Loans are senior and secured, contributing to a lower loss rate
- Loss given default is low for loans - 19% because recovery rates are so high – 80%
- Loan repayment rates are high, averaging 2.7% per month since 2001
- Loans are floating rate (based over LIBOR), so interest rate risk is minimal

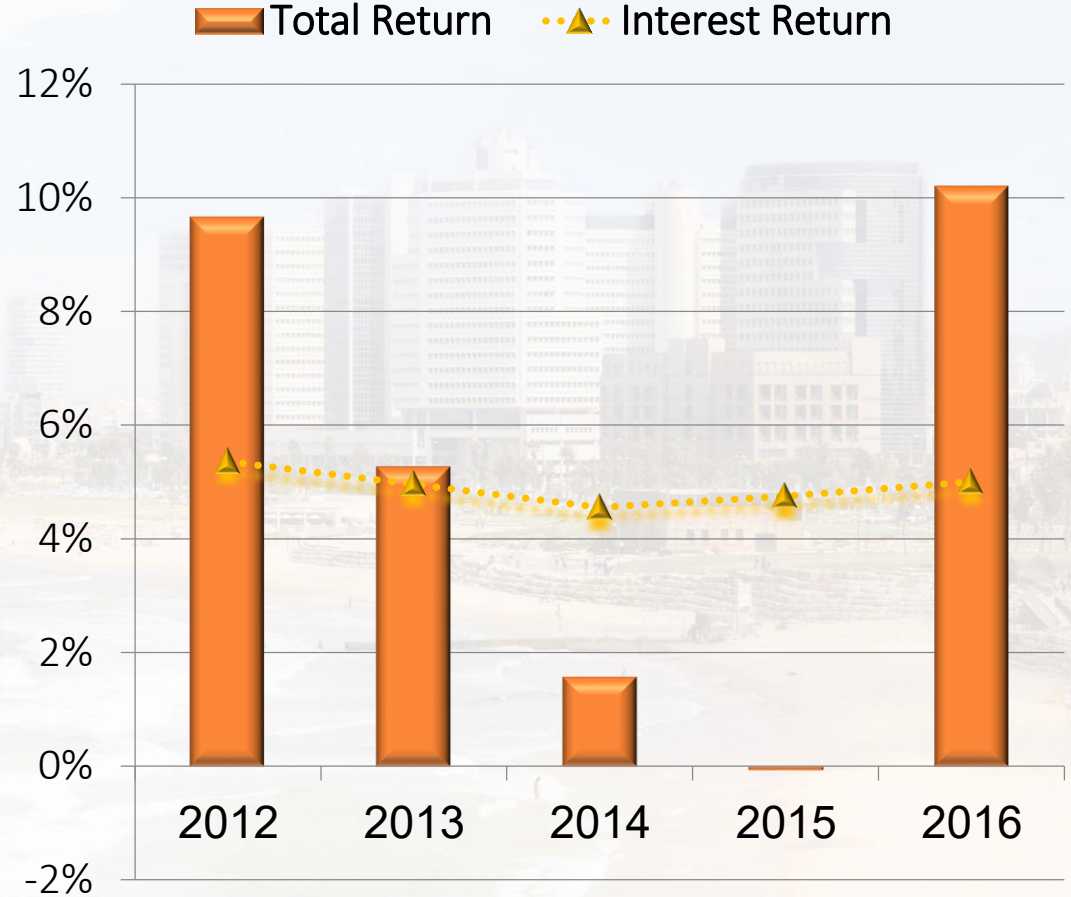
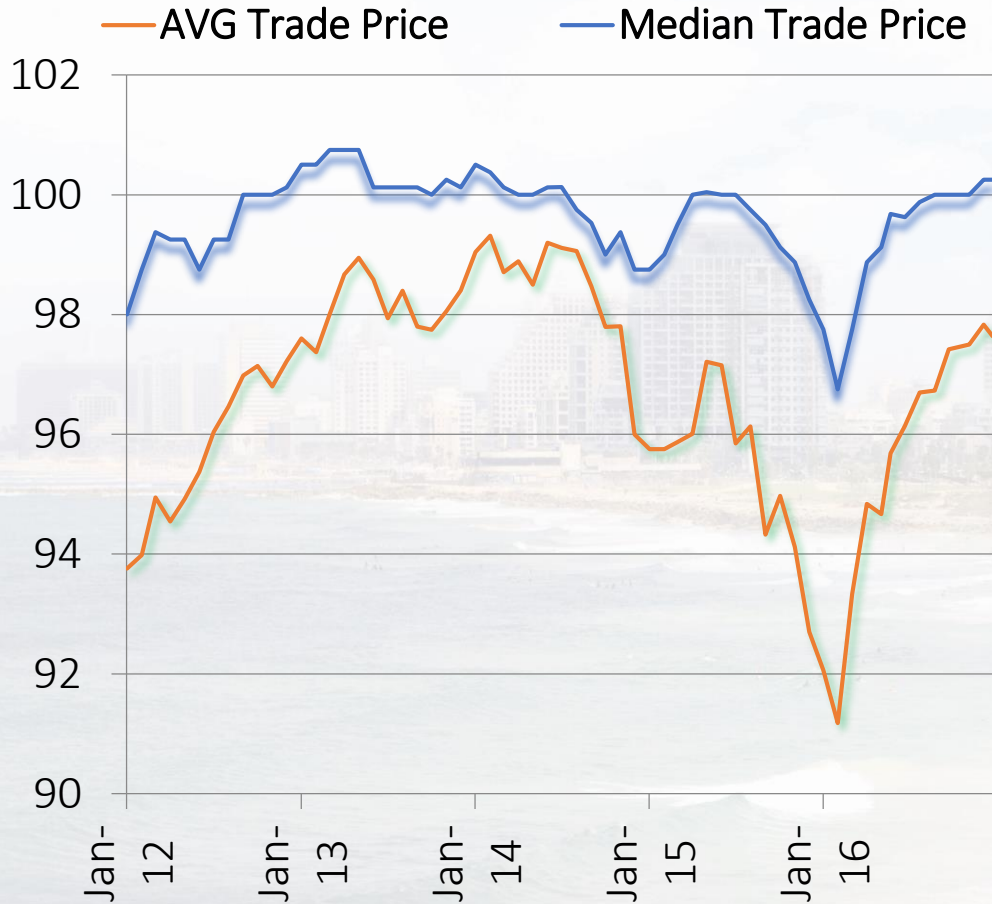
# Institutional Corporate Loans Have Returned 5.8% on Average Over 20 Years



Source: S&P/LSTA Leveraged Loan Index



# While Secondary Loan Market Prices Have Fluctuated Over the Past 5 Years, Annual Interest Income has Averaged 5%



Source: LSTA Trade Data Study & S&P/LSTA LLI

# Current Trends – Expectations for 2018

- How would corporate loans perform relative to bonds in periods of rising rates?
- If short term interest rates increase 75-100bps this year, what would impact be on the floating rate loan market?

# When 5 Year Treasury Yield Rises 70bp (or more) in 3 Months

3-months ending:	Increase in 5-year Treasury Yields	Increase in 10-year Treasury Yields	HY Bond Spreads Beg Month	HY Bond Return	HG Bond Returns	Leverage Loan Return	S&P 500 Return	Average VIX	% change VIX	Spread Tightening / Widening	HY Bond Returns next 3 months
June-09	0.90%	0.87%	1531bp	22.5%	9.7%	20.40%	15.9%	30.6	-9%	-512bp	15.1%
Jan-02	0.90%	0.80%	991bp	4.0%	-0.7%	2.60%	7.0%	22.9	-11%	-171bp	3.0%
Mar-90	0.81%	0.69%	790bp	-2.6%	-0.7%	NA	-3.0%	22.4	-10%	4bp	5.7%
May-08	0.95%	0.55%	765bp	4.0%	-1.3%	4.60%	5.8%	21.4	-14%	-115bp	-3.42%
Aug-03	1.18%	1.09%	746bp	3.3%	-3.6%	2.10%	5.1%	19.2	-4%	-152bp	6.2%
Mar-92	1.00%	0.83%	729bp	8.2%	-0.6%	NA	-2.16%	16.8	-3%	-239bp	2.5%
Dec-10	0.74%	0.78%	659bp	3.2%	-1.8%	3.20%	10.8%	20.8	-25%	-82bp	4.2%
Feb-99	0.74%	0.57%	611bp	0.2%	-1.0%	0.70%	6.8%	26.2	6%	-32bp	2.2%
Jan-00	0.74%	0.64%	605bp	2.3%	0.1%	2.30%	2.6%	24.6	1%	-65bp	-1.4%
Dec-18	0.78%	0.85%	558bp	2.6%	-2.8%	2.17%	3.8%	14.1	6%	-82bp	2.5%
Jun-04	0.99%	0.75%	499bp	-0.4%	-3.3%	1.20%	1.7%	15.7	-7%	-47bp	4.4%
Jul-13	0.70%	0.89%	469bp	-1.1%	-4.0%	0.60%	6.1%	14.8	-1%	25bp	3.0%
Apr-96	1.18%	1.09%	461bp	0.9%	-3.9%	1.90%	3.5%	17.3	-16%	-80bp	1.9%
May-88	1.05%	1.00%	458bp	0.5%	-2.9%	NA	-1.2%	NA	NA	-41bp	1.0%
May-87	1.44%	1.30%	425bp	-2.8%	-4.2%	NA	2.9%	NA	NA	-107bp	4.1%
Nov-94	0.98%	0.73%	405bp	-0.8%	-1.9%	1.80%	-3.8%	14.9	10%	8bp	5.5%
Apr-94	1.61%	1.40%	370bp	-4.8%	-5.7%	2.30%	-5.7%	16.4	-33%	9bp	1.1%
Average	0.98%	0.87%	651bp	2.3%	-1.7%	3.5%	3.3%	19.9	-7%	-100bp	3.6%
Median	0.95%	0.83%	605bp	0.9%	-1.9%	2.2%	3.5%	19.2	-7%	-73bp	3.0%

Sources: J.P. Morgan; S&P/LCD



# Current Trends – Expectations for 2018

- What is the outlook for corporate borrower's earnings, performance and defaults?

# Current Trends – Expectations for 2018

- What is current state of the corporate loan market?
  - Does supply exceed demand? Does demand exceed supply?
  - What are the expectations going forward?
  - What is the impact on corporate loans?

# Current Trends – Expectations for 2018

- Are there any regulatory issues or conditions that may impact the corporate loan market?
  - What are the implications of such regulatory issues on the performance of corporate loans as an asset class and liquidity?



# Current Trends – Expectations for 2018

- What is the current state of loan documentation and structures?
  - Are lenders losing important protections?
  - Are reports of weak loan protection overblown?

# Current Trends – Expectations for 2018

- What effect will the new tax law have on leveraged lending, now that interest is no longer fully deductible?

# Current Trends – Expectations for 2018

- With loan securitizations (CLOs) holding half of the bank loan universe, will the repeal of risk retention rules encourage excessive risk taking as a result of managers no longer having “skin in the game”?
- What is the expected consequences of the repeal of risk retention?
  - Will CLO Issuance increase?
  - Will CLO Issuance decrease?