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CORONAVIRUS: LEVERAGED FINANCE – CONSIDERATIONS FOR NEW FINANCINGS IN THE CURRENT U.S. MARKET

As the Coronavirus (Covid-19) pandemic continues to strain most industry sectors, many companies are experiencing some form of distress and are in need for liquidity. At the same time, many lenders are eager to deploy capital in an environment where they can demand favorable terms. As these needs have converged and other sources of liquidity (e.g., revolving credit lines) have faded away, parties are seeking creative ways to raise new financings that can meet the desires of both borrowers and lenders. This briefing discusses the race to find capital among the traditional sources available to borrowers and, in particular, highlights key considerations for financial participants looking to structure and/or fund into new term loan financings in the current market.

SOURCES OF LIQUIDITY

Initially, when pursuing a path towards liquidity, it is worth considering the common options available to borrowers and lenders.[1]

1. **Revolving Credit Facilities**: The first place many borrowers will turn to for a cash infusion is their existing revolving credit facility ("RCF"). Much has been written on whether borrowers can draw on their RCFs based on their ability to satisfy borrowing conditions in this environment.[2] Some

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[1] This briefing does not discuss liquidity options that may be available for companies under the federal government's new funding programs. Notably, the new Main Street Lending Program currently contains sizing limitations and conditions that may render it unhelpful for many borrowers of existing syndicated leveraged loans. Summaries of key information on these programs are provided in our briefings:

- Coronavirus: The US CARES Act and the Main Street Lending Program;
- Coronavirus Update: U.S. Federal Reserve Broadens New Term Asset-Backed Securities Loan Facility; and
- Coronavirus: The Economic Stabilization Provisions of the Coronavirus Aid, Relief, and Economic Security (CARES) Act;

Additional information regarding these programs may be found on the website of the U.S. Federal Reserve, at https://www.federalreserve.gov/monetarypolicy/policytools.htm

[2] See, for example, our briefings:

- Coronavirus: Implications for Material Adverse Effect Clauses in NY Law-Governed Credit Agreements;
- Coronavirus (COVID-19) Issues Relating to Loan Financings in APAC;
- Coronavirus: Leveraged Finance – Immediate Financing Considerations for Financial Sponsors, Underwriters and Debt Investors.

borrowers have still been able to draw and in some cases exhaust their available RCF commitments, rendering them no longer available (and, in covenant-lite deals, this may create a separate issue in respect of springing financial covenants).[3] In addition, as RCFs are typically advanced only by banks, revolving loans do not expand the universe of potential financiers that may be interested in advancing funds to the borrower. As a result, borrowers in need of more liquidity may look for solutions elsewhere.

2. **Asset Sales**: Another source of liquidity may be found through the cash proceeds received from asset sales, including, for example, meaningful non-ordinary course dispositions, factoring transactions, and sale-leasebacks. However, credit agreements often impose restrictive conditions on these types of transactions that may frustrate their usefulness in this environment, including the absence of defaults, the receipt of a certain amount of cash consideration, fair market value determinations, and the requirement that the proceeds be swept to repay the existing loans. Moreover, even where borrowers have suitable assets that can be monetized, sale transactions may require lead time and distressed sellers will likely experience decreased bargaining leverage. Thus, asset sales may not present an efficient solution to improve liquidity in an economic downturn like the one borrowers are encountering today.[4]

3. **Incremental and General Debt Baskets**: Where other doors are closed, borrowers may look to raise term-like debt in the market from a wide source of lenders, including banks, funds and institutional investors. To this end, leveraged credit agreements typically allow borrowers to raise new incremental debt up to a fixed (or "free-and-clear") amount either *inside* their existing credit facility as "add-on" loans or *outside* the facility as "incremental equivalent" (or "side-car") debt (which could be in the form of loans or notes). Borrowers can often raise additional meaningful debt outside their credit facility by using baskets available within their debt covenants, including general debt baskets up to a fixed amount and additional fixed amounts that may be incurred by entities that are not borrowers or guarantors.[5] As discussed below, when tapping these incremental or general debt baskets, parties must consider the flexibility (or lack thereof) under their credit agreements to allow them to obtain the funding they urgently need.

3 See RCF update from Leveraged Commentary & Data (LCD), April 17, 2020, reporting that roughly $228 billion across 447 borrowers has been drawn since March 5, 2020.

4 Indeed, many buyers and sellers are instead looking into issues as to whether one party may unwind sale transactions based on the occurrence of "material adverse changes".

5 Leveraged credit agreements often allow for greater amounts to be incurred based on a percentage of EBITDA growth of the group and/or pro forma compliance with leverage ratios. These features are likely unhelpful to borrowers that are experiencing financial stress and, thus, this briefing focuses on fixed general debt capacity.

CONSIDERATIONS FOR THE TERMS OF NEW TERM LOAN FINANCINGS

When structuring and funding into new term loans in the market, financial participants typically focus on key categories of terms, including, as further discussed below, pricing, credit support, maturity and priority.

1. **Pricing**: In the current climate, lenders are requiring favorable economic terms on new loan issuances. This, however, may risk the borrower having to boost the economics on its original term loans if the incremental term debt it raises triggers "most favored nation" (or "MFN") protections on overall yield (which are often set at a level of 50 basis points, or up to, in some credits, 100 basis points, and are designed to preserve the liquidity and tradability of the original debt).

   In some cases, incremental first lien term loans may be structured in a manner that does not trigger MFN provisions because of an available exception in the subject credit agreement. Depending on the nature of the existing deal, there may be a variety of MFN exceptions that apply to incremental term loans that are: (a) funded a certain number of months after the closing of the original loan, (b) raised in a different currency, (c) in a principal amount under a set ceiling, (d) incurred under the free-and-clear basket, (e) set with a fixed (versus a floating) interest rate, (f) not broadly syndicated, or (g) incurred outside the credit agreement as "side-car" debt (including in the form of a note or, in some cases, even as a first lien term loan). The MFN may also be avoided if the new term debt is raised via the general debt and liens baskets or at entities that are not loan parties since these baskets typically will not carry MFN requirements. In addition to interest spreads, parties may also consider structuring prepayment premiums for the new lenders which normally would not trigger any economic protections for the original lenders. The bottom line is: what parties have contractually negotiated should be closely scrutinized.[6]

2. **Credit Support and Priority**: Credit agreements almost universally specify that new lenders joining a credit facility through the incremental debt provisions, or funding incremental equivalent debt alongside such credit facility, will share in the same (or no better) credit support (i.e., guarantees and security) and payment rights provided to the original lenders. These assurances make incremental term lending an attractive opportunity for new lenders (but also may lead the borrower into MFN territory). Some credit agreements also permit (or otherwise do not prohibit) the same form of debt to be raised through the general debt and liens baskets (which, as noted, above typically would not trigger an MFN). These baskets are often silent as to priority and thus could be used to

[6] For example, as of the time of this briefing, (i) Everi Payments allocated a $125 million first lien term loan with the remarkable pricing of LIBOR + 1,050, a 1% LIBOR floor, and OID of 98 and (ii) Landry's Finance Acquisition Co. (a subsidiary of Golden Nugget) closed a $300 million first lien term loan with the notable pricing of LIBOR + 1,200, a 1% LIBOR floor, and OID of 96, and each contained favorable hard call protections for the new lenders. It was reported that the MFN for Everi's original term lenders (with a spread of LIBOR + 275) would not be triggered because the new loan would be raised using *incremental equivalent debt* baskets, which did not carry MFN protections. It was similarly reported that the MFN for Golden Nugget's original term lenders (with a spread of LIBOR + 250) would also not be triggered because the new Landry's loan was raised at a non-loan party subsidiary.

incur debt that is pari passu in right of payment and security with the original loans and (if the credit agreement provides a mechanism for entry into an intercreditor arrangement) such debt would be honored by the existing lender parties.

Notwithstanding the foregoing, it is less likely that new lenders can receive greater credit support or payment rights that are senior to the original lenders without amending the original lenders' credit facilities. Depending on the terms of the credit agreement, the consent needed from the original lenders may range from a simple majority of lenders (the most borrower friendly version) to consent from each lender or affected lender (the most lender friendly versions).

3. **Maturity**: Credit agreements typically provide that incremental term debt incurred after the closing date must mature no earlier than the existing term facility. However, in large cap and sponsor-backed deals, it is not uncommon to find an "inside-maturity" exception which allows a certain amount of debt to mature inside of the existing loans. Borrowers can achieve the same result by utilizing debt and liens baskets which normally do not contain maturity restrictions on raising new debt. Offering inside maturity is a form of seniority that may be an attractive feature for potential lenders.
4. **Structural Seniority**: In some deals, new financings may be structured at entities that are not obligors of the original loans. Many leveraged credit agreements feature meaningful baskets that permit non-guarantor restricted subsidiaries to incur secured debt and allow obligors to transfer assets to such subsidiaries that may serve as collateral (and, in some cases, unrestricted subsidiaries that are not subject to any negative covenants can be created to raise such debt as well). Structuring new financings at non-guarantors provides the new lenders with claims that are senior to any residual interests the original lenders may have against such entities.[7]

CONCLUSION

As borrowers face a period of prolonged market uncertainty, they would be well advised to consider what sources of liquidity are currently available, and financial participants may re-examine loan documents to determine what additional flexibility may exist to implement and fund new financings, including additional term loans. Existing lenders may also examine their existing protections to assess what risks they may have to preserving the value of their existing loans.

Our briefings on coronavirus considerations for the leveraged finance market and other coronavirus materials can be found here:

https://www.cliffordchance.com/insights/thought_leadership/coronavirus.html

7 For example, it was reported that the Landry's financing (described above) was structured at an isolated unrestricted subsidiary which possessed the group's valuable online gaming assets.

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