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Market Update: Delayed Draw Term Loans

Historically, delayed draw term loans ("DDTLs") were generally seen in the middle market, non-syndicated world of leveraged loans. DDTLs were used in bespoke arrangements by borrowers who wanted to get incremental committed term loan capacity (often for future acquisitions or expansions) but wanted to delay the incurrence of the additional debt (and thus the additional interest expense) until the funds were needed. DDTLs were provided by middle market lenders who, in contrast with investors in syndicated loans, were comfortable holding longer-term commitments on their balance sheets. But since 2017 we have seen a rise of DDTLs in the larger, broadly syndicated leveraged loan market. Recent leveraged loan transactions with DDTLs include *Spectrum Plastics*, *Convergint Technologies*, *PetVet*, *Worldstrides* and *Shutterfly*, to name a few. These deals range in size from $400 million – $800 million, which is well above the size of deals that would typically have had a DDTL.

While the fee structure for DDTLs has always been a negotiated point and has varied based on the actual arrangements, sponsors/borrowers and debt providers, the migration of the DDTL tranche 'upmarket' has put the spotlight on some of those economics: DDTLs carry ticking fees akin to commitment fees, which are payable during the commitment period on the unused portion of the DDTL commitment. In syndicated term loan financings, ticking fees have often been priced at half the margin within some period of time after closing, ratcheting up to the full margin at some point thereafter (usually six months to one year). However, in a recent deal, a strong sponsor was able to secure a DDTL in a large-cap transaction with the ticking fee set at 1% for the entire two years of the DDTL commitment period. Parties further continue to negotiate the upfront fee/OID structure for DDTLs, i.e., what percentage of such fees are payable at closing and what percentage are payable at draw. The increased use of the DDTL in the leveraged loan market is also driving longer commitment periods. DDTLs used to be available for three, six or 12 months, but the DDTLs in the recent deals are available for up to two years. Further negotiations may be around conditionality for the delayed draw and use of proceeds.

The spread of the DDTL from the non-syndicated market to the syndicated market can be attributed to a few factors. The first likely cause is the continued strength of borrowers in the leveraged loan market as a whole. Demand for yield continues to exceed supply in the leveraged loan market and sponsors and borrowers are well-positioned to negotiate for new and better instruments and terms. Additionally, DDTLs have proven to be a very useful tool for private equity firms that invest in platform deals with buy-and-build strategies. The DDTL provides borrowers with committed financing for post-closing acquisitions without the need to go through the (often more costly and lengthy) process of raising additional commitments, all the while keeping the revolver undrawn. The additional cost associated with the portion of the underwriting and upfront fees payable at closing and the ticking fee may very well be worth it, if the pipeline of acquisitions is strong enough so that there is little risk that the DDTL (or a meaningful portion thereof) will expire undrawn. We can expect more movement on DDTL terms if the structure remains available and becomes more widely used within the broadly syndicated loan market.