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Unitranche Loan Structures: Trending in the Middle Market

by Anthony R. Callobre, Los Angeles Shareholder & Alexandra E. Ciganer, Orange County Attorney, Buchalter

Unitranche loan structures are popular financing devices for middle-market borrowers and a good option for certain syndicate lenders. These loan structures appeal to borrowers because they offer a single streamlined set of loan documents, a single set of financial and other covenants, a blended interest rate, and little syndication risk. Borrowers (and lenders) value these facilities for their efficiency, speed and ease of execution.

A unitranche loan is a term loan that combines both senior and junior components in a single credit facility. Unitranche loans are typically made by a small syndicate of lenders. A unitranche loan is documented in a single set of loan documents. Pursuant to these documents, the borrower agrees to pay a blended interest rate on the entire principal amount of the unitranche loan and grants a single lien in favor of the administrative or collateral agent to secure the payment and performance of the entire unitranche loan.

A unitranche loan is divided into senior ("first-out") and junior ("last-out") components pursuant to a separate agreement among lenders (the "AAL") to which the agent and the lenders, but typically not the borrower, are parties. The AAL is essentially the intercreditor agreement for a unitranche loan. Through elaborate, and often extensive and complicated waterfall provisions, the AAL provides for a payment priority in favor of the first-out lenders. The AAL also reallocates interest payments so that the first-out lenders receive a lower interest rate and the last-out lenders a higher rate. Most of the negotiations in AALs center around voting rights, enforcement rights, assignment rights, buyout rights, and rights in a bankruptcy.

Commercial banks are logical participants in the "first-out" component of a unitranche. Before entering into a unitranche, however, banks should be aware of certain unique issues that these loans pose for first-out lenders, for example, voting rights, enforcement rights, the complexity and nuances of the AAL, enforceability of the AAL, liquidity restrictions and bankruptcy issues.

Despite these issues and complexities, unitranche loans continue to increase in popularity as appealing financing devices for middle-market borrowers, and banks will be presented opportunities to participate in unitranches as first-out lenders. Banks should embrace those opportunities to ensure an appropriate share of the middle-market leveraged lending business. Nevertheless, unitranches present several unique issues for banks and require careful drafting and negotiation of the relevant loan documents to ensure that banks are afforded rights and remedies consistent with their expectations.

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Anthony R. Callobre
Buchalter Shareholder Anthony R. Callobre practices in the areas of commercial lending and corporate finance. His clients include commercial banks, commercial finance companies, hedge funds, private equity groups, business development companies, and other investors and lenders. Contact Anthony at acallobre@buchalter.com or 213-891-5024.

Alexandra E. Ciganer
Alexandra E. Ciganer focuses her practice in the areas of commercial lending and corporate finance. She represents multinational financial institutions, leading private equity sponsors and public and private corporate borrowers in a range of financing transactions. Contact Alexa at aciganer@buchalter.com or 949-224-6202.