



Thomas Majewski

Founder & managing partner

Eagle Point Credit
Management

CLO indentures and allocation policies can help managers as borrowers refinance

Amend and extends have been the loan market's flavour of the year. At the same time, many CLO reinvestment periods are reaching their end because the reset market is virtually closed. Roughly 40% of CLOs are slated to be beyond their reinvestment period at the end of 2023. With CLOs holding nearly 70% of all loans, this effectively knocks out 28% of total loan buying capacity. These two forces cannot coexist peacefully. Something will need to give.

The focus on extending maturities is not new for chief financial officers. However, with rating agencies increasingly focused on the risks of short-term maturities, borrowers' sensitivity to near-term loan maturities in their capital structures has been heightened. With nearly 15% of the loan market facing a maturity before 2025, amend and extend transactions continue to be topical, with borrowers looking to get ahead of ratings reviews or a potential refinancing squeeze.

After their reinvestment periods end, CLOs are generally unable to commit to loan extensions due to the shortening of the weighted average life test demanded by triple A investors, or requirements that purchased assets have shorter maturities than the maturity of the sold or repaid asset that

forces. Certain well-structured CLOs contain indenture provisions for "maturity amendment" transactions that allow for the rolling of a loan investment into a longer-term loan, despite non-satisfaction of the weighted average life test, if certain limits are not breached and/or there is a credit reason for doing so.

Regrettably, of those CLOs that have such a provision, often the documents limit their usage to a mere 10%, or less, of the loan portfolio. And some CLO collateral managers might not be familiar with how to use these esoteric features.

Flexible amendment options

Other CLOs include language whereby a determination that the amendment is accretive to the overall CLO itself by the CLO collateral manager may permit larger participations, subject to less stringent restrictions. With many amend and extend transactions including additional economics and sponsor equity investment support, we have found it advantageous for CLOs to be able to consider the use of this flexibility.

Investors should understand their indenture provisions and CLO collateral manager allocation policies to ensure these opportunities are not

Borrowers are finding creative ways to address loan maturities

provided the initial proceeds. Unless the proposed extension is below the market standard of five or more years, most post-reinvestment CLOs will struggle to participate in extensions.

Refinancing via secured bond market

We are already seeing the effect of shorter remaining CLO reinvestment periods on borrowers' ability to amend and extend. Some borrowers have moved to the secured bond market to refinance portions of their loans. Others have sought private debt solutions for challenged credits, usually at more expensive financing terms. In fact, we have seen more than a twofold increase in the year-over-year percentage of high-yield issuance dedicated solely to loan refinancing.

As a final option, some borrowers have opted to request shorter extensions or decreased their facility sizes. One borrower, Internet Brands, decided to leave some of its short-term loans outstanding when it could not fill out the entire book. It is clear borrowers have had to get creative to ensure they can address maturities adequately.

CLOs will see significant variations in performance based on how CLO collateral managers are able to handle these conflicting

missed or assigned to other, newer accounts that didn't own a loan pre-extension.

We believe the market will eventually find a solution to the logjam. But they will be some adverse consequences for lenders and borrowers along the way, so it is essential CLO equity investors carefully monitor the performance of their CLO collateral management teams.