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Structuring Delayed Draw Term Loans: Conditions Precedent, Ticking Fees, Fronting Arrangements, Evolving Uses

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Today's faculty features:

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Structuring Delayed Draw Term Loans: Conditions Precedent, Ticking Fees, Fronting Arrangements, Evolving Uses

Presented by **Meyer Dworkin and Vanessa Jackson**

April 29, 2020

Davis Polk

Davis Polk & Wardwell LLP

Delayed Draw Term Loans – Background

- Hybrid Instrument
  - Initially undrawn commitments; but
  - Once funded, convert to a “term” (i.e., not revolving) structure
- Material Terms
  - Specified commitment period (after which commitments terminate);
  - Fees:
    - ticking fee;
    - upfront fee (OID); and
    - commitment fee (where applicable)
  - Relationship to existing loans (fungibility)
- Use of Proceeds
  - Historically “middle market” product;
  - Increasingly used as “dry powder” in large-cap financing structures

Commitment Period/Use of Proceeds

- Historically: finance a single identified (and signed) acquisition
  - *Commitment period*: relatively short (3-6 months) to match expected closing timeline of acquisition
  - *Structure*: Single draw on the acquisition closing date
- Increasingly: finance a broad range of transactions including:
    - Multiple (unidentified) “roll-up” acquisitions;
    - Repay maturing debt; and
    - Capital expenditures.
  - *Commitment period*: 18 - 24+ months
  - *Structure*: multiple draw (often subject only to a minimum borrowing amount)
    - Replenish (prior) revolver drawings; or
    - Borrow in advance based on “good faith” expectation of need.

Conditions Precedent

- General Rule:
  - Borrowings under (non-acquisition) credit facilities are generally conditioned upon:
    - No default/event of default; and
    - Accuracy of all representations/warranties
- Historically, delayed draw term loans (used for acquisition purposes) subject to “limited conditionally”:
  - No payment or bankruptcy event of default;
  - Accuracy of “specified” representations/acquisition agreement representations;
  - Consummation of the identified acquisition; and
  - Pro forma compliance with a maximum first lien/total leverage ratio (typically set at closing date levels)
- Increasingly, due to varying use of proceeds and longer commitment periods:
  - Lenders push for more customary no default/accuracy of reps (other than for acquisitions); and
  - Borrowers seek to remove leverage ratio condition

Fees – Ticking Fee

- Ticking Fee:
  - Similar to an unused commitment fee for a revolving credit facility, compensates lenders for providing undrawn commitments during the commitment period
  - Accrues on the undrawn commitment amount, subject to:
    - Initial post-closing holiday: 30-90 days
    - Rate step up (every 30-60 days): from 50% of applicable margin to 100% of applicable margin to 100% of applicable margin + LIBOR (inclusive of "any floor")
  - Payable, periodically (monthly/quarterly), upon any drawing and upon commitment termination
  - Differs from pre-closing "syndication" ticking fee, but "holiday" may lead to anomalous results

Fees – Upfront Fee and Commitment Fee

- Upfront Fee:
  - Fee (also referred to as OID) payable to lenders upon the making of term loans (and providing revolving commitments) at closing
  - Historically: upfront fee paid on delayed draw term loans in full at closing (whether or not made)
  - Increasingly: Mixed practice as to payment at closing (in full) or funding (on funded amount)
    - Highly dependent on syndication process and syndicate requirements (e.g., for compensation even where the DDTL is never funded)
- Commitment Fee:
  - Fee payable to lenders for provide agreeing to provide delayed draw term loan commitments in advance of closing
  - Historically: fee paid in full on delayed draw term loan commitments at closing
  - Increasingly: Same, although large-cap borrowers are starting to ask for same treatment as upfront fees
    - Lenders almost uniformly (and successfully) push back on the basis that so long as closing occurs, they should receive compensation for their pre-closing commitments even if the DDTL is never ultimately funded

Relationship to Existing Loans

- Fungibility:
  - In broadly syndicated deals, lenders generally prefer that the delayed draw term loans are identical to the existing term loans
  - Such “fungibility” permits the DDTL to “trade” together with the existing loans as a single, liquid “class” or “facility”
  - Less relevant to bilateral or “clubbed” deals, although different “tranches” creates administrative/operational complexities
- Issues to consider:
  - Fungibility requires the terms of the DDTL be identical to the existing term loans, including:
    - Interest rate; and
    - Maturity
  - Prepayment premium (if any) may need to be extended
  - Amortization payments (if any) may need to be increased

Fronting Arrangements

- Generally:
  - For operation convenience, administrative agents and lead arrangers often “front” loans in connection with:
    - revolving borrowings (especially in investment grade facilities), where the agent has extensive relationships with the other (primarily commercial bank) lenders;
    - term loans at the closing of a syndicated financing, where the arrangers have committed to the full amount of the term loans.
      - Arrangement is documented pursuant to a “backstop” fronting letter with the other arrangers
- Application to delayed draw term loans:
  - Given longer commitment periods, multiple draw features and need to consummate an acquisition, borrowers have increasingly requested agents to “front” DDTLs for the (potentially large) syndicate
  - However:
    - Agent is hesitant to take credit risk of 100+ institutional lenders; and
    - No fronting letter exists (as syndicated – not arranging lenders – have committed to make such loans)
- Solution: Expand “assumed lending” provisions from revolving borrowings to apply to the delayed draw context:

Fronting Arrangements (cont.)

At its option and in its sole discretion, the Administrative Agent may fund the Delayed Draw Term Loans on any Delayed Draw Funding Date on behalf of each Lender having a Delayed Draw Commitment immediately prior to such Delayed Draw Funding Date. To the extent the Administrative Agent funds the Delayed Draw Term Loans on behalf of such Lenders, **each Lender** with a Delayed Draw Commitment immediately prior to any Delayed Draw Funding Date **and the Borrower severally agree** to repay to the Administrative Agent **within one Business Day** after the Administrative Agent has funded the Delayed Draw Term Loans on such Delayed Draw Funding Date, the amount of Delayed Draw Term Loans corresponding to such Lender's Delayed Draw Commitment immediately prior to such Delayed Draw Funding Date together with interest thereon, for each day from the date such amount is made available to the Borrower to but excluding the date such amount is repaid to the Administrative Agent at (i) in the case of the Borrower, a rate per annum equal to the interest rate applicable at the time to the Loans comprising such Borrowing and (ii) in the case of such Lender, a rate determined by the Administrative Agent to represent its cost of overnight or short-term funds (which determination shall be conclusive absent manifest error). If such Lender shall repay to the Administrative Agent such corresponding amount, such amount shall constitute such Lender's Delayed Draw Term Loan as part of such Borrowing for purposes of this Agreement.

Fronting Arrangement (cont.)

Unless the Administrative Agent shall have received notice from a Lender holding Delayed Draw Commitments prior to the date of any Borrowing of Delayed Draw Term Loans that such Lender will not make available to the Administrative Agent such Lender's Pro Rata Share of such Borrowing, **the Administrative Agent may assume that such Lender** has made such Pro Rata Share available to the Administrative Agent on the date of such Borrowing, and **the Administrative Agent may in its sole discretion**, in reliance upon such assumption, make available to the Borrower on such date a corresponding amount. In the event that the Administrative Agent has elected to make available to the Borrower any portion of the Delayed Draw Term Loans and any Lender with a Delayed Draw Commitment has failed to fund its portion thereof on the date and time required by this Agreement (any such Lender, the "**Unfunded DDTL Commitment Lender**", any such Delayed Draw Term Loans provided by the Administrative Agent, the "**Fronted Delayed Draw Term Loans**"), until the time that such Unfunded DDTL Commitment Lender has funded its portion of any Fronted Delayed Draw Term Loans and reimbursed the Administrative Agent, the Administrative Agent shall be entitled to receive any interest accruing applicable to such unfunded Fronted Delayed Draw Term Loans and shall be entitled to retain the Delayed Draw Upfront Fee applicable to such Delayed Draw Commitments.

Upon funding by the relevant Unfunded DDTL Commitment Lender of any Fronted Delayed Draw Term Loans, (x) the proceeds of such funded Fronted Delayed Draw Term Loans shall be retained by the Administrative Agent, (y) the Administrative Agent shall remit the Delayed Draw Upfront Fee to such Unfunded DDTL Commitment Lender and (z) interest applicable to such funded Fronted Delayed Draw Term Loans commencing with the date of such funding shall accrue to such Unfunded DDTL Commitment Lender. Additionally, **if any Unfunded DDTL Commitment Lender becomes a Defaulting Lender, then such Unfunded DDTL Commitment Lender's Fronted Delayed Draw Term Loans may be assigned** to the Administrative Agent without any further action by any party and the Administrative Agent shall be the "Lender" with respect to such Fronted Delayed Draw Term Loans for all purposes hereof and the Administrative Agent shall be entitled to retain the Delayed Draw Upfront Fee. Each Lender hereby irrevocably appoints the Administrative Agent (such appointment being coupled with an interest) as such Lender's attorney-in-fact, with full authority in the place and stead of such Lender and in the name of such Lender, from time to time in the Administrative Agent's discretion, with prior written notice to such Lender, to take any action and to execute any such Assignment and Assumption or other instrument that the Administrative Agent may deem reasonably necessary to carry out the provisions of this clause.

Direct Lending

- Increasing willingness of direct lenders to provide delayed draw commitments:
  - Provides a borrower (especially one with deferred purchase price or similar obligations/"roll-up" strategies) with the flexibility to borrow only when/as needed and with certainty of funding
  - Size can be significant relative to original deal size (>50%)
  - Provides certainty of pricing (typically at the same pricing as the original financing), with variable ticking fees
  - Most common use is for acquisition-driven growth strategies
  - Conditions: maximum leverage (typically at or inside closing), customary representations and warranties bring down and other delivery requirements
  - Commitment length: Typically between 6-24 months

Thank You

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Mr. Dworkin is a partner in Davis Polk's Corporate Department, practicing in the Finance Group. He advises lenders and borrowers on a variety of finance transactions, including acquisition financings, asset-based financings, debtor-in-possession financings and bankruptcy exit financings and structured financings.

In addition, Mr. Dworkin regularly represents hedge funds and corporations in negotiating prime brokerage agreements, ISDA and BMA-standard agreements and other trading and financing documentation and other complex structured financial products.

Mr. Dworkin's clients have included many major financial institutions, direct lenders and corporations across various industries, including Ford, Ingram Micro, Match Group, Reynolds Group, Taboola and V.F. Corporation.

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