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‘Unitranche’ debt is gaining ground with some US mid-market investors

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In March, Chicago-based Monroe Capital closed a $250 million fund focused on mid-market debt investments. Within three months, it had invested roughly 25 percent of the fund in unitranche debt, which combines traditional senior and junior debt terms in a single senior facility.

Unitranche lending has become an increasingly common method of providing capital as of late, and many private equity firms and lenders actually prefer unitranche debt over the conventional capital structure, says Monroe president and chief executive Ted Koenig.

“It’s become much more popular post-credit crisis because it’s a much more efficient structure,” says Koenig. “You have fewer parties to deal with, no inter-creditor agreement issues with the company and one set of rules and regulations.”

Rather than having a separate interest rate for senior and mezzanine debt, the unitranche structure employs a single blended rate that averages out the cost of the two forms of capital. The simplicity of working with a single party can also help close deals quicker, an attractive characteristic for firms that value ease of execution.

In recent months, Monroe’s clients have increasingly been requesting the unitranche product, Koenig says. “Our goal is to put a lot of this product out into the market and help private equity funds purchase companies,” Koenig says.

Anne Hayes, a partner in the capital markets division at US mid-market firm The Riverside Company, has been working with unitranche loans since 2001, but says she has noticed the recent increase in that type of lending.

“I think a lot of the popularity right now is really driven by the business development companies,” she says. “The lull in the senior market, when people weren’t sure what they were going to be able to do, left this opening for unitranche, and people jumped in. I can think of a handful of our lenders who are super active offering unitranche.”

Mid-market lender Golub Capital has been offering unitranche debt since 2005 and has its own brand of the product called Golub One Loan Debt, or GOLD loans. President and founder Lawrence Golub says unitranche debt is a “fabulous product when the borrower and the lender have a long term relationship”, as a “relationship lender” is more likely to grant an amendment if a borrower has trouble making a payment.

“The most beautiful thing about a unitranche loan – when you do it with a relationship lender who can be rational and reasonable about a problem – is that it actually increases the odds that the deal will be successful.” If a problem does arise, pursuing a workout with just one group can also be significantly less expensive than having to settle with a long list of lenders.

“Just think about how much money goes to these turnaround consultants and to the lawyers,” Golub says.

On the other hand, borrowing a large amount of capital from a single lender can make it easier to be forced into financial distress should a company not be able to make a payment.

“If you take a unitranche loan from an aggressive lender, you risk getting your head handed to you,” Golub says.

Unitranche debt transactions are rarely completed when total credit facilities are $200 million or more, and only a handful of players make unitranche loans over $100 million. Still, the sudden prevalence of a product that has been around for years could potentially change the lending landscape in the mid-market, according to Koenig.“I think it’s an inherent challenge for mezzanine funds because mezzanine funds have a hard time matching the cost of capital,” he says.

Even if unitranche loans don’t drastically alter the lending environment, the ability to offer an alternative debt product only increases the likelihood of completing a deal, says Hayes.

“Some unitranche lenders can say ‘Here’s our senior proposal, here’s our mezzanine proposal, here’s our unitranche proposal,’” Hayes says. “That’s really valuable from a sponsor standpoint, particularly for us, who don’t have a bias towards one or the other.”

Golub says for the relationship-oriented borrower it could be a “game changer”. But, he adds, “For the non-relationship oriented borrower, it’s not.”