

Syndicated Lending

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Abstract

Syndicated lending involves a group of lenders providing a single loan to one borrower. This article considers the purposes and workings of syndicated loans in the Australian market, and the advantages of this type of lending for both lenders and borrowers. It finds that syndicated loans are a significant source of funding for large Australian businesses and for borrowers with large financing needs, especially as such loans are often more accessible and flexible than public debt markets. For lenders, syndication allows them to diversify their exposures, as well as to monitor loans and negotiate covenants efficiently.

Introduction

A syndicated loan is extended by a group of lenders to a single borrower. The borrower typically organises this by agreeing to terms with a small group of banks, called mandated lead arrangers. In most cases, the mandated lead arrangers seek other lenders to join the syndicated loan as participating lenders.^[1]

Syndicated lending in Australia has expanded since the mid-1990s, along with overall business debt. The flow of new loan commitments for syndicated loans (including refinancing) increased from about \$10 billion in 1995 to about \$140 billion in 2022, and annual commitments have made up around

10 per cent of the stock of total business debt for the period since the global financial crisis (GFC).^[2] In 2022, non-financial businesses in Australia borrowed about seven times as much through syndicated loans as they issued in corporate bonds (Graph 1).^[3] By contrast, globally, the US dollar syndicated loan market and the US dollar corporate bond market are similar in size (Lee, Liu and Viktors 2017).

This article uses a sample from Refinitiv of 4,000 loans to Australian borrowers since 1984 to summarise the features of syndicated lending and consider why firms engage in this market.^[4]

Purpose of syndicated loans

Firms use syndicated loans for a variety of purposes that can be grouped into three categories:

- **project finance** – including long-term infrastructure or industrial projects that require significant capital investment, such as projects for transport, mining operations or renewable energy, as well as public-private partnerships to build hospitals, schools and other public infrastructure
- **mergers and acquisitions (M&A)**
- **general purposes** – including loans for working capital, operating expenses and capital expenditures.

The refinancing of existing loans accounts for a significant share of syndicated loan commitments, particularly when the loan is for general purposes or project finance (Graph 2). A borrower may choose to refinance debt to access more funds, extend the maturity of a loan, consolidate multiple debts or negotiate more favourable terms. Since refinancing replaces existing debt, commitments for refinancing only add to total debt outstanding to the extent refinancing involves an increase in the size of the loan. Commitments excluding refinancing provide a better indicator of new lending activity (Graph 3).

Most of the growth in new syndicated loan commitments since 2010 has been in lending for general purposes. Commitments for project finance have been around the same level over this period, while much of the variation in overall commitments has reflected commitments for M&A (Graph 4). This

variation is consistent with research that shows debt funding in Australia is positively correlated with M&A (Connolly and Jackman 2017). The large volume of M&A in the period leading up to the GFC and around 2021 involved high levels of syndicated loan commitments. Commitments for M&A also picked up around 2016; however, this reflected a few particularly large loans for M&A rather than a material pick-up in total M&A.

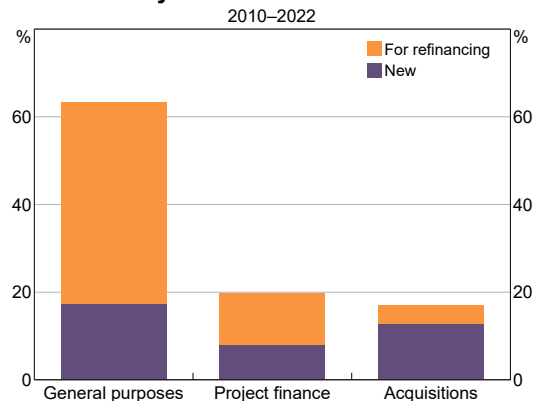
Advantages for borrowers

Large loan size

Syndicated loans allow borrowers to raise a large amount of funds with medium- or long-term maturities. The average facility in a syndicated loan is about \$300 million – a similar size to what firms can obtain by issuing a corporate bond. A single syndicated loan may comprise multiple facilities

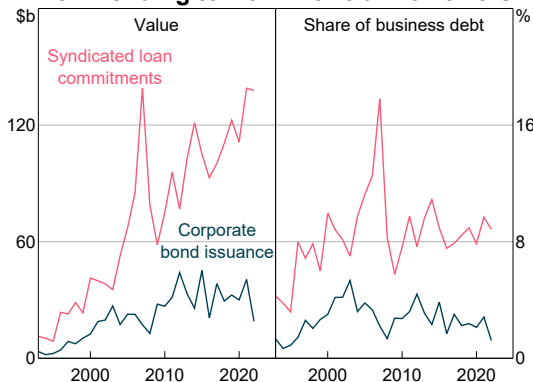
Graph 2

Share of Syndicated Loan Commitments



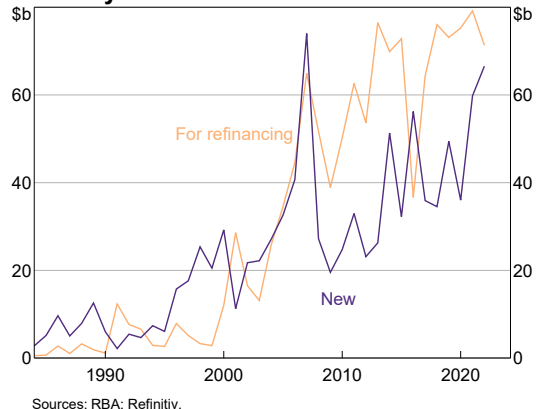
Graph 1

New Lending to Non-financial Borrowers



Graph 3

Syndicated Loan Commitments



with different features, such as whether the loan is fixed term or is a revolving line of credit (see below). By contrast, a bilateral loan provided by a single lender to a borrower is much smaller on average (Graph 5). Large syndicated loans over \$1 billion have accounted for about 30 per cent of the value of syndicated loan commitments since mid-2019 (Graph 6).

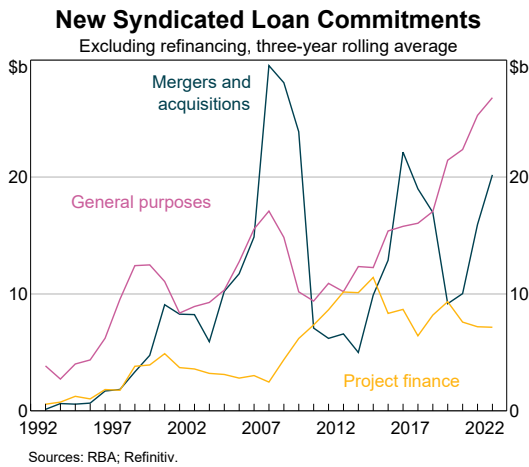
The size distribution of corporate bond issuance was similar to that of syndicated lending over this period, with the exception of a few very large loan facilities in excess of \$2.5 billion. There were no corporate bond issues of similar size by Australian borrowers between July 2019 and December 2022. Syndicated loans typically have a shorter term than corporate bonds, which may reflect the timeframes

of the underlying activities being financed (Graph 7). Some syndicated loans are for bridging purposes (with terms less than one year); loans for M&A tend to have shorter terms than loans for project finance.

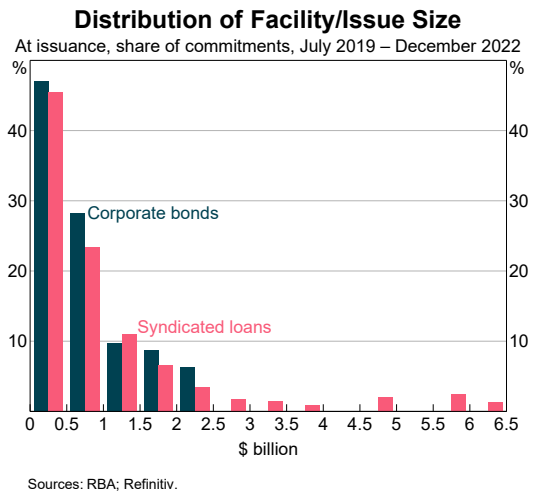
More accessible than the corporate bond market

Since 2010, about 1,200 Australian firms have contracted syndicated loans, while about 300 firms have issued corporate bonds. Smaller firms may be deterred by the substantial fixed costs associated with issuing bonds, such as the cost to disclose information or obtain a credit rating (Pattani and Vera 2011). Firms without an investment-grade credit rating typically find it more costly and difficult to access funding through corporate bonds than syndicated loans; only about 8 per cent of

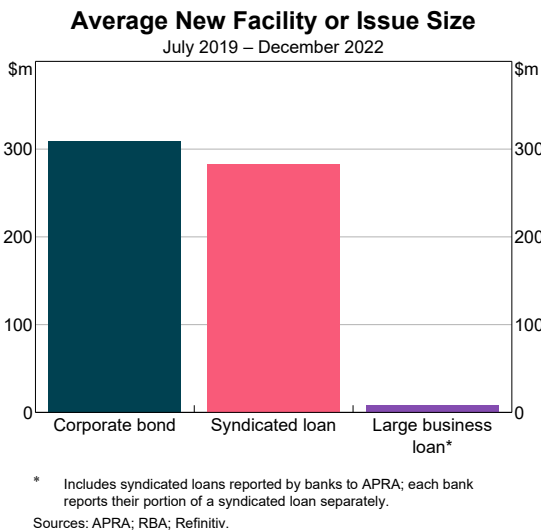
Graph 4



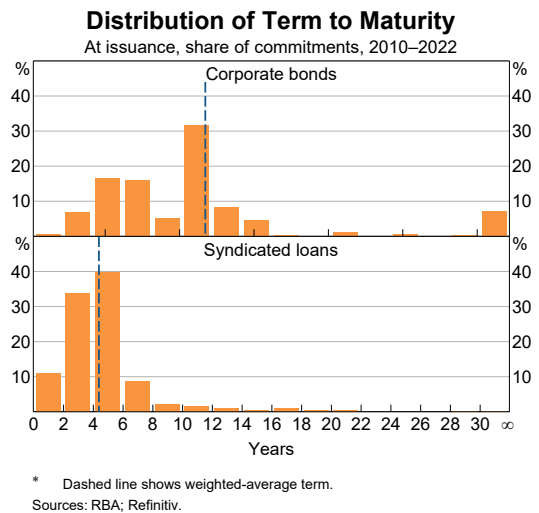
Graph 6



Graph 5



Graph 7



Australian borrowers in the syndicated loan market have at least one recorded credit rating, compared with about half of corporate bond issuers.

Flexible loan terms

About 60 per cent of syndicated loans comprise multiple facilities to suit the different financing needs of a given borrower – for example, a borrower may include a revolving credit facility to meet working capital requirements as well as a fixed-term loan facility to fund a long-term investment. Allowing for multiple facilities improves access to credit by allowing for different contractual terms across facilities but under the umbrella of a single syndicated loan. Facilities can have different collateral, maturity date, interest rate, or claim priority in the event of insolvency. Larger loans tend to have more facilities (Graph 8). Having more facilities in a loan, however, can increase transaction costs, such as legal or regulatory costs (Cumming *et al* 2020).

Advantages for lenders

Diversification

Syndication allows lenders to share the credit risk of a large loan and avoid excessive exposure to a single borrower or industry. Banks are subject to regulatory requirements such as limits on how much they can lend to any one borrower, which encourages them to share exposure to a large borrower with other lenders via a syndicated loan

(Simons 1993; Gadanecz 2004). Syndication also allows arranging banks to serve more borrowers and maintain relationships with customers to whom they could provide loans or other services in the future.

Access to foreign markets

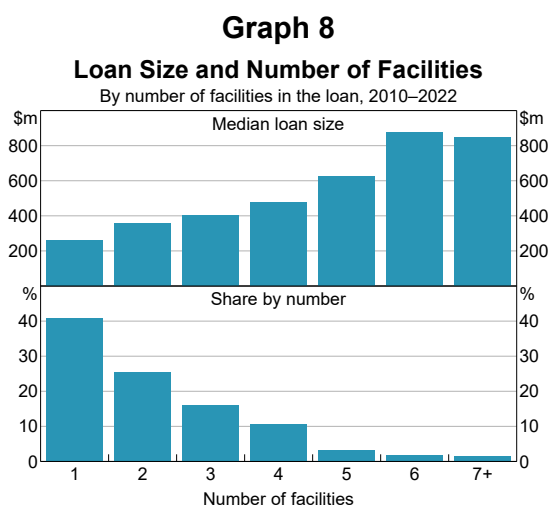
Alongside the major Australian banks, foreign banks are the main participants in the Australian syndicated lending market.^[5] Foreign lenders that lack expertise in the Australian market can gain exposure to Australian borrowers by participating in syndicated loans (RBA 2005). Participating lenders rely on the credit information and loan documentation supplied by the arrangers.

Over the past 30 years, about 90 per cent of syndicated loans to Australian businesses have involved at least one foreign bank. During that period, foreign banks have accounted for about one-half to three-quarters of the value of annual syndicated loan commitments. Not all of these foreign banks have operations in Australia; the foreign banks that do have such operations (and so report to the Australian Prudential Regulation Authority) have accounted for only about 30 per cent of total loan commitments to large businesses since June 2019 (the period for which the data are available).

Asian banks have increased their syndicated lending activity in Australia in the last two decades, while lending by European banks has decreased since its peak in 2007 (Graph 9). Following the GFC, European banks pulled back from syndicated and cross-border lending more generally (Howcroft, Kara and Marques-Ibanez 2014; BIS 2018).

Efficient monitoring and renegotiation

Banks can monitor borrowers more efficiently than can the holders of corporate bonds (Diamond 1984). Monitoring is important for identifying risks to the borrower's ability to repay the loan. The arrangers of a syndicated loan undertake most of the due diligence when the loan is originated, as well as most of the monitoring effort over the life of the loan (Dennis and Mullineaux 2000). Arrangers have an incentive to monitor more actively when they hold a larger share of the loan and when



Sources: RBA; Refinitiv.

borrowers are riskier or more opaque. This is particularly relevant when the borrowers are private firms, for which there is often limited public information available (Gustafson, Ivanov and Meisenzahl 2021).

Syndicated loans typically include covenants, which protect the lenders’ interests by restricting what borrowers can do. When a borrower fails to meet a covenant, a technical default occurs, and the lenders have the right to require the borrower to immediately repay the outstanding loan in full. This is the most extreme response and generally will cause the borrower to become insolvent. Lenders might otherwise renegotiate the terms of the agreement to waive a violation of a covenant in exchange for: a fee or an increase in the interest rate; additional collateral; or tighter loan terms. With syndicated loans, it is feasible and relatively straightforward to renegotiate loan conditions given the modest number of bank lenders involved in any one deal. By contrast, it is extremely difficult to change the covenants of corporate bonds because they are typically held by many different investors (Bradley and Roberts 2015).

Loan pricing

Syndicated loans are typically issued with a variable interest rate, paying a spread against a reference interest rate such as the bank bill swap rate (BBSW). The spread reflects the credit risk of the borrower and whether the loan is secured by collateral, as well as the type of loan and its term. Data on pricing are incomplete because syndicated loans are

confidential, and pricing is often not disclosed. Only 40 per cent of loan facilities by value (25 per cent by number) publicly report pricing information.

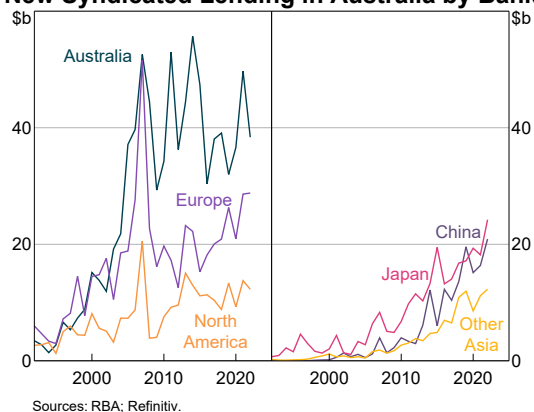
Based on the available data, larger loans tend to have narrow spreads, perhaps because larger loans are typically issued to larger borrowers that are generally less risky (Graph 10) (European Commission 2019). Loans for M&A typically price at a wider spread than loans for other purposes, likely reflecting the greater risk associated with corporate restructuring; these deals often involve a significant increase in leverage and may be more complex than other types of corporate investment.

BBSW is the most common reference rate for syndicated loans to Australian borrowers, based on available data (Graph 11). Since 2010, about two-thirds of total commitments (and over 90 per cent of Australian dollar commitments) referenced BBSW. Between 2010 and 2021, US dollar loans largely referenced the London Inter-Bank Offered Rate (LIBOR), which had long been the primary reference rate for syndicated loans in the United States. However, given limitations of the LIBOR benchmark, regulators globally determined that market participants should cease creating new contracts that reference LIBOR by the end of 2021 and switch to alternative reference rates (RBA 2021). Since 2022, US dollar loans have generally referenced the Secured Overnight Financing Rate (SOFR).

Average spreads on syndicated loans were around 170–180 basis points above the relevant reference

Graph 9

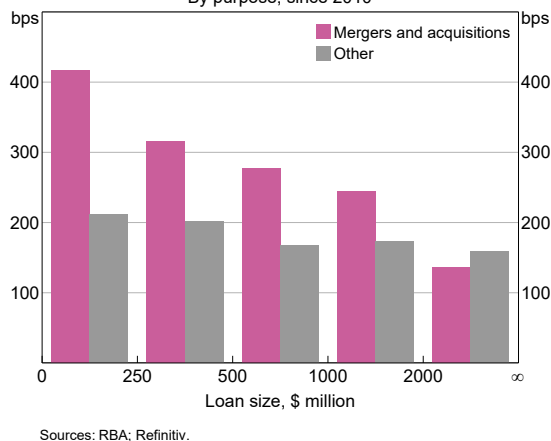
New Syndicated Lending in Australia by Bank



Graph 10

BBSW Spreads on Syndicated Loans

By purpose, since 2010



rate in 2022 (Graph 12). Interest rate spreads have increased for both Australian and US dollar denominated loans since the GFC, reflecting several factors including increased capital requirements, bank funding costs and a repricing of risks since the crisis.

Interest rates on syndicated loans are about the same or higher than the interest rates on variable-rate loans to large businesses more broadly, or on corporate bonds that receive a BBB rating (BBB+, BBB or BBB-) – the lowest rating above the threshold to still be considered ‘investment grade’. BBB-rated corporate bonds were around 150–210 basis points above the Australia dollar swap rate in 2022 depending on the tenor of the bond. New large-business variable-rate loans were around 120 basis points above the three-month BBSW (the standard benchmark used to price loans to large businesses).

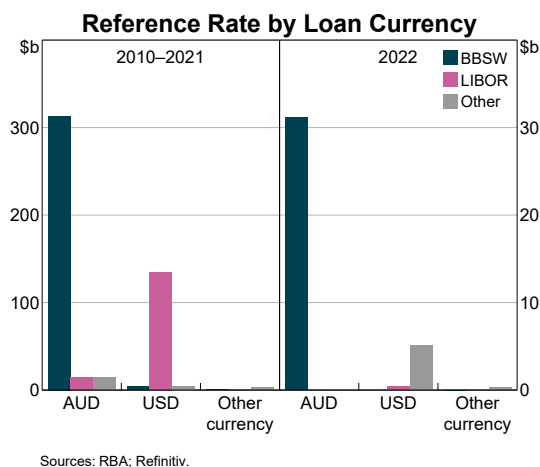
This comparison does not account for loan and borrower characteristics that may affect risk – for

example, riskier private firms may prefer syndicated loans over corporate bonds, and syndicated loans tend to have longer terms to maturity than bilateral loans. However, syndicated loans are not less expensive than bilateral loans, after accounting for loan and borrower characteristics (Cortés, Tribó and Adamuz 2020). Spreads on different syndicated loans also tend to be quite dispersed; in particular, riskier loans mostly for M&A can have spreads much higher than average.

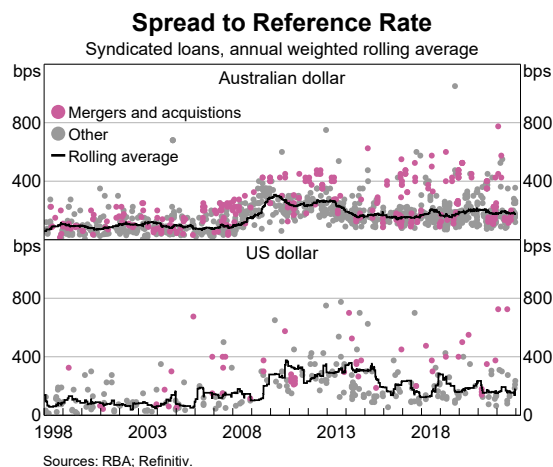
Conclusion

Syndicated loans are a significant source of funding for larger Australian businesses, particularly for large projects and M&A. The market is useful for borrowers requiring larger loans, flexible contractual terms or access to funds in the absence of having obtained a credit rating. Lenders benefit through diversification, efficient monitoring and access to foreign markets. ↗

Graph 11



Graph 12



Endnotes

- [*] The author completed this work in Domestic Markets Department. The author would like to thank Laura Nunn for further work on the data and code. Christian Maruthiah, Nick Eagles, Joel Bank and Andre Chinnery contributed to the data on lender region. This article draws on analysis of the Australian corporate bond market by Nina McClure.
- [1] About 35 per cent of loans by value to Australian borrowers are club deals, which are deals for which the lead arrangers commit to provide the full loan to the borrower without further syndication. Club deals are on

average about 80 per cent of the size of loans that are further syndicated. For more information on how syndicated loans are arranged, see RBA (2005); European Commission (2019); Pitchbook (2023).

- [2] Loan commitments are used throughout this article due to lack of data availability of credit data.
- [3] For more information on the Australian corporate bond market, see Lim *et al* (2021).
- [4] The sample excludes borrowers in financial industries identified as Standard Industry Classification (SIC)

60 through 64. This exclusion filters out credit institutions, security and commodity brokers, and insurers. These borrowers accounted for about 10 per cent of syndicated loans. However, venture capital firms and units investing on their own account are included in the sample.

[5] Although the dataset does not indicate institution type, a review of the top 20 lenders in each year shows that lenders in the Australian market are largely banks, rather than non-bank lenders. Smaller Australian banks tend not to participate in syndicated lending.

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