

# When is non-bank debt financing used?

## What is non-bank debt?

Non-bank debt is debt financing provided by an institution that is not a commercial bank. Non-bank lenders operate through dedicated entities/vehicles, set up to invest in companies by providing them with debt financing and generate a return for their capital providers by collecting interest/fees.



## When is non-bank debt considered?

- 1. Bank financing is not a fit.** Not all financing situations fit within a bank lender's "box". Non-bank lenders currently fund over 85% of leveraged loans compared to ~40% in the late 1990s<sup>[1]</sup>. Growing participation has been supported by non-bank lenders filling "white space" created by (i) post-'07/'08 banking regulation, causing bank lenders to take a more conservative leverage position and lending approach, and (ii) continued bank consolidation, causing bank lenders to move "up market" and focus on larger borrowers. Today, there are less than half the number of U.S. banks than there were in 2000, and the top 25 hold over 50% of all bank loans<sup>[2][3]</sup>.
- 2. More borrowing capacity is required.** Regulatory guidelines indicate banks are limited above 3.0x senior / 4.0x total leverage (debt-to-EBITDA; on a cash flow basis)<sup>[4]</sup>. In challenging economic environments, comfortable leverage points can move lower. Non-bank lenders are able to extend borrowing capacity beyond what a bank may provide – including through structures that are more "junior" on the capital stack to bank debt, such as mezzanine debt. Non-bank lenders are willing to extend "deeper" capacity in exchange for a higher cost of capital (e.g., interest rate; "risk/return").
- 3. More cash flow for business growth spend is required.** Non-bank debt tends to carry more flexible repayment requirements relative to bank debt, which can reduce debt service requirements and have a net positive impact on cash flow available for growth spend (e.g., capex, M&A, etc.; see illustrative comparison to the right). With many non-bank lenders set up like investment funds, they are incentivized to have capital deployed and generating a return for their investors (i.e., outstanding and collecting interest).

## Additional considerations

**Lender diversity.** There is a diverse group of non-bank lenders who are governed by the mandate and strategy agreed to with their investors. Investors that fund non-bank lenders span insurance companies, pension funds, endowment funds, hedge funds and other institutional investors. The diversity in perspectives shaping investment approach creates a similarly diverse lender landscape and range of non-bank debt financing options. Banks tend to have a more like approach given common regulatory and risk parameters.

**Additional Services.** Banks are set up to provide cash and treasury management services and offer related products (such as hedges, lines of credit, etc.). Non-bank lenders do not hold deposits or typically provide such products/services.

**All-in costs.** Different financing structures carry different costs and debt service requirements across bank and non-bank debt. Beyond interest rate, borrowers should evaluate the "all-in" cost of funds, including fees and cash flow requirements for repayment (timing, amount, etc.).

## Illustrative Debt Service Comparison

(\$000s)	Bank	Non-Bank
Debt Outstanding	\$20,000	\$20,000
Interest Rate %	8%	11%
Annual Amort %	10%	3%
Interest Expense	\$1,600	\$2,200
Principal Repayment	\$2,000	\$500
<b>Total Annual Debt Service</b>	<b>\$3,600</b>	<b>\$2,700</b>

## Conclusion

Non-bank debt should be on all borrowers' radars. By growing awareness, leadership can broaden their financing options and be better equipped to secure the right solution for their business.

[1] S&P LCD – FDIC Quarterly Review.

[2] FDIC Statistics at a Glance.

[3] Federal Reserve: Assets of Commercial Banks in the U.S.

[4] OCC Leveraged Lending Guidelines.

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