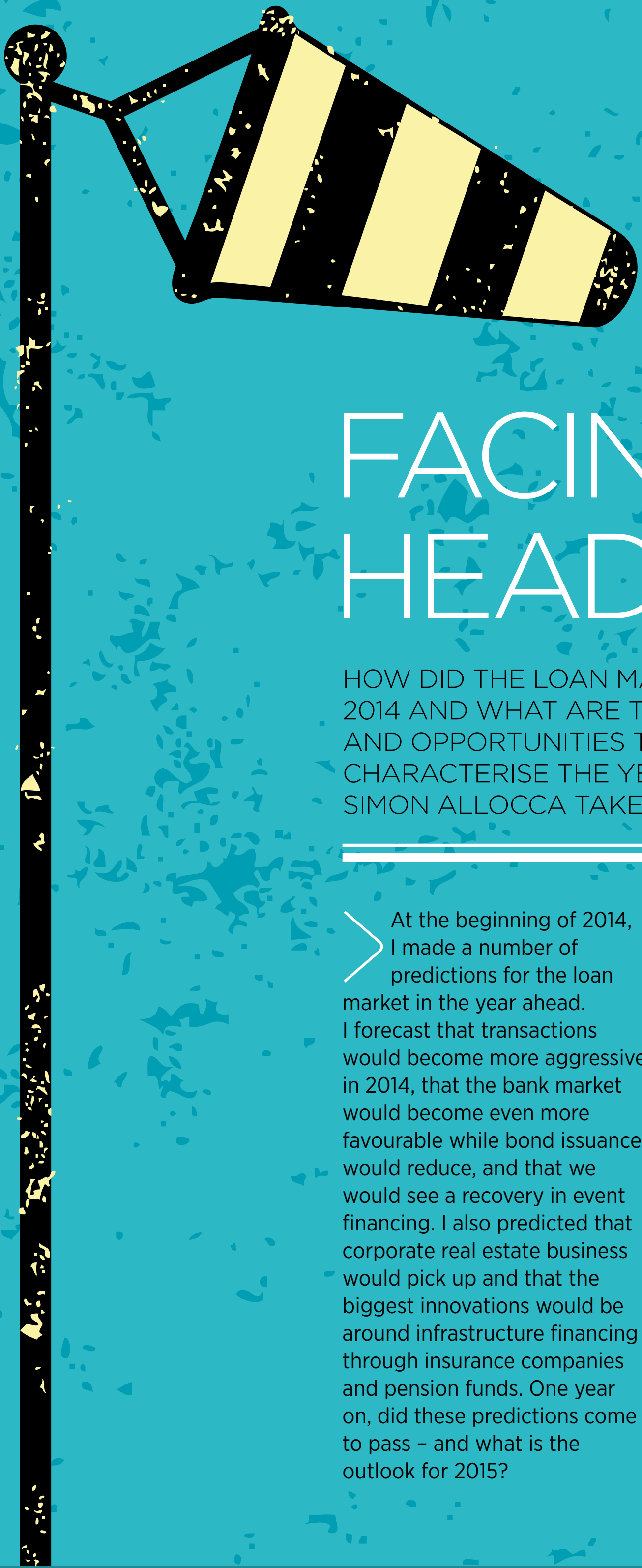
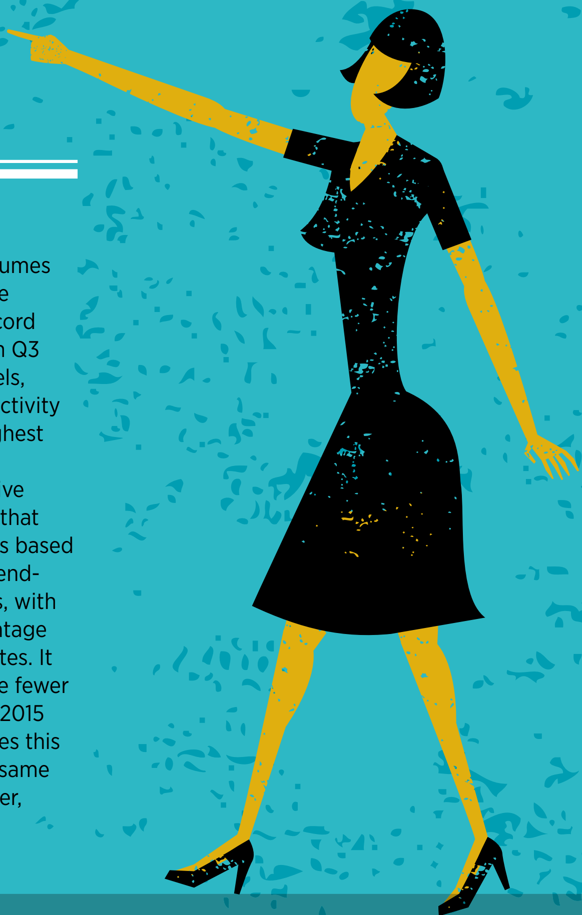


# FACING HEADWINDS

HOW DID THE LOAN MARKETS EVOLVE IN 2014 AND WHAT ARE THE CHALLENGES AND OPPORTUNITIES THAT WILL CHARACTERISE THE YEAR AHEAD? SIMON ALLOCCA TAKES A LOOK



At the beginning of 2014, I made a number of predictions for the loan market in the year ahead. I forecast that transactions would become more aggressive in 2014, that the bank market would become even more favourable while bond issuance would reduce, and that we would see a recovery in event financing. I also predicted that corporate real estate business would pick up and that the biggest innovations would be around infrastructure financing through insurance companies and pension funds. One year on, did these predictions come to pass – and what is the outlook for 2015?

## Activity in 2014

In 2014, loan market volumes were generally up on the previous year, with a record quarter in Q2. Activity in Q3 was back up to 2011 levels, while total global loan activity in 2014 achieved the highest annual level since 2007.

Although this is positive news, it is worth noting that much of this activity was based on refinancings and amend-and-extend transactions, with corporates taking advantage of favourable interest rates. It is likely that there will be fewer of these transactions in 2015 – so it is possible volumes this year may not reach the same level. That could, however, be countered by a genuine pick-up in M&A and event financing activity in the real economy across the market.

As anticipated a year ago, we have certainly seen pricing become significantly more competitive during the past year, with pressure on both margins and fees. This has benefited all borrowers, from the top investment-grade corporations to mid-market companies, and has taken place not just in the UK, but also at a European level. While pricing pressure may not manifest itself at the same pace as last year, it looks set to continue in 2015.

## Banks are focusing closely on the challenges ahead. Corporate borrowers have the opportunity to leverage this knowledge and expertise in order to meet their objectives

Sterling bond issuance was lower in 2014 than in the previous year, as forecast. A number of factors have contributed to this trend, including exchange rate developments, as well as a reduction in the number of issuers looking to borrow in sterling. At the same time, more companies have taken advantage of the opportunity to borrow in dollars and swap into other currencies. Loan issuance has remained higher than bond issuance, and is likely to do so in 2015 as well.

### Mergers and acquisitions

I anticipated that event financing would pick up in 2014 and this has proved to be the case. There has been a significant pick-up in activity compared with previous years – but, interestingly, this has been driven by some fairly specific factors.

The pharmaceutical industry, in particular, has seen sizeable activity, including the acquisition of some European companies by US buyers looking to take advantage of more favourable tax regimes in some locations. Large transactions, such as German pharmaceutical giant Bayer's $14.2bn purchase of US-based Merck & Co's consumer care business, somewhat inflated activity levels, with smaller companies yet to follow suit. As such, M&A event financing is not yet taking a central role – although this remains an area of opportunity to look out for in 2015.

### Corporate real estate

Corporate real estate financing picked up as predicted in 2014. With many more financings coming to the market – and investors returning – we have already experienced a tightening of both pricing and structure. I am optimistic, however, that this sector will continue to grow in 2015, with corporate real estate providing a strong source of activity during the course of the year.

### Innovation

Where innovation is concerned, the focus continues to be on infrastructure, energy financing, insurance and pension funds. Last year, for example, Lloyds Bank worked closely with Legal & General Investment Management (LGIM) on funding for the new Royal Liverpool University Hospital, providing short-dated equity financing and structuring the long-dated piece for LGIM. This is a great example of the model that banks and institutional investors can use to work together in the infrastructure space, and I would like to see it developing further.

The caveat here is that 2014 also saw a surge in some Asian and European banks offering long-dated loans on more competitive terms than insurance companies, both in terms of price and structure. This could impact the further development of insurance providers in this area.

### Big picture

Looking ahead, some other high-level macro factors are set to shape activity in the coming year. It is unclear at this point what impact the end of quantitative easing in the US will have on markets, and on Europe specifically. Meanwhile, the aftermath of last year's independence referendum in Scotland continues to resonate. As the referendum took on a life of its own, it began to impact the way in which people were looking at financing opportunities – and while this has subsided, there is a continuing question mark over the devolution of powers and what that will mean for the UK.

Further afield, increased levels of conflict continue in the Ukraine and Middle East – and the full implications are still unclear at this point. The same is true of other developments, such as the pro-democracy protests in Hong Kong, as well as the possibility that Ebola will spread beyond West Africa and begin to have a global effect on commerce.

### Regulation

Where regulation is concerned, a number of banks incurred fines for fixing Libor and FX in 2014 – a development that is likely to impact bank conduct during 2015. At the same time, this year will bring a greater focus on Basel III and the impact of the new regulation on costs. We will also see greater levels of uncertainty over ring-fencing and how this will affect banks and their clients in the UK and Europe.

No two banks manage regulation in the same way, and different jurisdictions take different approaches – the UK and Australia, for example, tend to be first movers and adopt regulation in advance of formal implementation, while other countries tend to implement changes once regulations actually come into effect. The impact of regulatory developments will therefore vary from market to market – but this is set to be a key theme in 2015.

### Working together

So how can corporates best position themselves to navigate the changing landscape? Banks are very close to these developments and are focusing closely on the challenges ahead. Corporate borrowers have the opportunity to leverage this knowledge and expertise in order to meet their objectives. Banks execute hundreds of deals for their clients over the course of a year, whereas the average corporate borrower might have executed one loan, one derivative and a handful of FX trades. I would therefore encourage corporates to tap into the expertise of a banking counterparty to access their knowledge of these transactions, in order to understand the headwinds we all face.

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