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Global CLO Roundup: Tightening CLO spreads point to 'rush of deals'

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US CLO AAA spreads last week reached the tightest levels in 20 months, setting the stage for a potential run of deals in the primary market as transaction costs shrink amid a repricing wave in the loan market.

In Europe, the first reset and new issue of the year have priced, with arrangers testing out levels last observed during the first half of 2022 on upcoming prints.

Year-to-date CLO issuance as of Jan. 22:

- US: $3.61 billion from nine transactions, compared to $3.23 billion from seven deals at this point in 2023.
- Europe: €0.51 billion from one deal, compared to €0.29 billion from a single deal at this time last year.
- Global: $4.16 (€3.80) billion from 10 deals, compared to $3.55 (€3.28) billion from eight deals in 2023.

US: Positives abound

Managers priced four new-issue broadly syndicated and middle market CLOs during the Jan. 16-22 period totaling $1.51 billion, pushing the year-to-date US volume tally to $3.61 billion, jumping ahead of 2023's pace of $3.23 billion.

Wells Fargo led the pricing of the $448.72 million GoldenTree Loan Management US CLO transaction, which garnered the tightest AAA spread (S+150) since May 2022 (BlackRock's Magnetite XXIII). Two other BSL deals from AGL Credit Management and Onex Credit Partners priced deals with triple-A coupons of 157 bps and 163 bps, respectively.

"AAAs are now firmly in the S+160s for BSL, with BBBs ranging from 400-450 bps," said Deutsche Bank in a Jan. 22 research report. "These levels mark a roughly -10 bps/-50 bps (AAAs/BBBs) tightening from the close of Q4 to the start of the year and should serve as a supply-side technical for managers to ink a rush of deals at current levels."

The tightening spreads coincide with a wave of loan repricings ($68.5 billion through Jan. 22) that have trimmed the average loan spread by 55 bps on the Morningstar LSTA US Leveraged Loan Index.

Along with tightening spreads in the secondary CLO securities market (S+141 for AAAs), "[t]he impact of these trends is visible when looking across CLO portfolios — market value metrics like Equity NAV and weighted average portfolio price (WAPP) have also climbed to their highest levels since May 2022," Deutsche Bank said, "and should provide a constructive knock-on effect for quarterly equity distributions and OC ratios, while also serving as a buffer to marginal credit softening across CLO portfolios... To be sure, these are all positives."

New issue

The Jan. 19 pricing of GoldenTree's new CLO, a two-year non-call deal that featured BofA Securities and Morgan Stanley as joint bookrunners, set the Class A coupon 15 bps narrower than GoldenTree's previous CLO deal, the $398.2 million GoldenTree Loan Management US CLO 18 in October.

Deutsche Bank was arranger on the Jan. 16 pricing of the $402.3 million AGL CLO 29, which priced five CLOs in 2023 totaling $1.90 billion. The S+157 AAA pricing met the original guidance set at launch.

Also Jan. 16, CIBC Capital Markets priced the $503.53 million OCP 2024-31 for Onex. The deal was reportedly upsized after launch, according to market sources.

BMO Capital Markets on Jan. 22 priced the lone middle market CLO of the week: the $156.3 million Brightwood Capital MM CLO 2024-1, a static deal managed by Brightwood Capital with a two-year non-call. The triple-A spread on the single-tranche middle market CLO vehicle — which priced at par — is S+230.

Refinancings/Resets

Two resets and a partial refinancing pricing last week brought monthly US CLO volume in those areas to a combined $1.52 billion across four transactions.

Sole bookrunner Morgan Stanley on Jan. 19 priced a $498.75 million reset of CIFC Funding 2022-V, a BSL CLO managed by CIFC Asset Management. The deal trims the primary triple-A tranche coupon to S+152 from the original 175 bps spread priced in June 2022.

Also on Jan. 19, Citigroup priced a $263 million refinancing of two tranches of Marathon CLO 14, a 2019 vintage BSL CLO managed by Marathon Asset Management. The transaction reduces the coupon for the AAA-rated Class A-1A-R tranche to S+138. The spread was previously at 169 bps, according to a Fitch report. The deal was originally sized at $405.8 million at issuance. A six-month non-call period is being established through July 20; the original reinvestment period ending on Jan. 20, 2025 is unchanged.

Bond exposure in CLOs/CBOs grows

US CLO and CBO portfolios finished 2023 with $19.5 billion in total high-yield and investment-grade bond holdings, an increase of $4.5 billion from the prior year, according to a Jan. 12 research report from BofA Global Securities.

About $11.3 billion is held in broadly syndicated CLO vehicles, according to BofA. The median share of corporate bonds is about 2.7% across US BSL CLOs, with about half (49%) of all BSL deals now taking advantage of a so-called “bond bucket.”

BSL CLOs are typically structured to allow managers to hold up to 5% of a deal’s assets in fixed-rate corporate bonds alongside senior secured leveraged loan assets.

The surge in bond purchases for CLOs has taken place over the past two years. Managers have used discounted bonds to replace riskier, floating-rate loans in order to build the par value of collateralized assets, thus boosting cushions to protect CLO debt investors and equity holders.

“Bond buckets have contributed to par build in 2022, or in mitigating par burn when managers sold loans at deeply discounted levels,” BofA stated.

The average purchase price of bonds in CLOs declined to $86.8 (per $100) in 2023, compared to $99.6 in December 2021, the firm said. Discounted bond purchases in 2022 included investment-grade corporate bonds from brands including Apple and Microsoft; total investment-grade bond exposure in US CLOs is at $2.1 billion, according to BofA.

Managers have intermittently held bonds in CLOs during the post-Global Financial Crisis era. CLO managers purchased junk bonds until 2017, when the Federal Reserve and other financial industry regulators enforced new Volcker Rule restrictions that effectively forced CLO managers to divest bonds that made their deals ineligible for regulated bank investment.

Regulators revised the Volcker Rule enforcement in 2020, exempting loan securitizations holding up to 5% in bonds.

Managers with the largest bond buckets across deals in their platforms include Seix Investment Advisors (4.9%), Z Capital Credit Partners (4.7%) and Sound Point Capital (4.6%).

Morningstar DBRS: Negative outlook on CLO assets

Morningstar DBRS this week issued a negative collateral performance outlook for 2024 for broadly syndicated CLOs, as well as middle market CLOs and the warehouses from which asset pools are ramped. But the ratings agency assigned a stable credit-rating outlook on CLO vehicles themselves in 2024, “supported by structural protections, including credit enhancement, excess spread and reinvestment criteria.”

In a Jan. 22 report, the firm cited concerns with the preponderance of B range credits in CLO collateral pools, a segment in which they expect “borrowers to experience significant stress in a challenging environment” amid rising debt servicing costs from high interest rates. Another factor in the negative outlook is that BSL CLO managers might have trouble with distressed borrowers as large syndicated lender groups “may not have an alignment of interest” in a workout.

With rising defaults and downgrades among borrowers, “realized recoveries may deteriorate due to [a] less favorable environment and increased prevalence of borrower-friendly loan documentation,” the report said.

The stable outlook for CLOs is backed by the standard credit protections in CLOs (including overcollateralization and interest-coverage tests) that shield senior noteholders from credit-quality deterioration. Middle market CLOs benefit further from higher overcollateralization levels and excess spreads compared to BSL deals, but contain less diversity of assets and less-liquid structures for par-building efforts in deals.

Morningstar DBRS cautions, however, that amortizing CLOs with little or no reinvestment options “will not be able to benefit from active management and diversify away from riskier sectors, which may cause concerns for the most junior notes.”

Europe: Growing pipeline

As the European market works through its first batch of pricings this year, CLO economics would appear to have improved on the liability side on the back of a more bullish tone across risk assets, evidenced by arrangers testing out levels last observed during the first half of

2022.

The pipeline has built considerably over the past week, and now includes Sound Point, Fidelity, GoldenTree, BlueBay, Partners Group, Capital Four and KKR, with Bain out with a reset.

Trinitas Capital Management yesterday priced the first European new-issue deal of the year, with its €506.54 million Trinitas Euro CLO VI, the largest CLO to price in Europe since March 2022, according to LCD data. The deal was upsized from an original €455.82 million target amount, with increases applied across all tranches.

Here, the triple-A notes came in at 160 bps, which is the tightest triple-A print for a reinvestment CLO (where full pricing has been disclosed) since June 2022, according to LCD data. However, those notes, as well as the double-A notes (245 bps) were spoken for prior to the deal being announced the week of Jan. 15.

The single-A and triple-B notes priced within IPTs, at 295 bps and 440 bps, respectively; the double-B and single-B notes notably came in tighter than IPTs to price at 670 bps and 935 bps on a discount margin basis.

The new issue closely followed the Jan. 19 pricing of a the €408.6 million reset of Palmer Square European CLO 2022-2, which also came in at 160 bps at the top of the capital stack, while the double-A to single-B notes priced at 250/300/400/675/900 bps on a discount margin basis.

Taking the tightest spreads of the two aforementioned deals, single-A, triple-B, double-B and single-B levels are at their tightest for a reinvestment deal since February 2022.

Capital Four on Jan. 17 took advantage of the tighter market for single-B notes, pricing the €12 million class F notes of Capital Four CLO V that was previously structured in delayed-draw format when the deal printed in February 2023, at 900 bps (E+863 coupon, at 98). Other managers that retained single-B tranches are looking to follow suit, including Invesco, which last week announced that it was considering options in relation to the sale of the class F notes it retained on Invesco Euro CLO IX.

In the primary, CLO triple-A spreads on some deals are currently being guided in the region of 150 bps. However, paper in secondary has been observed at 130-140 bps for certain managers, according to sources, leading some to expect that 140 bps could be achievable as the weeks progress.

“It’s been a strong start in CLO secondary since the beginning of the year and the market has seen a broad-based rally across the capital structure. There has also been good two-way flow in EUR CLO equity as well, a part of the capital structure where trading is somewhat muted in the secondary compared to CLO debt securities,” said Sharad Vohra, partner at Astra Asset Management.

Despite the tightening, triple-A paper still offers good relative value across the capital structure compared to equally rated corporate bonds, Vohra said. “EUR CLO AAAs could continue to offer superior current income, capital preservation and yield pick-up to equally rated instruments in the market.”

“There is a good new issue and reset pipeline building up in primary, which may cause a halt or pressure on spreads in the secondary as investors look to take profits to rotate into new issues,” Vohra added.