CASE STUDY: HOME SUITES (HSE)

We continue with the case study of Home Suites (HSE) discussed in previous chapters. Chapter 5 went through the analysis of the company (borrower) and the industry in which it competes. Chapter 6 assessed the transaction by running the projections both base case and stress case modes to see if the debt that was structured in can be supported. This chapter introduces the market risks of the bank that fully underwrites the loan and the risks of reducing its exposure via a successful syndication. In this case, DBC Bank was invited to participate as a colead arranger (Tier 1). Commitment breakdown is as follows:

FIGURE 7.6 SAMPLE LOAN SYNDICATION INITIAL COMMITMENTS

	Global	Tier 1	Tier 2
Facility Description	**Initial Commitment**	**Initial Commitment**	**Initial Commitment**
Revolver	400,000	100,000	40,000
Term Loan A	700,000	175,000	70,000
Term Loan B	800,000	200,000	80,000
Bridge Loan	795,000	198,750	—
Total	**2,695,000**	**673,750**	**190,000**

An underwriting memo needs to be created by the syndication department of DBC Bank. The syndication department needs to coordinate with the left-lead arranger on its syndication strategy, including fees, pricing, language in the agreement regarding any flexibility the banks need to change price and/or structure based on market feedback called pricing flex and structural flex, respectively.

The following repeats the summary of the company and the transaction, as well as the offering term sheet, from Chapters 5 and 6:

COMPANY DESCRIPTION

Home Suites Inc. (the "Company" or "HSE") together with its subsidiaries, owns, operates, and franchises hotels in the United States. As of December 31, 2020, the Company's hotel network consisted of 775 hotels operated under the brand name "Home Suites," of which the company owns 676 and franchises 99. HSE competes against other similar hotel brands in the mid-priced extended-stay segment of the lodging industry. It serves customers who require a week or longer stay. Founded in 1991, the Company is headquartered in New York City, New York.

TRANSACTION ANNOUNCEMENT BY PE FIRMS

SuperInv and AllStar announce that the two PE firms have formed a consortium to buy Home Suites, Inc. for $7.6 billion. As bookings plunged across the U.S. hotel industry in 2020 due to the COVID-19 pandemic, Home Suites, which specializes in economy temporary housing for health-care professionals, proved stronger than its peers. The PE firms' offer of $22.50 per share represents a premium of 20% to HSE's share closing price on April 2. Shares of HSE rose more than 22% before the opening bell.

Terms and Conditions (Senior Secured Facilities)

**Terms are subject to changes upon transaction closing.*

Borrower(s)	Home Suites Inc (the "Borrower")
Guarantor(s)	Home Suites Holdings LLC ("Holdings") and each material wholly owned domestic restricted, subsidiary subject to customary exceptions
Expected Closing Date	11/2021
Sponsor(s)	"SuperInv," "AllStar" (60%/40% ownership split)
Agent (s)	Admin Agent Bank (Left-Lead): Topbank Bank NA Join Lead Arrangers ("JLA"s): DBC Banking Corporation (DBC) and TBD
Facilities	RC: $400,000,000 TL A: $700,000,000 TL B: $800,000,000
Purpose Of Loans	RC: general corporate and working capital. TL A and TL B: to fund the LBO transaction
Base Rate(s)	~~LIBOR~~ (1% Floor) Upon discontinuation of ~~LIBOR~~, the Admin Agent Bank and the Borrower can choose a new rate that considers the then prevailing market convention, subject to negative consent of the majority lenders
Underwriting Fees	RC: 2.25% TL A: 2.25% TL B: 2.25% Bridge Loan: 1.50% plus 1.50% of Bond Economics
Original Issue Discount ("OIDs") Retail Level	RC: 97.75 TL A: 97.75 TL B: 99.75 Bridge Loan: N/A

Pricing Spread(s)	RC: L + 350 – 400 (50bps commitment) TL A: L + 350 – 400 TL B: L + 400 – 550 Bridge Loan: L + 650 – 700
Maturities	RC & TL A: 11/2026 TL B: 11/2028 Bridge Loan: 11/2031 (if Bonds are not issued to refinance loan)
Call Protections	TL B: 101 soft calls 6 months post-closing
Amortization Schedule	TL A: annual amortization schedule of 5%, 10%, 10%, 15%, 15% with quarterly payment (first payment in 3/2022), remaining at maturity. TL B: 1% per annual with quarterly payment (first payment in March 2022), remaining at maturity. Bridge Loan: 0% per annual with semiannual payment until June 2030, 100% on March 3031
Incremental Facilities	$350,000,000 free-and-clear, plus amount subject to negative covenants
Financial Covenant(s)	Net senior secured leverage ratio at 4.25x with two step-downs to 3.25x Net total leverage at 6.00x with two step-downs to 4.00x
Equity Cure(s)	Cap: two cures per four fiscal quarter period, five cures for life
Affirmative Covenants	Financial Statements Certificates; Other Information Payment of Obligations Taxes Maintenance of Existence; Compliance Maintenance of Property; Insurance Inspection of Property; Books and Records; Discussions Notices Environmental Laws Additional Collateral, etc. Use of Proceeds Know Your Customer Further Assurances Leases Post-Closing Requirements

Negative Covenants	Financial Condition Covenants Indebtedness Liens Fundamental Changes Restricted Payments Transactions With Affiliates Certain Amendments Amendments to other Loan Documents Regarding Debt Incurrence
Events of Default	Missed Interest or Principal Payment Material Inaccurate in Representations and Warranties Breach of Covenants ERISA Event Cross-default Insolvency Change of Control Material Adverse change
Mandatory Prepayments	Subject to reinvestments or prepayment of loans: 100% proceeds from selling assets subject 100% proceeds from equity investment
Excess Cash Sweep	Starts at 50% with two step-downs: • Step-down to 25% at 2.50x net first-lien leverage ratio • Step-down to 0% at 1.50x net first-lien leverage ratio
Others	MFN: 50bps (no sunset)

Syndications Process

Figure 7.7 shows the anticipated allocation flow on the stages of syndication from the initial underwriting of the left-lead arranger to commitment allocation to Tier 1 and Tier 2 banks to the sale and allocation to the retail on a pre-close basis.

Figure 7.7 shows four levels of anticipated allocation based on preliminary syndication analysis: Lead Left, Tier 1, Tier 2, and retail level. DBC Bank was invited to participate in Tier 1, which requires a total commitment of $673.75 million and includes the bridge loan that will be taken out by the bonds. The placement of the bonds is scheduled to close simultaneously with the bank loan, so most likely the bridge loans will not be funded at closing. The bridge loan is necessary in this case to mitigate the risk where the issuance bonds are delayed as dictated by the market and SEC process. For this consideration, the banks are offered attractive up-front fees of 1.5% on the bridge commitment and bond economics of an additional 1.5% when the bonds get priced and issued usually at a discount price ("OID").

FIGURE 7.7 SAMPLE LOAN SYNDICATION PROCESS

SYNDICATION TIERS	Syndication Level	Facility Description	Initial Commitm.		Initial Commitm.	First Tier Allocation Commitm.	Second Tier Allocation Commitm.	Retail Level Allocation Commitm.	After Bond Issuance Commitm.	Per Bank Commitm.
COMPANY/ ISSUER → TOPBANC BANK LEAD ARANGER BANK Administrative Agent	LEFT LEAD	Revolver	400,000	1x	400,000	100,000	40,000	40,000	40,000	40,000
		Term Loan A	700,000	x	7	175,000	70,000	70,000	70,000	70,000
		Term Loan B	800,000	1x	800,000	200,000	80,000	-	-	-
		Bridge Loan	795,000	1x	795,000	198,750	198,750	198,750	-	
		Total	2,695,000		2,695,000	673,750	388,750	308,750	110,000	110,000
DROU BANK CO-LEAD ARRANGER #1 Syndication Agent; SPRING BANK CO-LEAD ARRANGER #2 Documentation Agent; SUMMER BANK CO-LEAD ARRANGER #3 Documentation Agent	FIRST TIER	Revolver	100,000	3x		300,000	120,000	75,000	75,000	25,000
		Term Loan A	175,000	3x		525,000	210,000	131,250	131,250	43,750
		Term Loan B	200,000	3x		600,000	240,000	-	-	-
		Bridge Loan	198,750	3x		596,250	596,250	596,250	-	
		Total	673,750			2,021,250	1,166,250	802,500	206,250	68,750
ABC Bank Co-Mgr Bank #1; BCD Bank Co-Mgr Bank #1; CDE Bank Co-Mgr Bank #1; DEF Bank Co-Mgr Bank #1; EFG Bank Co-Mgr Bank #1; FGH Bank Co-Mgr Bank #1	SECOND TIER	Revolver	40,000	6x			240,000	135,000	135,000	22,500
		Term Loan A	70,000	6x			420,000	236,250	236,250	39,375
		Term Loan B	80,000	6x			480,000	-	-	-
		Bridge Loan	-	3x			-	-	-	
		Total	190,000				1,140,000	371,250	371,250	61,875
Bank 1; Bank 3; Bank 5; Bank 7; Bank 9; Bank 2; Bank 4; Bank 6; Bank 8; Bank 10	RETAIL LEVEL	Revolver	15,000	10x	Banks			150,000	150,000	15,000
CLO/PF; CLO/PF; CLO/PF; CLO/PF; CLO/PF; CLO/PF; CLO/PF		Term Loan A	26,250	10x	Banks			262,500	262,500	26,250
CLO/PF; CLO/PF; CLO/PF; CLO/PF; CLO/PF; CLO/PF; CLO/PF		Term Loan B	40,000	20x	Average Hold CLO/PF			800,000	800,000	40,000
CLO/PF; CLO/PF; CLO/PF; CLO/PF; CLO/PF; CLO/PF; CLO/PF		Bridge Loan	-	30x				-	-	
		Total	81,250					1,212,500	1,212,500	
		Bond Investors							795,000	
		Total			2,695,000	2,695,000	2,695,000	2,695,000	2,695,000	

Syndication Strategy

DBC Bank's syndication department has approached more than 30 banks and institutions to receive preliminary "market color" given the transaction information as presented in the application, including credit and pricing feedback.

Syndication Analysis. Based on early feedback, approximately 80% of the banks contacted will do this transaction given the terms, 10% will need better terms, and the other 10% will not pursue the transaction. The syndication department is highly confident that our initial commitment of $673.75 million will be reduced to our approved hold level of $68.75 million. Out term loan exposure of $200 million is anticipated to be syndicated before the close of the transaction. Based on Topbank Bank's (left-lead) feedback, it is anticipated that the Term Loan B syndication will be successful given a few recently placed Term Loan Bs within the proposed pricing range. We are also highly confident that the bridge loan facility will be taken out by the issuance of bonds by close. The highest risk for the bridge loans is the delay of the bond placement, which means that we need to fund the bridge loan at closing.

Figure 7.7 shows that the HSE loan facilities are committed fully (firm commitment) by Topbank Bank, left-lead arranger bank. Invitations were sent by Topbank asking them to participate at Tier 1 or Tier 2 levels (Figure 7.6). DBC Bank was invited at the Tier 1 level. It is anticipated that there will be three Tier 1 banks and six Tier 2 banks. After adding the left-lead and Tier 1 and Tier 2 banks, it is anticipated that the total facilities will be allocated among them before the general retail level syndication.

Figure 7.8 shows the expected reduction of the exposure from the initial commitment amount of $673.75 million to the final stage of $68.75 million. DBC Bank expects the syndication will be successful and meet its final hold level of approval.

FIGURE 7.8 LOAN SYNDICATION STRATEGY

($ 000's)	Initial Commitm.	First Tier Allocation Commitm.	Second Tier Allocation Commitm.	Retail Level Allocation Commitm.	After Bond Issuance Commitm.
Revolver	100,000	100,000	40,000	25,000	25,000
Term Loan A	175,000	175,000	70,000	43,750	43,750
Term Loan B	200,000	200,000	80,000	—	—
Bridge Loan	198,750	198,750	198,750	198,750	—
Total	**673,750**	**673,750**	**388,750**	**267,500**	**68,750**

DBC Bank anticipated net up-front fees after skimming are as follows (Figure 7.9):

FIGURE 7.9 SYNDICATION STRATEGY AND FEE BREAKDOWN

($ 000's)	First Tier Allocation Commitm.	Second Tier Allocation Commitm.	Retail Level Allocation Commitm.	After Bond Issuance Commitm.
Revolver	100,000	40,000	25,000	25,000
Term Loan A	175,000	70,000	43,750	43,750
Term Loan B	200,000	80,000	—	—
Bridge Loan	198,750	198,750	198,750	—
Total	**673,750**	**388,750**	**267,500**	**68,750**

	Tier 1	Tier 2	Retail	
	Fees % before skimming	Fees % before skimming	Fees % before skimming	
Revolver	2.25%	2.25%	2.25%	No Skim for RC
Term Loan A	2.25%	2.25%	2.25%	No Skim for TL A
Term Loan B	2.25%	1.50%	0.25%	
Bridge Loan*	3.00%			

(Includes 1.5% Bridge and 1.5% Bond Economics)

($ 000's)	First Tier Fees	Second Tier Fee Skim	Retail Level Skim	Final Fee	Effective Fee %
Revolver	2,250	(1,350)	(338)	563	2.25%
Term Loan A	3,938	(2,363)	(591)	984	2.25%
Term Loan B	4,500	(1,800)	(200)	2,500	
Bridge Loan	5,963	—	—	5,963	
Total	**16,650**	**(5,513)**	**(1,128)**	**10,009**	**14.6%**

Figure 7.9 shows that the net fees after successful loan syndication and bond placement will be approximately $10 million or 14.6% of the hold level of $68.75 million. Figure 7.9 shows the original underwriting fee of 2.25% of the bank loan facilities and 3.0% for the bridge and bond placement. Starting with the bank loan facilities, the revolver and Term Loan A (refer to as pro rata facilities, which are sold to commercial banks) will be allocated to other tiers and the retail level with no skim. All tiers will be getting the 2.25% up-front fee. DBC Bank is anticipating selling the entire exposure of Term Loan B at a lower up-front fee called "skimming." The "skim" refers to the amount of front-end fee, which the lender can retain of the face amount of commitments provided by banks they may receive commitments from. The commitment to Term Loan B, for example, will first

secure a 2.25% up-front fee on $200 million or $4.5 million of fees. Out of the $200 million Term Loan B, $120 million will be then re-allocated to the next tier down (Tier 2 banks) at 1.50%, giving back $1.8 million fees ($120 mm x 1.5%). Then the entire balance of $80 million is anticipated to be sold to the retail banks and financial institutions at 0.25% (99.75 OID) or giving back $200,000 ($80 mm x 0.25%). Following Figure 7.9, the skimming process should generate a very profitable arrangement for DBC Bank—basically selling the entire $200 million Term Loan B exposure and keeping net fees of $2.5 million ($4.5mm − $1.8mm − $0.2mm). Underwriting the bridge loan can be even more profitable but a riskier proposition, as it solely depends on placing the bonds prior to funding the bridge and getting 1.5% on the $198.75 million commitment twice: once for committing to the bridge loan (1.5% x $198.75) and second receiving bond economics of the same by placing the bonds. Between underwriting the bridge and receiving bond economics of 1.5% and 1.5% respectively, DBC Bank can generate $5.96 million of fees with zero hold.

Market Risk Analysis

Figure 7.10 shows both the price and structure maximum flex. The pro rata facilities (revolver and term loan) can be flexed up to L+4.0%, and the loan institutional facility Term Loan B can be flexed up to a maximum L+5.50% if the arranger bank sees it is necessary to change its market offering to L+3.50% and L+4.0%, respectively. Additional flex is given to the underwriters of the bridge loan and bonds with a maximum interest rate of L+7.0% and fixed coupon of 9.00%, respectively.

Additional flex is given to the retail level OID for the Term Loan B and bonds at 96.50 and 96.00, respectively. The combination of the two though (between interest rate and OID) is limited to an old initial yield, as shown in Figure 7.10: last column 5.50% and 6.5% for the pro rata and Term Loan B facilities, respectively. The left-lead arranger bank has the flexibility to increase the spread pricing and decrease the OID if the overall max yield is not more than is contractually agreed.

The syndication agreement between the banks and the company will also include a structural flex language. The left-lead arranger bank can suggest a more conservative structure with lower leverage ratios and higher equity contribution.

The breakeven analysis for DBC Bank is shown in Figure 7.11. Based on this analysis the pricing of these facilities could be approximately 32.0% higher (weighted average between facilities) than the initial offering for DBC Bank to be unprofitable. Figure 7.11 shows that if DBC Bank exercises full flex and increases any components of pricing, including the spread and OID, the revolver, Term Loan A, and Term Loan B would be priced at an all-in yield of 5.94%, 6.28%, and 7.39%, respectively, or approximately 32% higher than the original offer. Please note that the all-in yield pricing is calculated by adding LIBOR or LIBOR floor, spread and up-front fees divided by an average life of 4 years.

FIGURE 7.10 SAMPLE SYNDICATION RISK ANALYSIS

PRICING FLEX								
($ 000's)	Drou Bank Initial Commitment	Offered LIBOR Spread	Max Flex LIBOR Spread	Offered OID	Max Flex OID	Offered Initial Yield*	Max Flex Initial Yield*	Max Contractual Flex Initial Yield*
Revolver	100,000	3.500%	4.000%	97.75	97.75	5.06%	5.56%	5.50%
Term Loan A	175,000	3.500%	4.000%	97.75	97.75	5.06%	5.56%	5.50%
Term Loan B	200,000	4.000%	5.500%	99.75	96.50	5.06%	7.38%	6.50%
Bridge Loan	198,750	6.500%	7.000%					
LIBOR Floor=	1.00%							

*Bank Yield = LIBOR Floor + Spread + [(100 – OID)/4]

($ 000's)	Initial Commitment	Offered Fixed Rate Pricing	Max Flex Fixed Rate Pricing	Offered OID	Max Flex OID	Offered Initial Yield	Max Flex Initial Yield	Max Contractual Flex Initial Yield*
Bonds	198,750	7.500%	9.000%	99.00	96.00	7.58%	9.38%	9.00%

* Bond Yield (YTM) = (Coupon Rate % x 100) / OID

STRUCTURE FLEX		
	Offered Structure	**Max Flex Structure**
Senior Leverage	**3.9x**	**3.0x**
Total Leverage	**6.0x**	**5.0x**
Equity %	**69.80%**	**75.00%**

FIGURE 7.11 SAMPLE BREAK EVEN RISK ANALYSIS—BEYOND PRICING FLEX

($ 000's)	Drou Bank Initial Commitment	% of Total (Weights)	Offered All-In Yield*	Max Contractual Flex Initial Yield*	Fees to give back to the Market Break Even $	Additional Fees to give back to the Market Break Even %	Total Fees to give back to the Market Break Even %	% higher than initial offered Price
Revolver	100,000	21.05%	5.063%	5.50%		0.44%	5.94%	17.41%
Term Loan A	175,000	36.84%	5.063%	5.50%		0.78%	6.28%	23.98%
Term Loan B	200,000	42.11%	5.063%	6.50%		0.89%	7.39%	45.92%
Total	475,000	100.00%			10,009	2.107%		31.83%
LIBOR Floor=	1.00%							

*Bank Yield = LIBOR Floor + Spread + [(100 – OID)/4]