The Rise of Alternative Lending: Will It Cushion the Next Recession?

PRESENTED BY PAUL HASTINGS

Regulating an industry is like squeezing a balloon: one side may get smaller, but the other side expands. In the same vein, bank lending became more regulated and stringent as a result of the last recession – however, non-bank alternative lenders were able to capitalize on the opportunity and offer flexible, nimble and expeditious financing to businesses across industries.

“Fifteen years ago, alternative lending was referred to as shadow banking,” says Bill Brady, Partner at Paul Hastings and head of the firm’s Alternative Lender and Private Credit Group. ”Today, alternative lending is considered mainstream – it’s extremely flexible and nimble capital. These funds can react quickly and tailor a solution for their borrowers. They devise creative solutions that make it significantly easier for borrowers to get deals done.”

When banks are on the sidelines, alternative lenders can meet some of the demand

Alternative lenders – referred to as mezzanine lenders in the past – have existed for some time. Yet the recession and its aftermath have made them major players in corporate finance. As loan growth at commercial banks decreased substantially and remained slow years after the financial crisis, private equity and alternative lenders increased their funding.

“It was a tremendous vacuum to fill,” explains Brady. “That fueled the fundraising fire even more because general and limited partners were looking for places to park their cash and saw an opportunity. This lead to raising a lot of money and more flexible capital, which could be used as different parts of the capital structure. Fund documents gave general partners flexibility to really go out and compete.”

No matter the strength of the economy, alternative lenders are here to stay

Brady says that not only are there more alternative lenders today, but they’re lending far more money than in the past.

As an example, five years ago, Brady assisted clients with loans ranging from $20 to $100 million. In comparison, he says, “Last year, my smallest deal was in the teens in terms of millions, and the largest deal was financing a $4.5 billion buyout, with the alternative lender providing more than $1 billion of the purchase price.”

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This upward trend is likely welcome news. Despite evidence of a strong economy, some banks have become more cautious about lending to reduce their exposure to what some see as a recession in the near future, according to **Reuters**. Given their greater tolerance of risk compared to banks and investors' eagerness to provide capital, the next economic downturn could be softened by alternative lenders.

Brady predicts that in the next economic downturn, alternative lenders may be very active, keeping businesses operating and their employees on the job. This is because of their flexibility and the amount of capital they can access.

"There is so much money on the sidelines waiting to be invested," he says. "Even if there is a downturn in the future, I think many of the alternative lenders will see it as an opportunity to invest and provide solutions to troubled borrowers."

Brady explains that clients like his would focus not on bad businesses, but good businesses with bad balance sheets. Alternative lenders will seek opportunities that will give them positive returns on their investment while allowing distressed companies to recapitalize and continue operating.

Alternative lending depends on attorney expertise

Alternative lending is a growing and robust industry that relies on attorneys to handle complex finance matters. "The alternative finance space is extremely reliant on legal services both on the funds side, where you are negotiating funds documents with the investors, and on the deal side," says Brady.

Identifying a law firm with substantive strength in acquisition finance and distressed debt, and one that focuses on complex finance transactions and credit arrangements is critical as the industry expands and corporate clients require legal assistance. Paul Hastings has seized the opportunity to service the alternative lending space – a natural evolution given the firm's deep, global finance expertise – and has shifted its focus more on alternative lenders, while still continuing to represent a wide range of traditional banks.

"These deals are very sophisticated," says Brady. "Our role is to find creative solutions to help clients get the money out the door while they're still protected – and to do it in a tailored way to ensure that no matter what kind of deal they're considering, we can create a solution for them to deploy the cash and get a good return."

*For more information on alternative lending, please contact **Bill Brady**, Partner at Paul Hastings or visit PaulHastings.com.*