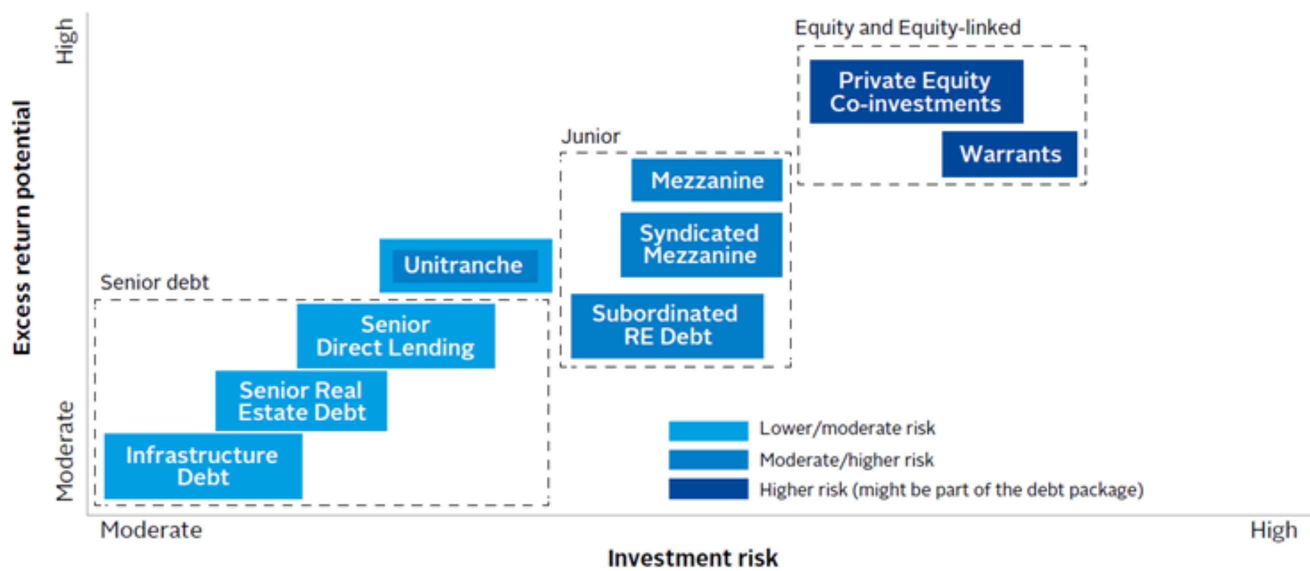
An overview of private debt

Private debt has only recently been considered an asset class in its own right, and the term covers a range of different investment styles and strategies. The term ‘private debt’ is typically applied to debt investments which are not financed by banks and are not issued or traded in an open market, while the word ‘private’ refers to the investment instrument itself and not necessarily the borrower – i.e., public companies can borrow via private debt just as private companies can. Private debt falls into a broader category termed ‘alternative debt’ or ‘alternative credit’, and is used interchangeably with ‘direct lending’, ‘private lending’ and ‘private credit’.

Within the private debt market, investors lend to investee entities – be they corporate groups, subsidiaries or special purpose vehicles established to finance specific projects or assets – in the same way that banks lend to such entities. Private debt investments are typically used to finance business growth, provide working capital, or fund infrastructure or real estate development.

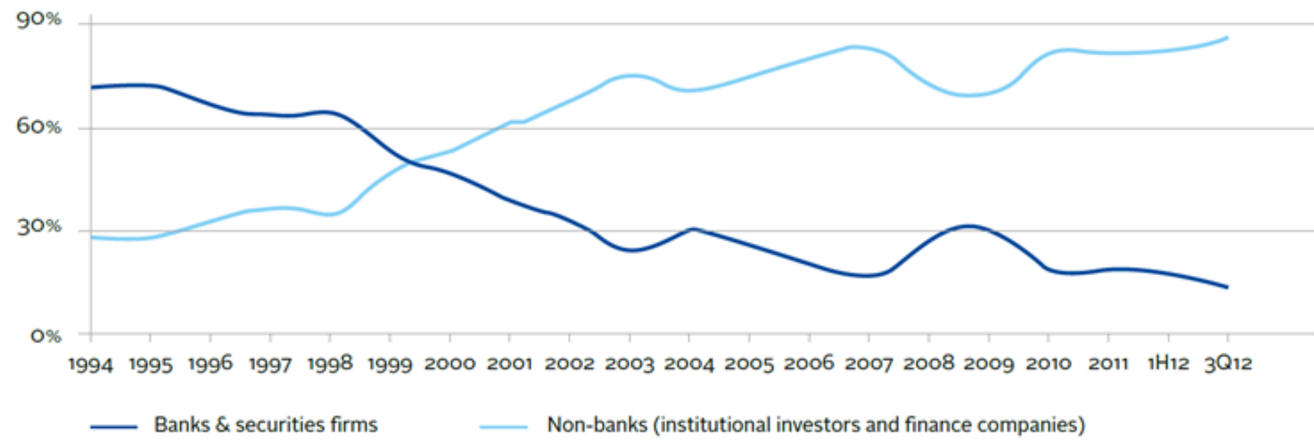
	EQUITY		DEBT	
	PUBLIC	PRIVATE	PUBLIC	PRIVATE
Investee entity	Public company	▪ Private company ▪ Special Purpose Vehicle (SPV)	▪ Government-related entity ▪ Public company ▪ Private company ▪ SPV	▪ Public company ▪ Private company ▪ SPV
Investor/investee relationship	Legal owner (partial)	Legal owner (full or partial)	Lender (contractual relationship only)	Lender (contractual relationship only)
Returns profile	Investor potentially participates in both upside and downside	Investor potentially participates in both upside and downside	Investor participates in downside only	Investor participates in downside only
Investment holding period	Potentially unlimited	Potentially unlimited (typically seven-15 years for Private Equity funds)	Limited by bond tenor	Limited by terms of loan (illiquidity typically requires hold-to-maturity approach)
Liquidity	Most liquid	Somewhat liquid	Most liquid	Least liquid
Investment objective	Growth (occasionally income)	Growth	Income	Income
Investor control over investee	High (via voting and engagement)	High (via engagement and board seats)	Medium to low (limited opportunities to engage)	High to low (dependent on access to management)
Investee reporting requirements	Stock exchange requirements and national legal minimum	National legal minimum	Stock exchange requirements (public companies only) and national legal minimum	National legal minimum (for private companies)

(Note: the authors recognise that some points are generalised and therefore exceptions may arise)



State of the private debt market

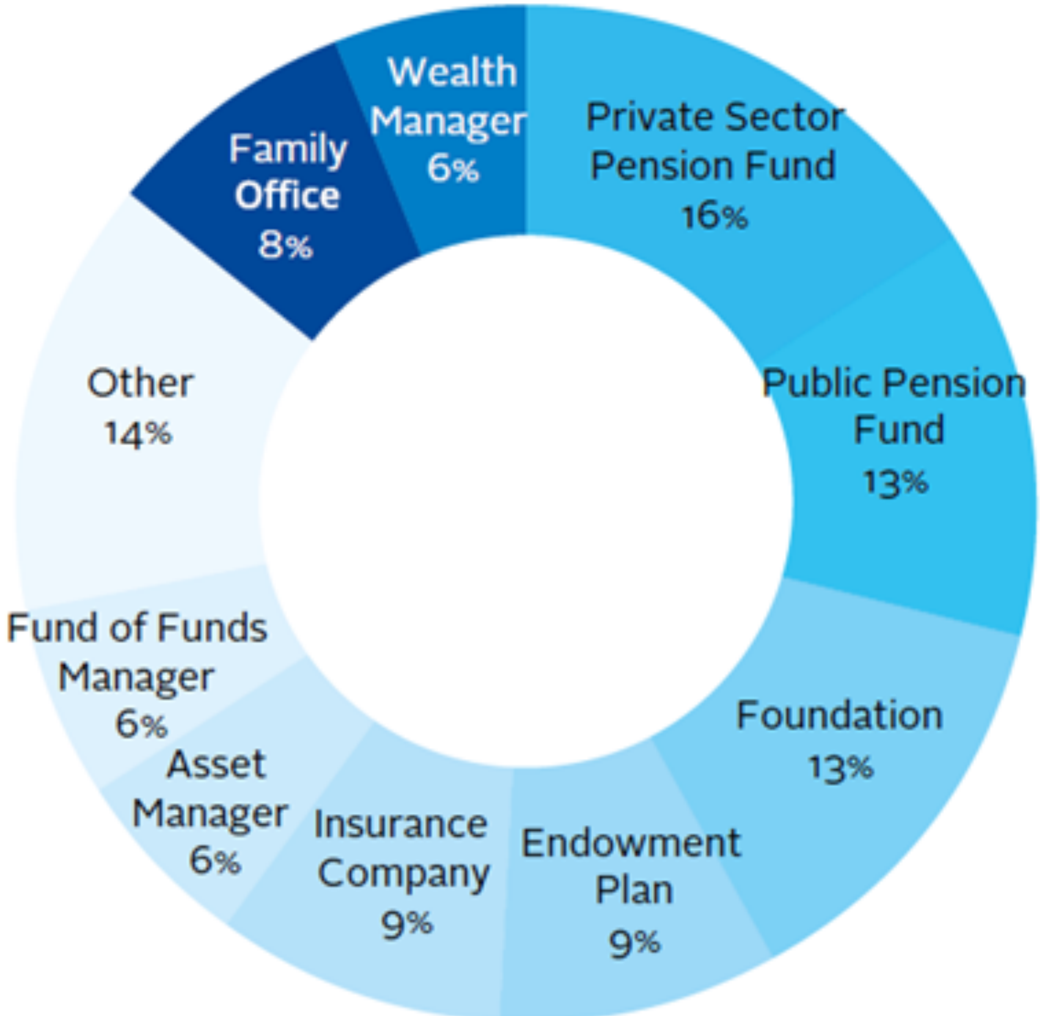
The global market has grown considerably as a result of both supply and demand factors.

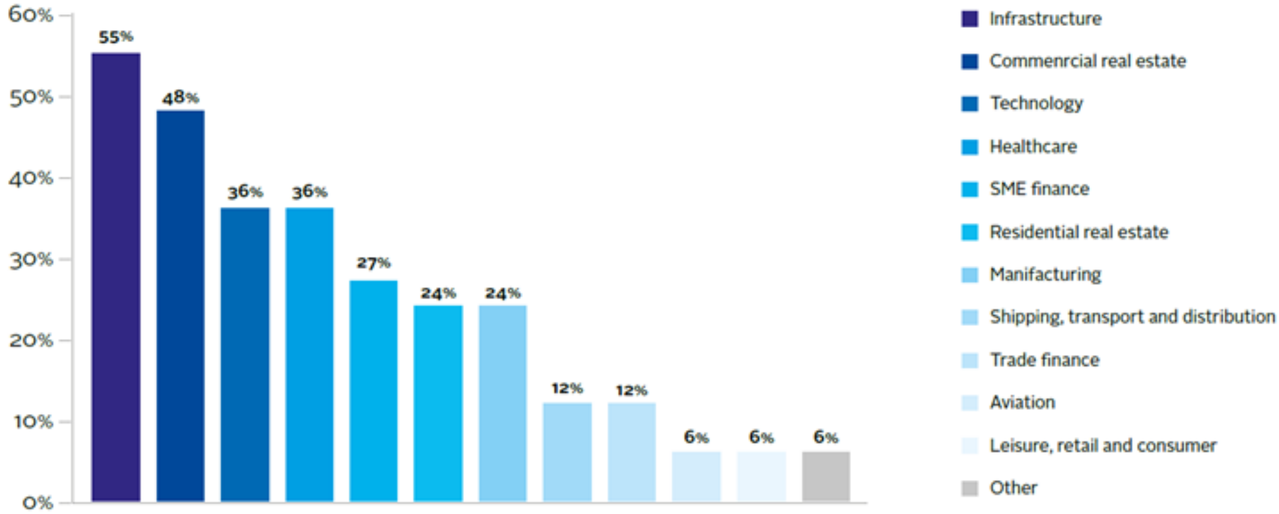


The total volume of institutional assets under management allocated to private debt is estimated to be around US$638bn globally. There are two dominant private debt markets globally, in the US and Europe. The US market is larger and more mature than that of the EU (which is predominantly comprised of UK and French issuers).

Roughly US$107bn of new capital was raised by private debt funds in 2017 globally, of which US$67bn was raised by funds in the US, US$33bn by funds in Europe, and USD$6bn by funds in Asia5. Elsewhere – particularly Germany and the Nordics – banks still dominate the lending market for historic and/or regulatory reasons.

The most active investors in the private debt market are pension funds, foundations, endowments and insurance companies (see Figure 5). The sectors which are likely to attract the largest allocations from investors in the next 12-24 months (based on Q4 2017) are real assets such as infrastructure and commercial real estate, followed by private equity-sponsored companies (see Figure 6).

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Infrastructure
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Technology
Healthcare
SME finance
Residential real estate
Manifacturing
Shipping, transport and distribution
Trade finance
Aviation
Leisure, retail and consumer
Other