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Private Debt Intelligence – 8/7/2017

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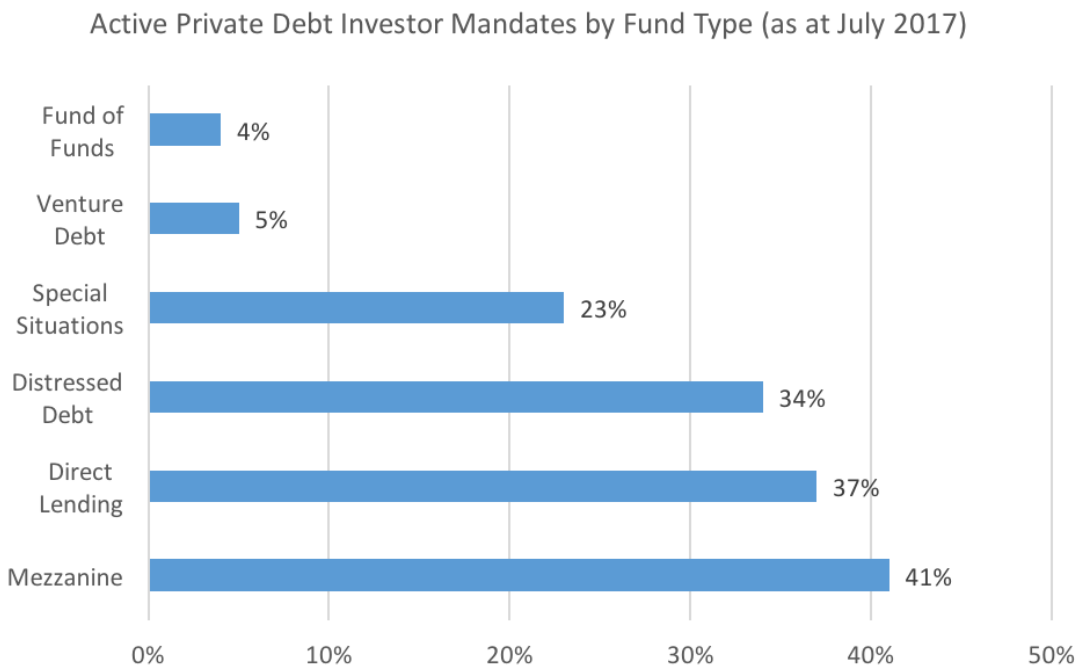
Mezzanine Funds Become Most Sought-After

Chart



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Last week, Preqin examined the stated preferences of private debt investors and showed that mezzanine funds are currently preferred by the largest proportion of investors, a shift from 12 months ago. This week, Preqin explores this trend further and shows that investors are currently pursuing mezzanine opportunities as they feel they offer the best risk/return profile.

According to Preqin's latest investor surveys, the highest proportion of investors (62%) feel that direct lending currently offers the best opportunities. However, 40% see mezzanine as the top private debt strategy, a greater proportion than the 32% which cited distressed debt. At the same time, almost half (48%) of investors said that mezzanine vehicles have the best risk/return profile, compared to 27% which cited distressed debt, and 23% that said senior debt.

As a result, investors are seeking out mezzanine funds at a greater rate than for any other fund type. Forty-one percent of active investor mandates tracked by Preqin in July 2017 were for mezzanine funds, compared to 37% of investors that are seeking direct lending vehicles, and 34% seeking out distressed debt.

Part of the growing interest in mezzanine funds might be their strong recent performance. The fund type has returned 10.1% annually in the three years to the end of 2016, and 15.6% over five years. This makes it the highest performing private debt fund type over the longer term, and is higher than the five-year returns of both distressed debt (14.7%) and private debt as a whole (11.5%).

This may explain why mezzanine funds saw record fundraising in 2016, with 43 funds raising a total of $31bn. While momentum has not carried into 2017 so far, with 18 vehicles securing just $4.3bn as of the start of August, there are a further 62 mezzanine funds still in market targeting a combined $14bn. Given investor appetite for mezzanine investments, we may see several more of these funds close in H2 and provide a boost to fundraising.

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