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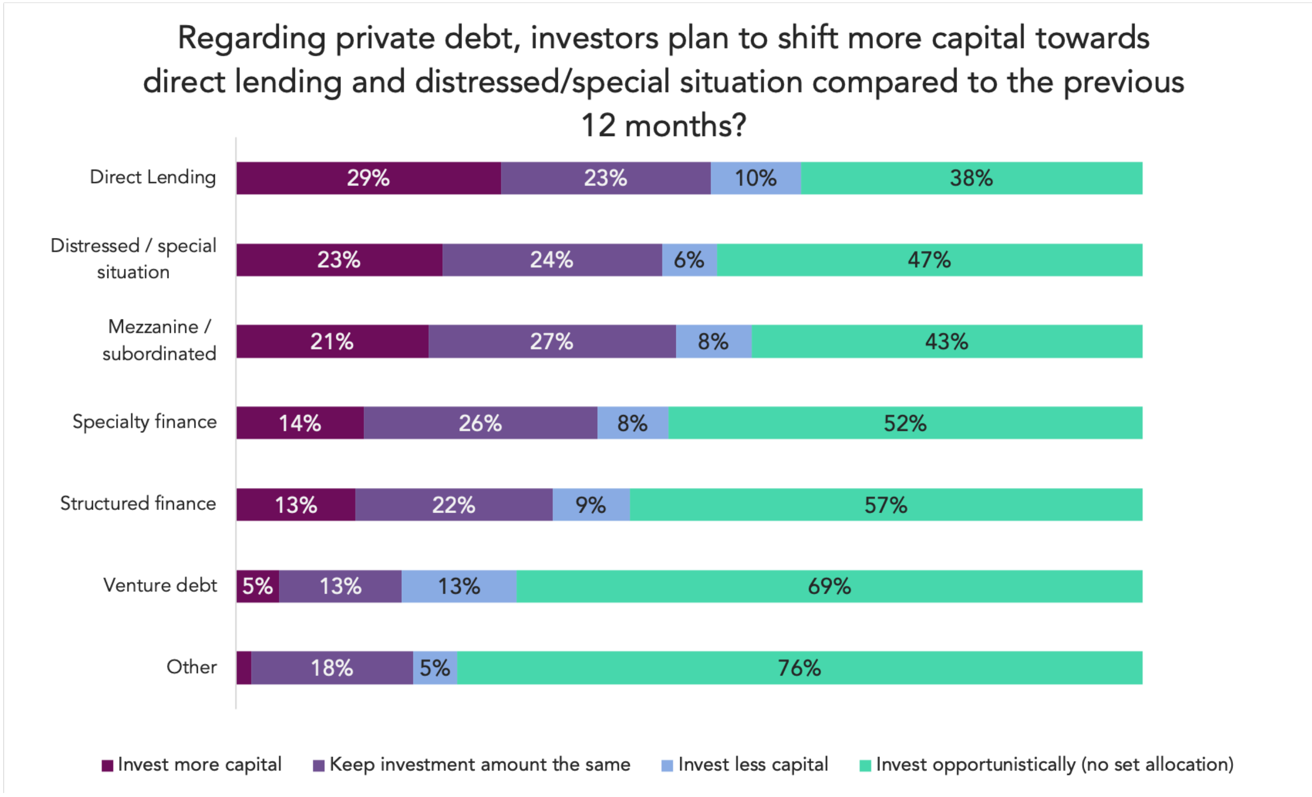
Are there tastier options than vanilla?

Private Debt Investor | March 3, 2020



Senior debt is still fundamental to many investors' private debt portfolios. But, as competition increases, LPs are increasingly hunting for less populated spaces.

While there is little evidence of investors falling out of love with the senior secured private debt market, competition for mid-market direct lending opportunities is such that some limited partners are starting to look outside what is becoming a crowded marketplace.

In the case of sponsored deals in particular, there is now so much capital chasing deals that credit protections are being seriously weakened, even if returns have so far proved fairly resilient. According to *PDI*'s latest fundraising report, senior debt fundraising dropped for the second year running in 2019, down to $51 billion from a high of $85 billion in 2017, with distressed strategies inching ahead to become the largest strategy in terms of fundraising for the first time.

Alexander Bode, founder of Cologne-based private debt advisory firm BB Alternative Partners, told *PDI* investors are aware of the challenges but not necessarily put off: "Margins are not decreasing any more, but what is deteriorating is the documentation, which is particularly difficult to follow for investors."

He adds: "Investors kind of don't have a choice. A lot of them have substituted fixed income returns from corporate bonds and are now looking more and more to the senior or direct lending market in the alternatives space to get 4-5 percent returns. So, are they worried by developments? Yes. But they don’t see many other options.”

Distressed and special situations strategies are the obvious beneficiaries as potential signs of market distress become more apparent, with documentation often seen as better from an investor perspective. However, most investors are shying away from that market as they don’t know it well and don’t have the resources to pursue the opportunity.