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The State of Private Credit in Europe (Last of a Series)

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As we conclude our European private credit series, let's review what we've learned so far:

– Europe suffered a similar Covid slump (and enjoyed a similar rebound) as the US. Yet Europe also retained the country-by-country distinctions they had pre-Covid. The recovery in all capital markets was swift; deal volumes are now at record highs.

– Pricing in the US and across the pond is fairly close. Though European upfront fees are higher, certain credit terms are decidedly more issuer-friendly. Banks have been more aggressive than direct lenders in some locales relative to others.

– Issuers and investors toggled less between US and Europe than pre-Covid, but that could rebalance in the medium-term. Private credit fundraising has been robust, with most capital dedicated to senior and subordinated debt strategies, as well as distressed.

What's the private credit outlook for the rest of 2021 and beyond? Regardless of the course of Covid and its variants, the asset class will remain popular with investors. As one veteran fundraiser points out, private credit retains favorable features such as floating rate, Libor floors, and contractual yields. And it retains an illiquidity premium over "public market equivalents."

That demand will accelerate the search for growth opportunities. A Proskauer survey reported 31% of UK/EU private debt fund managers are "considering purchasing a loan portfolio,"up from 17% last year. A whopping 92% are "currently raising a debt fund" or have "plans to fundraise."

The same survey showed 78% of UK/EU managers were seeking performing senior secured loans, compared to 87% in the US. An even higher share – 92% – was looking for acquisition financings (vs. 86% in the US). The overseas market reported more interest in pursuing second-lien and mezzanine strategies this year, 78% and 84%, respectively, than US managers (67% and 53%).

There's plenty of dry powder to deploy. Our *Chart of the Week* depicts European direct lending fundraising on a tear coming into Covid, then falling off. But 2021 activity is on the mend. PDI estimates there's about $86 billion in Euro debt capacity, with $49 billion dedicated to direct lending.

Our 2016 study of European private debt showed how its development lagged the US. That could change. A recent study out of Oxford's Said Business School predicted Europe could surpass the US as a share of GDP with a 50% growth spurt over the next five years. Of course with vigorous US fundraising forecast, AUM growth here in private debt won't be standing still.

With banks continuing to push issuer-friendly terms on private equity sponsors, some observers believe Europe's real opportunity in private debt lies at the lower end of the middle market. As one advisor put it, "that's an underserved part of the market with better structural protections and better risk-reward dynamics.”