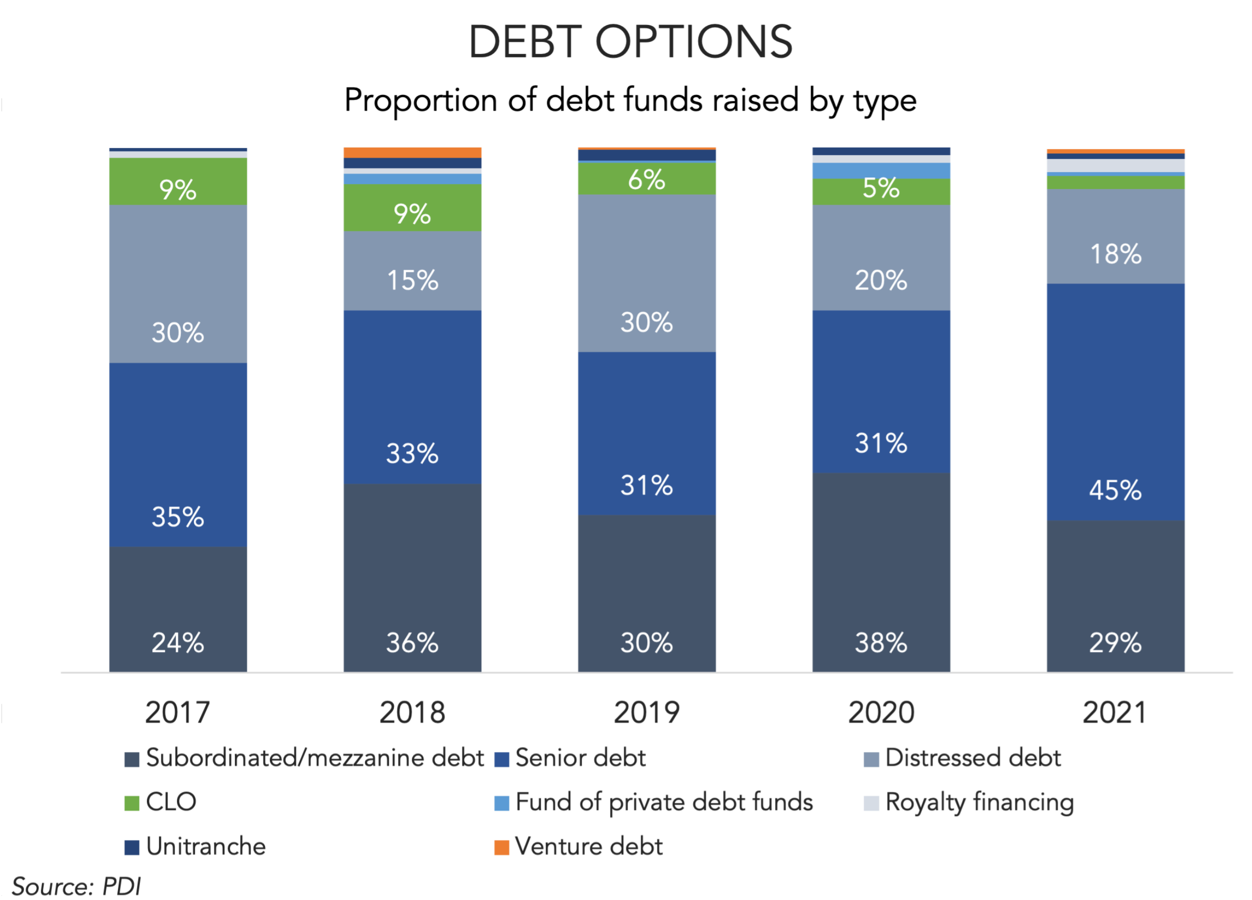
Safety first is good news for senior debt

Private Debt Investor | March 8, 2022



Investors coming from fixed income, and with anxiety around inflation, see the senior end of the spectrum as their natural entry point into private debt.

The covid-19 pandemic has seen senior debt fundraising take more market share, with *PDI's* 2021 Fundraising Report recording that 45 percent of all capital raised was for senior debt strategies, the highest proportion ever recorded and up from just 31 percent in 2020. By comparison, distressed debt fundraising fell from 20 percent in 2020 to 18 percent last year, while subordinated debt dropped from 38 percent down to 29 percent over the same period.

For many LPs, risk will be a crucial issue when reallocating public bond market investments into private markets and senior credit is one of the areas which can offer similar levels of risk to corporate bonds but with significantly enhanced returns, though areas such as real estate debt and infrastructure debt may also fit the bill.

But senior debt also offers another significant advantage to investors in the current environment, says Alastair Baird, principal at placement agent Rede Partners.

“Inflation is rising, and it is really hurting bond portfolios right now, prompting many investors to rotate into floating rate instruments as they offer some protection from capital erosion. This has been a trend in the market for some time, but we’ve seen that accelerate through 2021.”

Another factor pushing LPs into senior debt funds is that many will be dipping their toes into private credit for the first time.

“The nature of our business means we often work with investors making allocations to private credit for the first time,” says Trevor Castledine, senior director at consultants bfinance. “When they want to reallocate from their bond portfolio they want the next safest thing, and we see that in a preference for senior-secured credit, which is the safest form of private credit, but there’s less interest in stretched senior and unitranche.”

He adds that investors who were previously cautious about private debt are now more receptive to making commitments given that the asset class generally has performed well during the economic downturn caused by covid-19.

(Past performance is no guarantee of future results.)