EXPERT Q&A

Private markets are typically viewed as a below investment-grade 'alternative asset', but we believe the investment-grade component of private debt provides interesting advantages, say MetLife Investment Management's Nigel Murdoch, Jennifer Potenta and John Tanyeri

Dispelling myths around private debt

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Q What are the key benefits of private debt?

Jennifer Potenta: Diversification is one of the key benefits. Through private placements, investors get access to opportunities that they wouldn't see in public markets. Another benefit would be financial covenants, with real teeth, that can help protect the investor in a downturn. Those covenants can get you to the table with other senior lenders to work through challenges with a borrower, with the goal of protecting the credit and potentially resulting in an incremental source of income.

John Tanyeri: We believe the private market offers compelling economics coupled with historically lower credit losses versus comparable public bonds, according to data from MetLife and Moody's Investors Service. The private market is a very structured, negotiated market, compared to public markets.

For example, the asset class offers flexibility by providing various maturities and currencies. The debt can be structured as either amortising or in bullet form. In addition, the private secondary market continues to grow, helping to provide substantial liquidity.

Q What types of investor has the asset class historically appealed to? Is it changing?

JP: Private placement debt really began as an asset class for insurance companies, providing an ideal asset liability match. But as the asset class has grown, driven by expansion into new sectors and geographies, we have seen increased interest from other types of investors, in particular defined benefit pension plans, looking for investment-grade opportunities, diversification and enhanced economics. We see that these defined benefit pension plans are increasingly viewing the asset class as a complement to their public fixed-income allocations and as

Q What do you see as the biggest challenges on the horizon and how are you preparing for them?

JP: One challenge that we face is demand dynamics. Investor appetite for the asset class has grown substantially and while supply has also increased, this is still only a $100 billion a year market, according to Reuters, Private Placement Monitor, and Private Placement Letter data. It is up to us and other leaders to help open up new sectors, like sustainability, to bring new sources of opportunity to the private placement market.

JT: I agree. The biggest challenge is the amount of liquidity in the market. We, therefore, are disciplined in our underwriting with a focus on strong credits and good structure. For example, as the focus on sustainable assets grows not all deals will make economic sense. We have to ensure we are not blinded to the risks, just because an investment looks strong from an ESG perspective. We started out in infrastructure debt in 2009 and have been through numerous economic cycles. We believe that staying disciplined, especially in times of high liquidity, is critically important.

a great match for long-dated pension liabilities.

JT: Historically insurance companies have been the main participant in infrastructure debt with the pension funds and PE funds focusing on equity. But that is now starting to change. Today, we see traditional equity players participating in infrastructure debt as the pricing differential between equity and debt returns on core infrastructure has narrowed significantly. Also, competition for banks is increasing. Banks that originally participated in their own jurisdiction in the past have been encouraged by local regulators to diversify their holdings and take a more global outlook post the global financial crisis.

Q What are some of the misconceptions that pension funds may have had about the asset class in the past and how does your own offering contradict those?

JP: There is a tendency to automatically put anything private into an alternatives bucket. The perception is that it must be high octane and high yielding. While below investment-grade private placement opportunities are available, the nucleus of the private placement market is classified as investment-grade debt, based on data from the NAIC's Securities Valuation Office. With that, come the structural protections in the form of financial covenants, as well as attractive historical performance that I have mentioned. Really, we believe this is better thought of alongside public fixed-income allocations in a pension plan. There are a lot of similar characteristics, but with some added potential benefits. While not as liquid as public fixed-income, liquidity can be available where necessary in the 'by appointment secondaries market.

Q Do you think private debt's performance through the pandemic has changed perceptions around the asset class?

JP: I think the asset class has performed as it was built to and as it has in previous crises. Those meaningful covenants kick in and, more importantly, the meaningful relationships that have been established mean you get to sit across the table from a CFO, understand their business and work through the challenging times together. This may entail restructuring a deal temporarily by amending the covenants and potentially providing the additional liquidity required to help the company get through.

JT: We believe the infrastructure asset class has traditionally been more resilient to economic cyclicality and in many ways can act as a hedge. The assets we invest in fund physical assets that are backed by long-term contracts and are essential in nature. Our aim is for the assets we invest in to be less tied to the economic cycle due to stable contracted or regulatory cash flows.

Nigel Murdoch: We believe not only has the asset class performed well from an investor perspective, it has also worked well for borrowers. Businesses have been able to come out the other side of this crisis largely unscathed and we feel that will only strengthen our relationships with issuers going forward.

Q Where do you currently see the most interesting deployment activities?

JT: On the infrastructure side, as the world shifts its focus from fossil fuels to sustainable assets, we see growing opportunities in renewables. In addition to traditional wind and solar generation, we see energy transition assets growing substantially with a focus on financing electric vehicles, battery storage, biomass and hydrogen. In the US, the currently proposed $1.2 trillion infrastructure bill is set to add around $550 billion of new federal spending to the renewables market, as well as around $65 billion for high-speed broadband internet, $110 billion for roads and bridges and $25 billion for smaller airports. It will also increase much needed funding for Amtrak, which is pertinent given the recent derailing in the Midwest, which has emphasised the urgent need to upgrade and modernise.

JP: On the corporate side, we see a broad range of attractive opportunities. Some of those are in the slightly more structured space – credit tenant lease deals, for example. We also see opportunities to work with asset managers, as well as sports finance, where we are active through both our corporate and infrastructure teams. Elsewhere, we see diverse opportunities in the UK and continental Europe, through our London team, as well as opportunities in education and healthcare. Finally, whilst the vast majority of what we do is investment-grade, we see opportunities to pursue high quality sub-investment-grade assets, offering enhanced yield potential and attractive structures, as well.

Q What factors do you believe are important to borrowers and how do you differentiate yourselves?

JP: Our sector-based approach is very important. We believe it adds a lot of credibility with our borrowers and informs better investing decisions. Scale is another differentiator – having different pockets of capital to invest over different tenors, currencies and at fixed or floating rate. The ability to plug holes wherever they appear in the capital structure is a big benefit to issuers, in our view.

And while the agent bank channel is a critical one for us, we also work with advisers and directly with borrowers. We have direct relationships with many of the companies in our portfolio and these are an important source of deal flow for us. Borrowers come to us directly for a variety of reasons, such as when they are looking for something discreet, bespoke or of significant size. Our multi-channel sourcing model provides added diversification and we feel that is a differentiator.

> *"Another misconception that we commonly hear is that the asset class is illiquid"*
>
> **JENNIFER POTENTA**

JT: We aim to differentiate ourselves by providing a customised approach and flexibility to our partners. We offer multiple tranches, currencies and maturities. We can provide amortising debt, fixed or floating. Given our size, we have regional offices around the world. We believe that having boots on the ground is vital when you consider regulatory and political changes.

In the US, our global government relationship group has significant political influence. A prime example is the dialogue we have had with US senators around why we feel the public-private partnership (PPP) model is an attractive alternative to traditional state on-balance-sheet financing for infrastructure. It is pleasing to see that the new infrastructure bill explicitly states that if a project is looking for more than $750 million of federal funding, it will need to go through a value-for-money analysis to see if a PPP is a viable option.

Q What role do ESG considerations play in your decision making and how do you approach sustainability factors in your lending?

NM: More of our clients are making net-zero commitments and are looking for an asset class to help them achieve those ambitions. The benefits of private debt are stark here, particularly on the infrastructure side, which is playing a major role in the energy transition.

JT: Investors are undoubtedly paying more attention to ESG considerations. Infrastructure assets are designed to last for decades and any investor with long-term liabilities needs to make sure those stable cashflows are sustainable over that duration.

ESG is also a prime concern for us internally and is discussed in every investment committee and addressed in memos for our clients.

JP: I would agree that ESG considerations are always factored into credit analysis, and our ongoing engagement with issuers plays a critical role as well. But we are also actively driving sustainable issuance in our market, by lending to sectors such as not-for-profit healthcare, education and renewables, as well as structuring deals as green private placements, where the use of proceeds is tied to an activity that directly benefits the environment, for example. ■

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