

PRIVATE CREDIT

Avoiding the Crowds:

Finding Opportunities in Private Structured Credit

Introduction

2020 is still closely in the rear-view mirror and it feels somewhat cliché to note what a wild ride it was for markets. The pandemic fueled sell-off and financing scramble in the first half of the year created significant challenges and opportunities for investors, particularly during the “closure” of the broadly syndicated, asset-backed new issue market. There were highly attractive private structured credit (PSC) investments in consumer loans, RMBS and CMBS. However, the spreads and opportunities we saw at that unprecedented time did not endure.

Here we are - back to where we started 2020 with low rates, tight spreads, and warnings from some that asset prices across sectors may be overheated. What are fixed-income investors to do now? For MIM's PSC strategy, it's back to the basics – seeking to avoid crowded asset sectors and find deals that fall through the cracks in the market. This means trying to identify higher-yield, investment grade opportunities that don't fit neatly into the traditional asset-backed securities market or private securities market and work with borrowers to find financing solutions for these non-conforming sectors.

In markets where spreads are incredibly tight, we search for bonds backed by less commonly-funded assets, which may have some complexity to them and can potentially lead to greater opportunities. We have interest in transactions where other investors may lack expertise and fewer investors are adequately positioned to invest in the market. An example of this could be a diversified pool of low-income housing assets. Fewer traditional ABS investors pursue these assets for two reasons. First, low-income housing is generally not funded through CMBS transactions. Senior debt in low-income housing debt carries significant tax credits that result in specific buyers and market structures that provide a lower cost of debt for issuers than the CMBS market. On the other hand, traditional low-income tax credit investors are not set-up to invest in a large pool of assets that are not tax advantaged. In addition, many investors lack expertise in low-income housing or have it separated from other investment teams. This investment ends up not fitting well in any one sector for many investors.

We also find it is advantageous to search for transactions that require a collaborative investment approach involving both asset and structuring expertise. We look to leverage our Private Placements team's asset experience to provide us with insights and how we can best utilize any prior due diligence we may have conducted as part of a past relationship. We look to layer on the PSC team's expertise in structuring and modeling a diverse pool of assets. The complex nature and higher risk profile of these investments gives us the opportunity to potentially pick up significant spread over similarity rated corporate bonds in the market.

Deep relationships play a key role in sourcing opportunities for a PSC portfolio. Major players are often searching for partners with deep pockets who can deliver all the unique financing needs of the transactions and at the same time have demonstrated the ability to understand sophisticated structures. An example is a transaction that requires underwriting a deal with multiple special purpose vehicles, tax implications, and international legal reviews. To complete these transactions, you need a collaborative team including underwriters familiar with the asset class, internal and external counsel and tax experts.

These examples illustrate how fixed income investors can find value by sourcing deals that otherwise fall through the cracks of traditional investing platforms. By working in these less crowded corners of the markets, we aim to deliver investment opportunities that have the potential of coming with enhanced yields. With fixed income spreads at or near all-time tights in many areas, the need to widen the investment funnel is more important now than ever. For investors that can allocate to less liquid investments, the PSC strategy is based on the belief that finding deals without natural homes is a better path to yield enhancement than moving down the capital structure in more publicly-traded alternatives.

Figure 1 | MIM Private Structured Credit Portfolio Breakdown By Sector

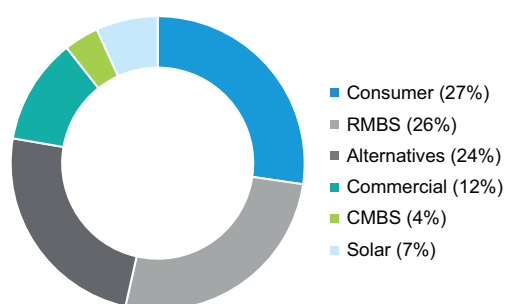
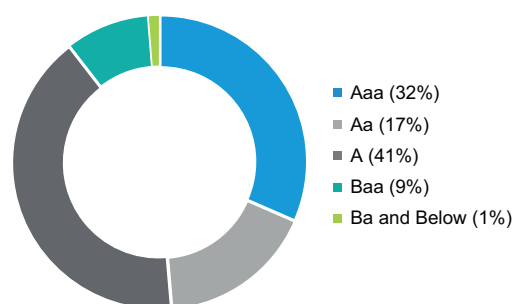
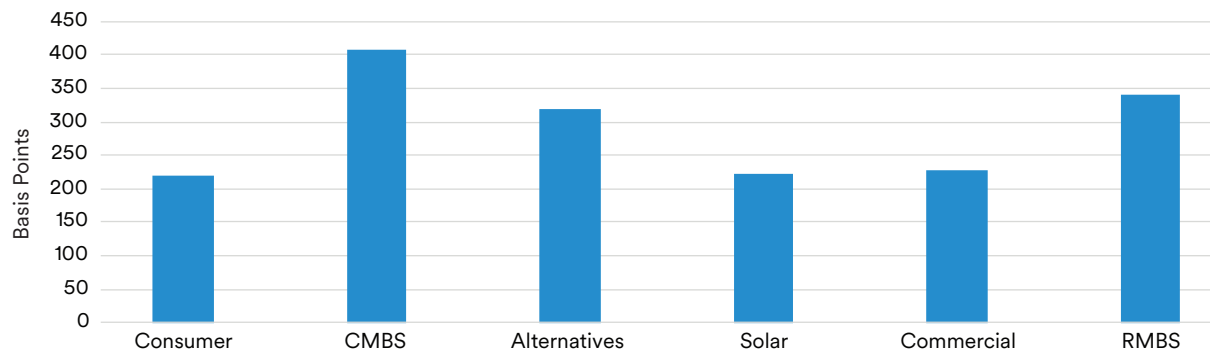


Figure 2 | MIM Private Structured Credit Portfolio Breakdown By Ratings



Source: MetLife Investment Management, December 31, 2020

Figure 3 | MIM Private Structured Credit Portfolio Weighted Average Purchase Spread

Source: MetLife Investment Management, December 31, 2020

Authors



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Scott Waterstredt leads the alternatives, sustainable investment strategies (SIS), Private Structured Credit and residential whole loans teams at MetLife Investment Management (MIM).

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Poorvi Dholakia is head of credit for Private Structured Credit at MetLife Investment Management (MIM) and is responsible for sourcing and underwriting investments in private structured credit.

Poorvi began her career at MIM in 2007, advancing through several positions within MIM's structured finance group and leading credit research efforts for ABS, CLO and CMBS sectors. She most recently was the head of portfolio management and strategy for all structured finance assets across total rate of return and insurance portfolios.

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Paul Carroll is a portfolio manager for Private Structured Credit at MetLife Investment Management (MIM). In this role he is responsible for sourcing, underwriting and managing private structured credit portfolios.

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Allison Hock is a product specialist for Private Capital, including Private Structured Credit, at MetLife Investment Management (MIM).

Previously, Allison was the structured finance assistant portfolio manager and product specialist at MIM. She also served in several other roles at MIM, including as the lead credit analyst for auto, equipment, credit card and timeshare ABS sectors, deputy chief of staff to the chief investment officer, portfolio manager in the US Domestic Portfolio Management Unit and analyst on the High Grade Corporate Trading Desk. Allison previously worked at Aflac as head of the office of the global CIO.

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