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Private markets

For many years the private debt market was inaccessible to retail investors, but this is no longer the case.

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ACCORDING TO the Reserve Bank of Australia, non-bank lending has grown rapidly and currently accounts for around 5 per cent of the financial system, with managed investment funds representing approximately half of this share.

Metrics Credit Partners is among the growing cohort of non-bank lenders providing investors with the opportunity to access private debt through managed funds. Like other private debt providers, it generates returns by raising money from investors and lending it directly to medium-to large-sized companies.

Managing partner, Andrew Lockhart, says private debt can have a key role in a portfolio, especially in the current inflationary environment where it can act as a defensive asset and an alternative to equity exposure.

"The beauty of private debt is that at one end of the spectrum it can deliver stability of capital and attractive income, making it an alternative solution to traditional fixed income such as hybrids or bonds," Mr Lockhart says.

"At the other end, a lot of Australians are holding portfolios of equities because they're looking for dividend income that comes from shares.

"With share markets subject to greater bouts of volatility, it's also possible to structure an allocation to private debt in a way that can replace this equity component."

This is particularly relevant amid continued inflationary pressures, with some asset classes failing to deliver the stability or protection investors are seeking.

"What people are looking for is an asset class that provides higher total returns as interest rates rise, and that's what private credit delivered over 2023," he says.

"The combination of low loss rates and low default rates together with rising real income that's

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Andrew Lockhart
Managing partner
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keeping pace with inflation has presented private debt as a pretty attractive investment proposition in comparison to other asset classes."

Much of the demand for private debt, he explains, has come from high-net-wealth individuals, retail investors and institutions seeking a high-income-generating investment. It also aims to protect capital through negotiated terms, conditions, covenants, and controls in debt contracts.

"It's an opportunity to originate directly with the company rather than through an exchange. We source attractive opportunities, make a detailed assessment and price the transaction in accordance with the value and the capital that we deliver," Mr Lockhart explains.

It's crucial to mitigate the risks, and Metrics does this by leveraging access to confidential information provided by the borrower.

"We drill down into a deep understanding of what drives the cash flows of a company or project we're providing financing to," he explains. "That's quite different to a public market investor that might be trading a security."

This is especially important since there is less liquidity – because it is not possible to trade out of private debt in the same way as an exchange-listed investment.

Accordingly, Mr Lockhart adds, the process of negotiating terms is a distinct component of private markets exposure.

"For example, if you think of a listed bond, the issuer is never exactly sure who the investor will be. As a result, the company will try to negotiate looser terms and conditions because the investor is free to manage their risk through the trading of that instrument."

"In a loan, it's much more difficult to trade in and out, and the trade-off is the lender seeks the ability to gain access to information to assess risk and adjust terms and covenants accordingly."

When it comes to private debt, Metrics says larger companies are the focus rather than smaller businesses or consumers.

"We see opportunities across a broad range of sectors," Mr Lockhart says. "What we're looking

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for is companies that can provide us with a greater degree of certainty around the cash flows that service and repay the debt."

This means it tends to stay away from more cyclical industries and looks for multiple ways to secure its investment.

"Something like agriculture or natural resources is dependent on production volumes, commodity prices, weather, foreign currency, trade disputes between governments, all of which mean the company's earnings can be quite volatile and present a different risk profile," he says.

"We tend to prefer companies which have more stability in their business models, and where some of those external risks are not there."

For example, a big focus is commercial real estate, especially in short-term development funding for residential and industrial development activity.

"Large-scale land subdivisions or residential high-density apartments can be an attractive lending proposition because you can take security and mitigate your risk," he says.

"And on completion, you have a known source of repayment from the sale of the property."

Mr Lockhart adds Metrics has a good relationship with its borrowers, providing an ongoing service via long-term partnerships.

"Our team has gone through many cycles over the decades, and we can demonstrate the management of risk," he adds.

In addition to private debt, Metrics also invests in private equity and says the latter in real estate can be attractive. For this reason, it maintains some flexibility across its funds.

"We see a broad range of transactions across the market, and our role is to see where we can deliver the best outcomes for investors," Mr Lockhart says.

"Sometimes that might be in a lending transaction, and sometimes there might be an opportunity to participate in equity or profits."

Often, these investments, like debt exposure, are private transactions that are not available to the broader market.

For example, residential apartment developments are often privately funded and can provide attractive private equity opportunities.

"The return profile can vary depending on risks. For example, if you're developing a commercial site that needs to be re-zoned to residential, then the risk is higher and the return needs to reflect that," Mr Lockhart says.

As well as planning risk, there is also market risk — determining the end market for the investment, as well as the risk associated with a project's budget and development timeline.

However, these risks can deliver attractive returns relative to other asset classes.

"The Australian share market is quite mature, and not delivering excess returns from the core of the businesses."

"Investing in private real estate equity represents a pretty attractive alternative."

He says Metrics looks at value-delivering development projects rather than more passive income generation from leasing arrangements.

"What we're looking to do is partner with good-quality developers where we can assist them with access to funding and assess the risk to determine whether it's an appropriate investment opportunity for our clients." ●

Metrics is a leading Australian non-bank corporate lender and alternative asset manager with an excess of $15bn in AUM and a greater than 10-year track record of performance and capital preservation*. Through its managed funds, Metrics offers a range of investments across private debt and private equity. To learn more, visit www.metrics.com.au

*Past performance is not a reliable indicator of future performance.

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