

# Preqin Investor Outlook: Private Debt H1 2015



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# Private Debt

## Investors Are Looking to Increase Their Exposure to Private Debt

The growth of the private debt asset class has been one of the standout features of the alternative assets industry over recent years, with many investors looking to allocate capital to private debt opportunities due to the prospect of strong risk-adjusted returns in a low interest environment. Continued regulatory developments have restricted the flow of debt financing from traditional sources, creating opportunities for non-bank lenders, such as private debt fund managers, to become a greater source of capital to companies looking to secure such financing.

The private debt fundraising market is at an all-time high; as of January 2015, there

were 193 private debt funds on the road targeting aggregate capital commitments of over \$108bn. With increased competition among managers for investor capital, it is vital that fund managers understand what investors are looking for to ensure a successful fundraise.

Preqin interviewed over 50 global institutional investors that actively invest in private debt, or that are considering making their maiden allocation to the asset class, to gauge their satisfaction with their private debt investments, their plans for the coming year and their attitudes towards fund terms and conditions. The results show positive sentiment towards the private debt industry, with a significant 90%

of investors feeling that their private debt investments have either met or exceeded expectations. As well as investors being satisfied with returns, nearly half (47%) have a positive perception of the private debt industry, with a further 37% of neutral opinion.

In an increasingly crowded fundraising environment, it is also positive to see that investors are planning to increase their allocation to private debt, with 55% expecting to allocate more capital to private debt in 2015 compared to 2014. Nearly two-thirds (65%) also expect to increase exposure to the asset class in the longer term.

### Data Source:

Preqin's **Private Debt Online** contains detailed information on all aspects of the private debt industry worldwide.

Constantly updated by our team of dedicated research analysts, the service features in-depth data on fundraising, fund managers, institutional investors, net-to-LP fund performance and much more.

For more information, please visit:

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### Key Facts



Proportion of investors that feel the returns from their private debt portfolio have met or exceeded expectations in 2014.



Proportion of investors that plan to increase their private debt allocation in the long term, with a further 27% expecting their exposure to stay the same.



Proportion of investors that stated Europe currently presents the best investment opportunities, signalling significant appetite for the region in 2015.



Proportion of investors that plan to make their next commitment by the end of 2015, with a further 25% unsure of the timing of their next allocation.



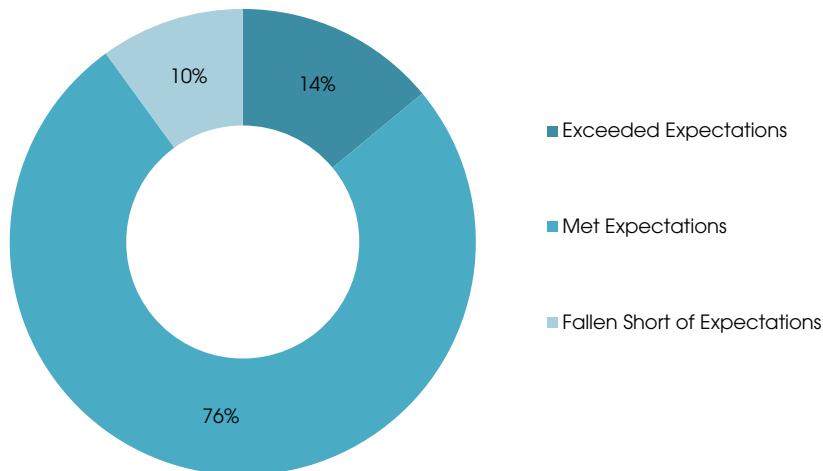
# Satisfaction with Returns and Confidence in the Asset Class

Private debt has attracted significant inflows of investor capital in recent years, with investors confident of strong risk-adjusted returns created by increased opportunities in the market as a result of bank retrenchment from the space. As private debt in many cases operates much like a fixed income product, with less scope for outperformance than many equity-based alternatives, it is encouraging to see that over three quarters (76%) of investors interviewed stated their investments had met expectations, while 14% stated their investments had exceeded expectations (Fig. 6.1).

With investors generally happy with the returns they have received from their private debt investments, it is interesting to look at investors' general perception of the private debt industry, as this likely will be in their minds when they consider allocating capital to the asset class in future. As shown in Fig. 6.2, nearly half of respondents (47%) hold positive views towards private debt, with a further 37% of neutral opinion and only 16% viewing the asset class negatively.

Despite investors holding a positive view on private debt, it is important for fund managers to understand what investors feel are the key issues in the asset class for 2015. Fig. 6.3 shows that over half of respondents (51%) feel that investment opportunities are a key issue for private debt in the current market. This can be explained by the large amounts of dry powder currently available to fund

**Fig. 6.1: Proportion of Investors that Feel Their Private Debt Fund Investments Have Lived up to Expectations over the Past 12 Months**



Source: Preqin Investor Interviews, February 2015

managers, coupled with the significant number of funds raising capital, leading to concerns that there is too much money chasing limited opportunities. Other key issues named by a large proportion

of investors interviewed include the economic environment (45%), performance (43%) and fees (34%).

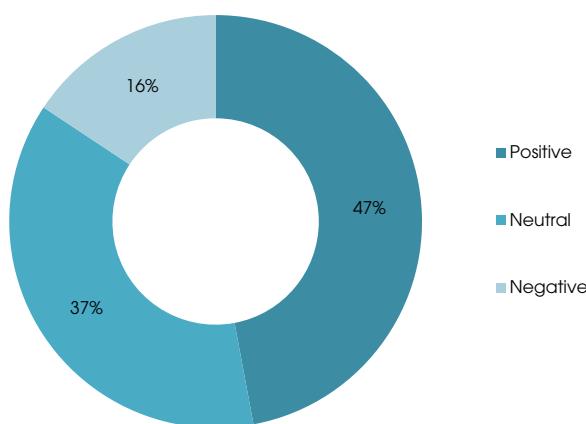
## Industry-Leading Private Debt Performance Data

Preqin's **Private Debt Online** contains net-to-LP performance data, with full metrics for over 620 named vehicles.

For more information, please visit:

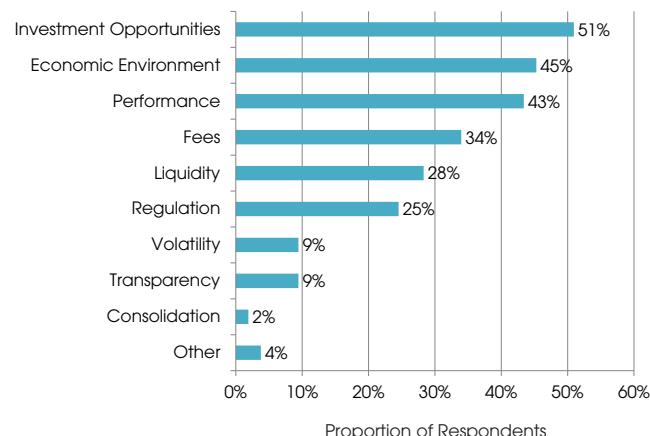
[www.preqin.com/privatedebt](http://www.preqin.com/privatedebt)

**Fig. 6.2: Investors' General Perception of the Private Debt Industry at Present**



Source: Preqin Investor Interviews, February 2015

**Fig. 6.3: Investors' Views on the Key Issues for the Private Debt Market in 2015**



Source: Preqin Investor Interviews, February 2015



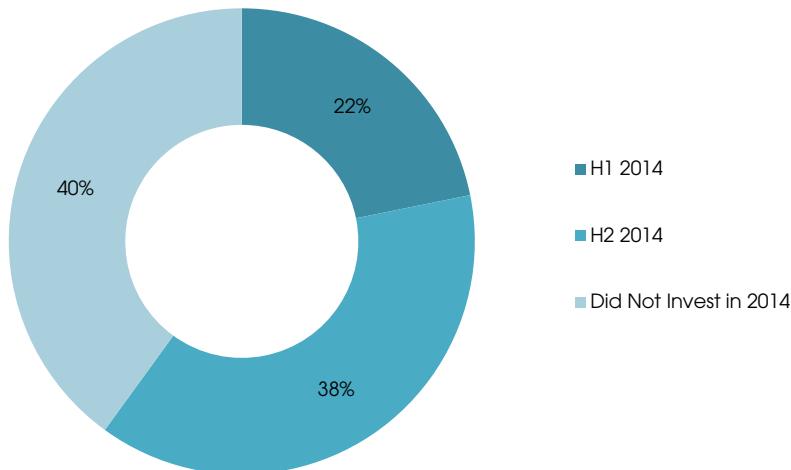
# Investor Activity in 2014

Preqin's recent survey shows that 60% of investors made a private debt fund commitment in 2014, with over a third (38%) of investors making a commitment in H2 2014 (Fig. 6.4). Despite this, 40% did not make a private debt fund commitment in 2014, showing that despite positive attitudes to the asset class and a large number of funds seeking capital, many investors decided against making new investments in 2014.

Fig. 6.5 indicates that all investors interviewed are either at or below their target allocations to private debt, with no investors interviewed currently being over-allocated; this paints a positive picture for private debt fundraisers, as investors have the capacity to make new commitments to the asset class, both to move closer towards target allocations or to maintain current levels of exposure as they receive distributions from existing investments.

In light of steady growth within private debt in recent years, Preqin asked investors how they feel the size of the market may change, whether the market has already reached its peak or if it can grow further. As shown in Fig. 6.6, the majority of investors (86%) expect the size of the private debt market to grow in the coming five years, either slightly or significantly. In contrast, only 6% of respondents expect the size of the market to decrease over the same timeframe.

**Fig. 6.4:** Proportion of Investors that Made New Private Debt Fund Commitments in 2014



Source: Preqin Investor Interviews, February 2015

## Data Source:

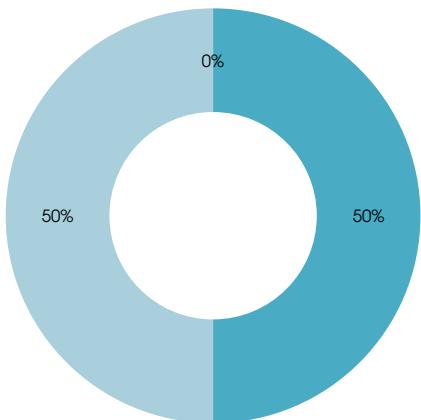
Preqin's **Private Debt Online** tracks in-depth data on over 1,400 active investors in private debt around the world.

Search for investors based on their current allocation to private debt, location, investment preferences, and much more.

For more information, please visit:

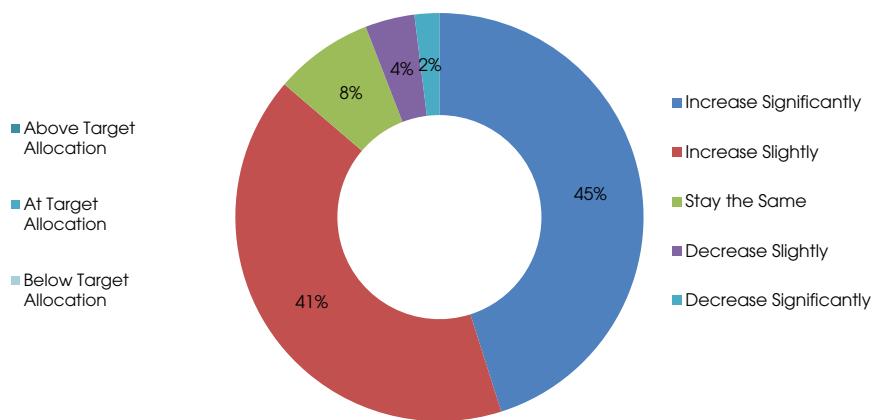
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**Fig. 6.5:** Proportion of Investors At, Above or Below Their Target Allocations to Private Debt



Source: Preqin Investor Interviews, February 2015

**Fig. 6.6:** Investors' Views on How the Size of the Private Debt Market Will Change over the Next Five Years



Source: Preqin Investor Interviews, February 2015



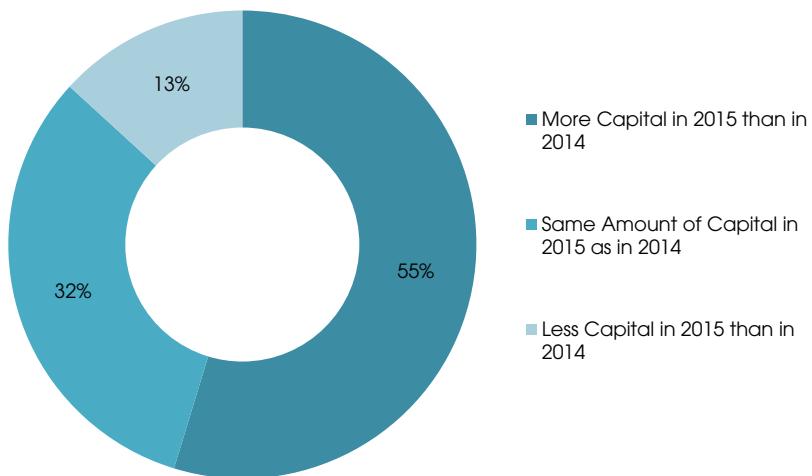
# Investor Activity in 2015 and the Longer Term

Although the private debt fundraising market is becoming increasingly crowded, Preqin's recent survey indicates that, encouragingly, investors expect to not only allocate fresh capital to the asset class in 2015, but at a greater rate than in 2014 (Fig. 6.7). Over half (55%) of respondents expect to allocate more capital to private debt in 2015 compared to 2014, with 32% expecting to allocate the same amount of capital.

Preqin's interviews with investors also revealed that the majority (57%) plan to increase their current allocation to private debt in next 12 months (Fig. 6.8), with only 6% looking to decrease their exposure. Results are also positive for the asset class in the longer term, with 92% of respondents stating that they anticipate either increasing or maintaining their current allocation to private debt in future.

With investors looking to increase their exposure to private debt, Preqin asked investors when they expect to make their next private debt fund commitment. Forty-four percent of respondents expect to make a commitment in H1 2015, with a further 20% expecting to allocate to their next private debt fund in the second half of the year (Fig. 6.9). A quarter of investors are unsure as to when they will make a new commitment, perhaps allocating to the asset class on a more opportunistic basis. Only 11% of respondents do not expect to commit to a private debt fund in 2015.

**Fig 6.7: Investors' Expectations for the Amount of Capital They Will Commit to Private Debt in 2015 Compared to 2014**



*Source: Preqin Investor Interviews, February 2015*

These results can be taken as a vote of confidence for the private debt industry, as investors are not only looking to continue allocating capital to the asset class but

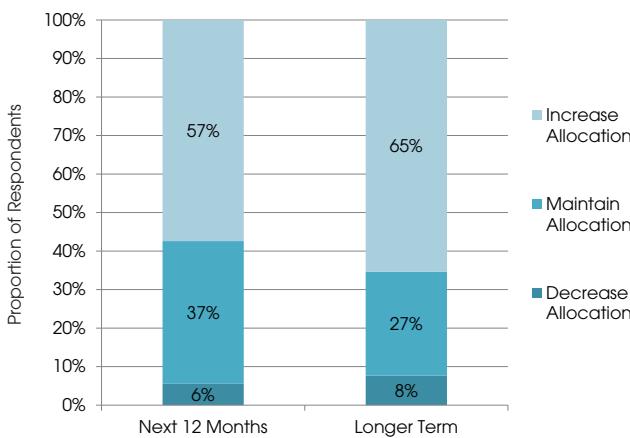
are planning to increase their activity in the space by allocating greater amounts of capital in 2015 than in 2014.

## Data Source:

The **Future Fund Searches and Mandates** feature on Preqin's **Private Debt Online** is the perfect tool to pinpoint those institutions that are seeking new private debt investments now. Search for potential new investors by type and location, as well as their current fund type and geographic preferences.

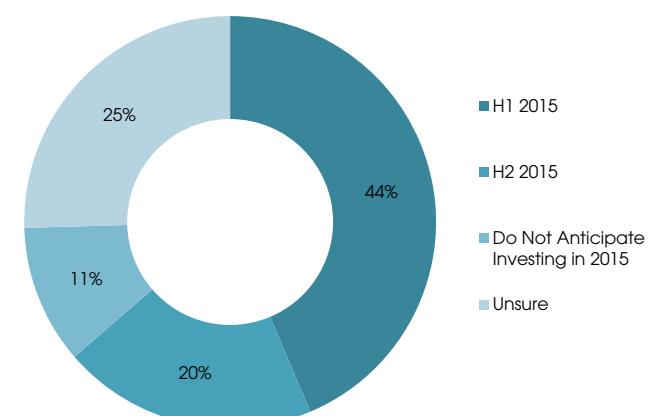
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**Fig 6.8: Investors' Intentions for Their Private Debt Allocations**



*Source: Preqin Investor Interviews, February 2015*

**Fig. 6.9: Investors' Timeframe for Their Next Intended Commitment to Private Debt Funds**



*Source: Preqin Investor Interviews, February 2015*



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# Strategies and Geographies Targeted

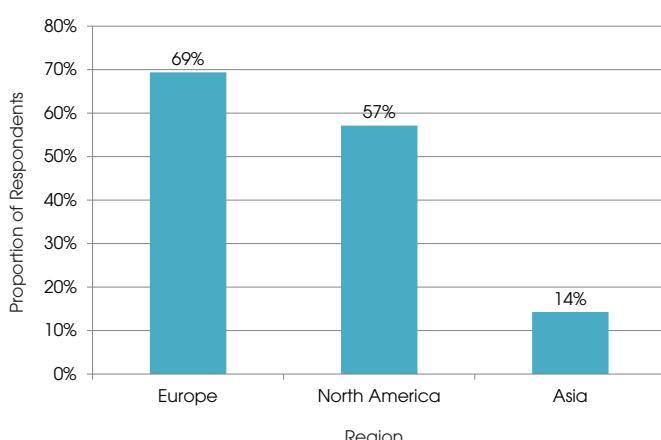
## Fund Type Preferences

Direct lending is viewed as the most attractive private debt fund type to investors in the current financial climate, named by 62% of respondents (Fig. 6.10). This is in line with the current fundraising market where direct lending vehicles form the largest amount of funds seeking commitments, both in terms of number and the amount of capital targeted. Special situations are viewed as attractive by half of respondents, while distressed debt and mezzanine funds, which have historically dominated the private debt space, are viewed as attractive by less than a third of respondents, with 30% and 28% naming these fund types as presenting the best opportunities in the current market respectively.

## Geographic Preferences

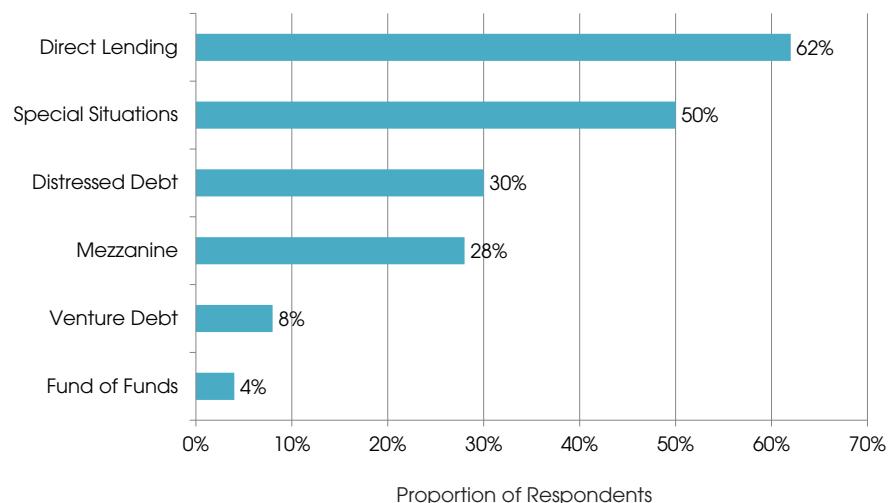
Europe is viewed favourably by 69% of investors, and was the most cited region when investors were asked which regions currently present the best investment opportunities (Fig. 6.11). This is a consequence of the relative immaturity of the European private debt market compared to North America, coupled with a significant amount of potential deal opportunities as Basel III regulations start to kick in. North America is still viewed by a significant 57% of respondents as presenting attractive opportunities, whereas only 14% of respondents thought Asia presented strong opportunities at present.

**Fig. 6.11: Regions Investors View as Currently Presenting the Best Investment Opportunities**



Source: Preqin Investor Interviews, February 2015

**Fig. 6.10: Private Debt Fund Types Investors View as Currently Presenting the Best Investment Opportunities**



Source: Preqin Investor Interviews, February 2015

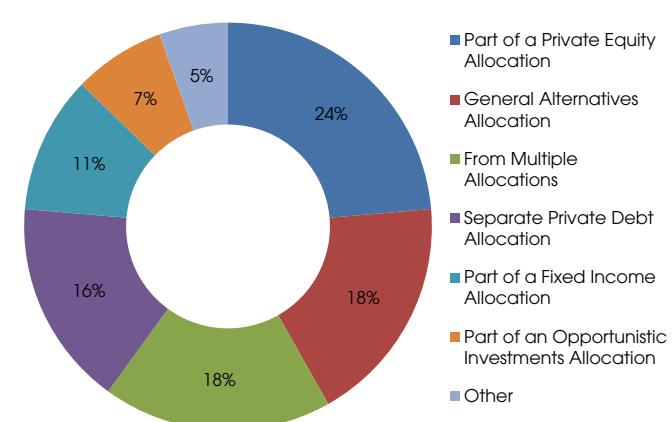
## Investors' Source of Allocation

As private debt continues to grow, it is especially interesting to see how investors define, place and understand the asset class. As shown in Fig. 6.12, nearly a quarter (24%) of investors allocate to private debt via their private equity allocation, with a further 18% accessing the asset class through their general alternatives allocation. By contrast only 11% invest through their fixed income allocation. This indicates that the asset class is very much viewed by investors as an alternative investment similar to private equity, with which it typically

shares characteristics such as illiquidity, as opposed to fixed income instruments, with which it shares features such as the underlying investments paying a coupon.

Importantly for the growth of private debt as an independent asset class, a notable 16% of investors now maintain a separate allocation to private debt; this proportion is expected to grow in the coming years as investors struggle to place private debt target returns in a private equity bucket, while at the same time struggling to place it within a fixed income allocation due to its illiquidity.

**Fig. 6.12: Breakdown of Investor Allocations Used for Private Debt Investments**



Source: Preqin Investor Interviews, February 2015



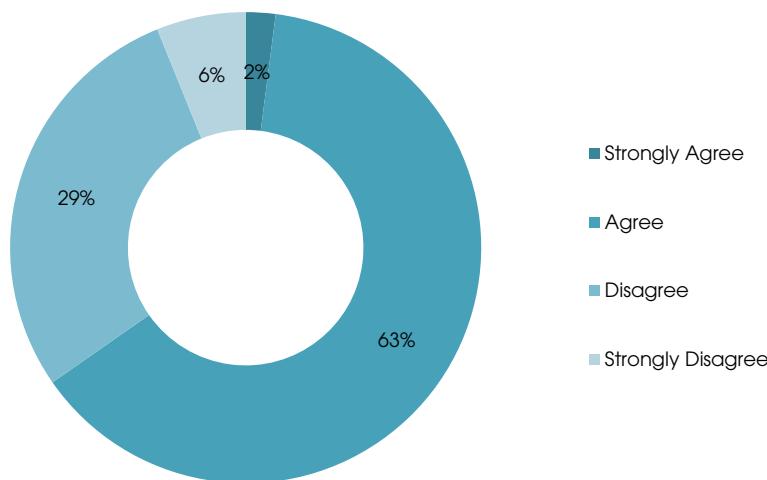
# Fees and Alignment of Interests

Preqin's latest investor interviews reveal that the majority of investors in private debt believe that fund manager and investor interests are properly aligned, with 65% stating they either agree or strongly agree with this statement (Fig. 6.13). However, for over a third (35%) there is a lack of confidence in the alignment of interests between fund managers and investors, indicating there is still room for improvement within the industry.

Fig. 6.14 illustrates the areas in which investors believe LP and GP alignment could be improved. The amount of capital fund managers commit to their own vehicles is the most common answer (55%), indicating investors feel that a manager having a greater stake in a fund leads to a greater alignment of interests. Management fees were also named by over half (53%) of respondents as an area in need of improvement, with hurdle rates (49%) and performance fees (47%) also named by a large number of investors.

In understanding investors' opinions on fund terms and conditions and areas for improvement, it is interesting to put this in context by looking at the factors they consider most important when selecting

**Fig. 6.13: Proportion of Investors that Believe Fund Manager and Investor Interests Are Properly Aligned**



*Source: Preqin Investor Interviews, February 2015*

a private debt fund manager. As shown in Fig. 6.15, 42% of investors named strategy as the most important factor they consider when selecting private debt fund managers for investment, with a further 23% naming past performance as the key factor.

Only 19% named alignment of interests as the most important factor, indicating that while a number of investors feel this is an area for improvement, it is generally not considered the most important factor when allocating capital to private debt.

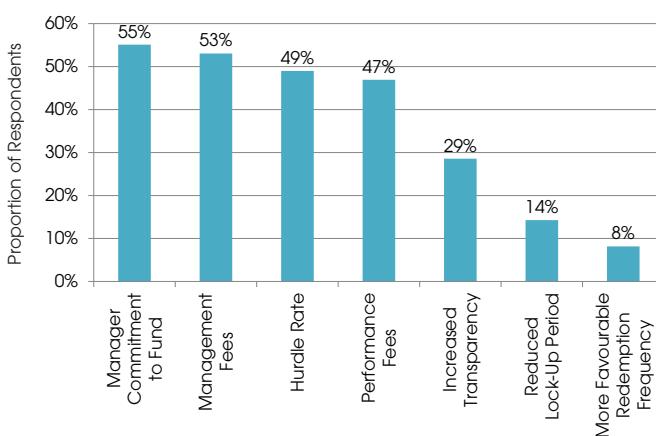
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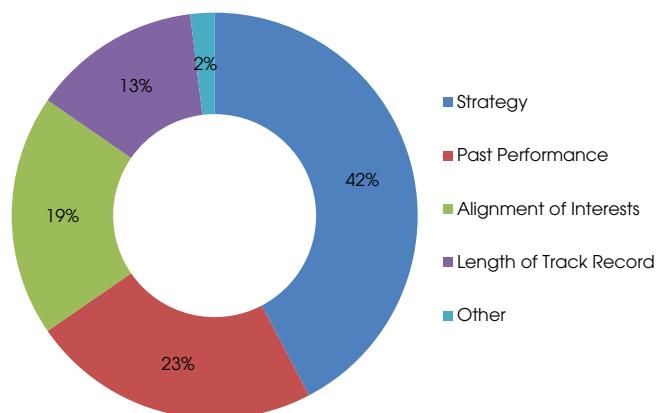
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**Fig. 6.14: Investors' Views on Areas of Fund Terms and Conditions Where Alignment of Interests Can Be Improved**



*Source: Preqin Investor Interviews, February 2015*

**Fig. 6.15: Investors' Views on the Most Important Factor They Consider when Selecting a Private Debt Fund Manager**



*Source: Preqin Investor Interviews, February 2015*



# Preqin Investor Outlook: Private Debt H1 2015



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