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Direct lending is popular – and thus bucks the trend

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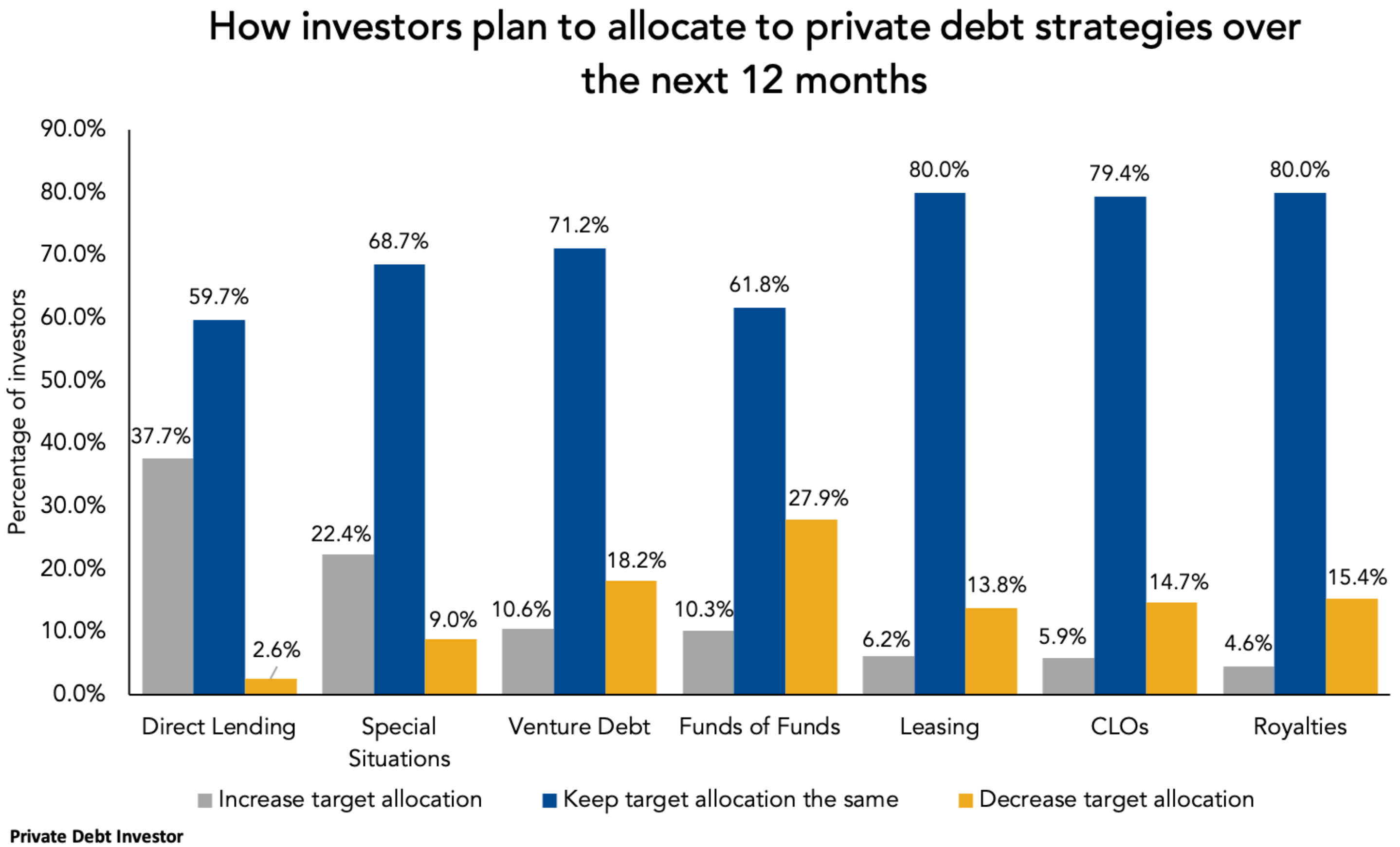

A new survey shows the strategy retaining a strong level of demand, while other areas of private debt lose their allure.

They still can't get enough. Ever since the global financial crisis, the theme of direct lending has gathered pace – and also gathered increasing piles of limited partner capital. According to a survey of investors recently conducted by sister title Private Equity International, there is very little sign of this enthusiasm waning.

The survey revealed that almost 38 percent of investors canvassed were looking to increase their target allocation to direct lending over the next 12 months. Out of seven private debt strategies, this was easily the largest percentage looking for an increase – well ahead of special situations, for which 22 percent of LPs were looking to boost their exposure.

A large number of new direct lending funds have been launched, some by relatively inexperienced managers, and the view is often expressed that competition for deals has heated up considerably. However, the potential universe of target companies – particularly when you take into account the non-sponsored market – is enormous.

Investors appear to be persuaded that this is an investment theme that has a bright future.

The same cannot necessarily be said for private debt as a whole, with investor appetite seemingly reaching something of a plateau. A clear majority of LPs – an average of 71.5 percent, measured across the seven strategies – are keen to keep their target allocations the same over the next year. Of those keen to change the target allocation, slightly more want to reduce it (14.5 percent) than to increase it (14 percent).

The strategy with the most challenging future appears to be funds of funds, where investors are perhaps wary of the double fee layer – despite FOFs being a way to access in-demand and niche funds. Almost 28 percent of those LPs surveyed said they would be seeking to decrease their funds of funds allocation in the year ahead.