The State of Private Credit in Europe (Sixth of a Series)

THE LEAD | July 21, 2021

Our *Chart of the Week*, courtesy Preqin, highlights how both US and European fundraising for private debt came into Covid with a head of steam. That momentum slowed in the wake of the pandemic last year. Since then, however, things have picked up.

Our content partner, Private Debt Investor, recently published some excellent commentary related to investors' views of the "European opportunity." One CIO told PDI it started looking more attractive when US yields dropped precipitously last year. Since then, the difference in yields between cross-Atlantic credit markets has not been "nearly as substantial as it use to be. Plus the Euro's relative strong showing against the dollar gave the investment opportunity another boost."

In the same article, the CEO of one large private debt asset manager reported that "European private equity firms have around £200 billion of dry powder they need to deploy." As it does in the US, that's driving PE deployment, as well as private credit fundraising and investing.

According to PDI, there's $116 billion worth of funds in the North American market, $85 billion in Europe and $12 billion in the Asia-Pacific region. The asset mix of these efforts primarily includes senior, subordinated, and distressed debt, with about $35 billion raised with interim closes in North America, $22 billion in Europe, and less than $5 billion in APAC.

So what's the view of European private debt as an investment option for LPs? A recent PDI survey showed just under 90% expressed an interest in having similar or greater exposure in private debt.

Campbell Lutyens, a global private debt advisor, said US LPs focusing on private credit are coming from a more private equity perspective. That leads them to seek higher return instruments such as mezz and distressed. "In Europe," they reported, "investors are coming from more of a fixed-income background." That means high-single digit returns are relatively attractive.

They also suggested LPs were presently sticking closer to home. "We continue to see North American investors focused on investing in North American assets and European investors looking to deploy in Europe." Interestingly, they noted "the cost of capital among pension funds and insurance companies in Europe is lower, whereas American investors need to seek higher returns."

When will investors look farther afield for opportunities with private debt managers? PDI highlighted LPs who said they "continued to see home-focused investing preference where dollar investors prioritized US dollar opportunities. European allocators also looked closer to home, partly due to foreign exchange and hedging cost considerations."

Campbell Lutyens concurred. "We will continue to see pulling away of the largest managers, and expect European investors to start looking towards North America again to augment their portfolios. How strong that trend will be remains to be seen, but European investors will see a bigger need to be in North America than vice-versa."

Next week we conclude our series with a forecast for European direct lending.