

Lenders find new ways to team up and put cash to work

European direct lenders are teaming to put money to work, *Alt Credit* talks innovative partnerships and creating win-win-win relationships

[Jon Close](#) | August 1, 2019, 9:55 am

Direct lending has seen a massive influx of investment in recent years, and larger managers are teaming up with smaller managers or niche lenders to get access to their markets in exchange for balance sheet.

Alt Credit spoke to some of the managers building these relationships from ad hoc deal flows into more sustained formal co-operation.

"Because of the wall of money going into alternatives, the managers who have the money now need to invest it," says Ainun Ayub, alternative fund servicing product manager at Brown Brothers Harriman in London. "Dry powder is a hot topic in alternatives at the moment, so structurally people are being more creative and more open-minded about how they go and source deals, whilst staying true to their brand."

"Managers working together is not such a new thing in the private equity space, where this would be quite a normal co-investment, and managers have been doing the same in direct lending – called co-lending – and this is often found in sponsored transactions," explains Oliver Fochler, founder and managing partner of Stone Mountain Capital, which raises funds for direct lenders, and raises capital for borrowers.

"If a smaller manager really likes a deal but they don't have the capacity to fund it, or it's too large for their investment guidelines, they might bring in another larger manager or vice versa," adds Fochler. "They might bring in other lenders with on equal level, as *pari passu* lenders, and then the sourcing manager will write the documents and find another fund willing to come in on their terms."

Sometimes a deal may be split horizontally, where one lender has a different risk tolerance than the other.

"Those transactions can also be done by unitranche, where there is an inter-lender agreement, where you have a controlling piece, which would've historically been done by a bank. Then the mezzanine slice has the higher return and has fewer voting rights," says Fochler.

These deals could be done on an ad hoc basis, with fund managers paying sourcing fees to banks and funds, and at times receiving fees back for deals that they bring to their peers.

The most famous permanent tie-up was between Ares and GE Capital, where a fund lent to borrowers but was split at the portfolio level into junior and senior exposures to the portfolio as a whole. That deal was about volume and speed, but the latest tie-ups are about getting access to more niche strategies. Data looking at the terms used in mandates seen by *Fundmap* suggests investors are looking beyond the standard mid-market 'direct lending' funds as they expand their private debt searches, with SMEs, special situations and differentiated strategies becoming more common.

Mandates for direct lending vs other private debt funds by allocation size

Source: Fundmap

The time-limited opportunity

The latest wave of tie-ups is on a more permanent basis, which requires a much more formal arrangement between the sourcing firm and the management firm. *Alt Credit* recently reported that Chenavari was launching one such fund, aiming to target Greek assets by teaming up with a local asset manager who would bring local expertise and source deals.

"Our bank deleveraging strategies have been in operation since 2011 to assist banks through their deleveraging cycle via acquisitions of non-core performing loans, non-performing loans and regulatory capital relief transactions," explains Ahmed El Mahi, a structured credit expert at Chenavari, who says that the firm had looked at Greece broadly much earlier in the eurozone crisis.

Initially, Chenavari looked at some deals in Greece with an international component such as shipping, which weren't as affected by the national economy. But as the outlook for Greece has continued to improve, the firm is looking to take advantage of the country's broader recovery, with a very targeted fund that might be a one-off.

"The signals for us to enter Greece was when we started to see Syriza, a non-traditional left-wing party, implement the right-of-centre reforms proposed by Brussels, then came the debt relief package, the sovereign returning to the market, and the beginning of an upward rating trajectory," says El Mahi.

"That's what we needed to see to believe that we were seeing a return to normalcy for Greece."

Bigger asset services have also entered the country and some large US NPL buyers have also become active. These firms can analyse deals on a statistical level from the US, and need just a handful of relationships with the largest banks; typically they are sold in auction like conditions. But Chenavari is looking for smaller deals, with less competition, which would typically need staff on the ground.



"The due diligence, underwriting and investment committee is done in London while Chenavari's Greek partner provides value added in sourcing and expanding our network of relationships in Greece to help with the negotiations and due diligence," explains El Mahi.

The fund is thought to be time-sensitive, so establishing an office and getting set up with regulators in Greece may take too long.

"The first instalment of the fund has been focused on investing in the sixth-largest Greek bank looking to expand its portfolio in a very concentrated banking system, where the four major banks control over 90% of assets, and prime real estate around central Athens which follows Chenavari's experience of the wider bank deleveraging cycle, this is where we see the initial returns."

The specialist opportunity

Another fund taking a similar approach to finding niche assets is Culross Capital. Traditionally a fund of hedge funds manager, the firm is moving into a niche it has spotted in the direct lending space. In particular, the firm is said to be raising money for a fund focused on lending to high-growth tech companies in Silicon Valley.

Not only is Culross teaming up with a bank to source deals, it's also joining forces with a fund to pick the loans. The firm has teamed up with a specialist lending bank which has signed an exclusive agreement to show loans which fit Culross's criteria to a US fund. That fund then does due diligence and picks the loans that work for the portfolio, and Culross has final veto over loans and handles risk management for the portfolio.

The bank gets a steady source of foreign capital to help it source deals, the US fund gets an income stream, and Culross brings a differentiated niche portfolio to investors in its core market of Europe, which would be near-impossible to source independently.



The devil's in the detail

A win-win-win is usually hard to find, and even harder to pull off. These tie-ups take a great deal of trust, and a decent amount of legal paperwork to back that trust up.

"The first deals were done on an ad hoc basis, which helped us build trust, and now the partnership has evolved into a fund-level agreement," says Chenavari's El Mahi.

Fochler adds: "To get a regular deal flow, a manager will show any relevant deals to the third party after they sign a non-disclosure agreement and sign some form of partnership agreement."

the details of how any 'first look' deals may work may be signed in an engagement letter, which is kept private and not signed by the fund itself. Usually that agreement would have some sort of 'right of first refusal clause' and lay out the details of the what deals must be shared and for how long, and for what fees.

There will typically be back-to-back indenture agreements too, which will mean that if a deal is taken by the fund and it later transpires that the sourcing party made some form of mistake, the fund will be forced to repay the investor, and the sourcing party will repay the fund. The details of who is responsible for what 'mistakes' will also be laid out in the engagement letter.

But these engagement letters don't necessarily have to be sent to the investor in the fund, and investors can be in the dark about how much power the fund manager has.

"They won't necessarily even disclose who the third party is, even to investors in the fund, and might try and keep the details of the extent of the relationship private, but they will disclose what fees they are paying," says Diala Minott, a partner with Paul Hastings in London, adding: "The payment of any fees has to be disclosed and investors are very sensitive to what they're paying the manager to do and what the manager is outsourcing someone else to do."

When the fund manager is sourcing exclusively through a third party they may disclose that; if it's a bank that's doing the sourcing they may insist on the manager being explicit, as the manager will be restricted from signing a similar deal with another party in the same asset class.

Aligning interests while staying exclusive

One of the balancing acts that a fund manager must do in these types of arrangements is adding value to the investor and the sourcer. They have to bring reliable capital to a sourcer who couldn't otherwise get it and provide portfolio management and access to the investor they could not get.

For example, Chenavari's deal is with a manager that doesn't typically do debt deals in their own strategy, which reduces much of the risk of the sourcing party shopping around for or hiding away their best deals.

"While we review a real estate deal, it is always helpful to be able to connect with local developers for example. And it's incredibly useful for insight on some of the potential pitfalls in operating in the local Greek market," says El Mahi.

The platform

While most managers are focusing on tie-ups on the asset-buying side, others are looking for collaboration on the asset-raising side.

In Europe, there has been a significant rise in the number of direct lending 'platforms'.

So far these have largely been single-manager platforms, which have an umbrella fund of permanent capital to allocate to the firm's various lending strategies.

In March it was reported that TSSP had raised \$2.5bn for its TSSP Adjacent Opportunities Strategies fund, which works roughly along these lines, allocating to TSSP's growth debt, direct lending and special situations strategies.

Multi-manager platforms have also been well-established in other alternatives before and managers of such of platforms are increasingly trying to put private debt onto more multi-asset platforms.

"Multi manager platforms are a different kind of relationship promoted by a big name manager that can attract the funding, which, in partnership with other managers, offers different kinds of exposures to geographies, deals, and industry segments. These various exposures roll up into an overall strategy that the platform is selling to investors," says BBH's Ayub. "In this way, investors gain access to these smaller managers where they don't have the bandwidth to allocate to each one themselves."

Ayub is also seeing investors practically create their own platforms to simplify their own operations and workload.

"We're seeing some of the largest asset owners create their own alternative investment platforms, especially where they have highly specific reporting requirements. Having established a model they like with BBH, they then request managers they award mandates to set up sub-funds under their own umbrella." Ayub concludes.

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