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EDITORIAL COMMENT

At the forefront of the cycle

Dear Reader,
Welcome to the *Private Debt Investor* Fundraising Supplement.

Earlier this year, we published our inaugural PDI 30 – a list of the top 30 private debt managers based on the amount of capital raised in the past five years. The total amount raised by those firms in that timeframe – $322 billion – is, as First Avenue founder Paul Buckley acknowledges in our interview on page 8, "a really big number for a new asset class".

Our in-house data show there are more than 200 funds targeting combined commitments of $114 billion out in market at the moment. The data pages at the back of this supplement show that the featured funds closed this year which total $64 billion. For a relatively nascent asset class, that's an impressive number.

There are plenty of challenges for firms looking to raise capital however. A lucky few have the brand name and pedigree to attract commitments with relative ease. Just look at the amount of capital raised by the likes of Oaktree Capital Management this year, or the inexorable growth of GSO, which has outstripped The Blackstone Group's core private equity business in assets under management.

But for aspiring managers in particular, fundraising is a long and thankless task. While some investors have taken a progressive view of the asset class and have discrete allocations to private debt, many struggle to pigeon-hole it. Should an allocation come from a fixed income bucket, or an alternatives one? The answer to that question inevitably varies, but it points to the need for managers to have a clear idea of how they want to position their fund.

Generating momentum in a fundraise is key to success. Hitting a first close early, possibly via a sizeable cornerstone commitment, allows a GP to deploy capital and demonstrate to potential investors that the model works. Thanks to the characteristics of debt investing – with assets yielding income from the start in many cases – it's possible to demonstrate the ability to generate a return far quicker than with a private equity fund, for example.

Structuring a fund appropriately is a key decision too, as Macfarlanes pair Alex Amos and Damien Crossley note in their piece on page 12.

But there's undoubtedly a secular shift happening, playing very much in private debt's favour. Capital is being reallocated from sovereign and public corporate credit and into the private arena at an increasing pace as investors hunt yield. Other alternative asset classes are undergoing a period of consolidation. With skill, and plenty of perseverance, private debt fund managers will find themselves at the forefront of this fundraising cycle.

We hope you enjoy the supplement,

Oliver Smiddy, Editor

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Englightenment focuses on the aerospace and defence sectors

AEROSPACE AND DEFENCE

Enlightenment raises $41m for Fund I

Enlightenment Capital has raised more than $41 million for its Enlightenment Capital Solutions Fund I.

Enlightenment is targeting $100 million for the fund, which the firm will use to make senior debt, mezzanine and minority equity investments in the aerospace, defence and government sector, firm co-founder Devin Talbott told *PDI*.

Talbott, a former vice president at DE Shaw, founded Enlightenment in 2012 alongside Pierre Chao, a co-founder of aerospace, defence and government sector due diligence firm Renaissance Strategic Advisors. The pair launched the firm to target investment opportunities created by the withdrawal of traditional lenders and banks from the mid-market loan business, which led to a supply/demand imbalance for capital.

DISTRESSED DEBT

Washington backs TPG Opportunities III

The Washington State Investment Board has approved a $200 million commitment to TPG Opportunities III according to an investment board spokesperson.

"TPG has been a long-term investment partner of the WSIB," the spokesperson said in an email. "Since 2000, the Board has committed in excess of $2 billion to seven TPG-sponsored investment vehicles, including, most recently, $200 million to TOP II in 2012 and TGP Growth II in 2011."

TPG is targeting $2.65 billion for the fund. Pennsylvania Public School Employees' Retirement System documents describe Fund II as specialising in corporate special situations, distressed debt and non-performing loans.

TPG Opportunities II had generated an 18.01 percent net internal rate of return and 1.1x multiple as of 30 June, according to Washington documents.

LEVERAGED LOANS

Partners Group raises $800m for private debt

Switzerland-headquartered Partners Group has raised more than $800 million for its leveraged loans program this year, it said today in a statement. Its third leveraged loans fund accounts for about two thirds of that amount, with separate account mandates accounting for the remaining third, according to a spokesman.

The firm's Private Market Credit Strategies 2013 vehicle will capitalise on the current senior secured debt market opportunity resulting from constrained banks, expiring European CLOs and the demand for refinancing, it added. It is the firm's third PMCS fund.

Private debt is one of Partners' core strategies alongside private equity, private real estate and private infrastructure, with the firm having adopted a progressive approach to the asset class. This latest vehicle has an "investor friendly" investment structure, according to the firm, with a quick ramp-up period of 12 months.

The firm has invested in more than 40 leveraged loan deals so far this year.

DISTRESSED DEBT

American Securities within reach of $750m target

American Securities, led by senior partners Anthony Grillo and Lawrence First, is within reach of its $750 million target for its third opportunities fund.

The firm raised at least $725.1 million for the vehicle as mid-November, according to an SEC filing. The fund will invest between $20 million and $100 million per deal in companies with revenues in the $100 million and $1.5 billion range.

The Los Angeles City Employees' Retirement System committed $30 million to the vehicle earlier this year. A Hamilton Lane report suggests the firm may raise as much as $1 billion for the distressed debt fund. The vehicle will include a commitment of up to $20 million from the GP, according to the report.

The firm's 2010 vintage opportunities fund had generated a 14.18 percent net internal rate of return as of 31 March, according to a Public Employee Retirement System of Idaho report. ■

NEWS ROUND-UP

FUNDRAISING: PRIVATE CORPORATE DEBT

Oaktree chairman Howard Marks

DISTRESSED DEBT

Oaktree raises $8.4bn this year

Oaktree Capital Management has raised $8.4 billion in the first three quarters of 2013, including $3 billion through new strategies, according to a third quarter earnings report.

"The third quarter was another period of strong investment returns across our platform of diversified alternative investment strategies. This performance continues to drive fundraising success," chairman Howard Marks said in a statement. "Notably in the third quarter, gross capital raised was $3.7 billion, bringing the total for the first nine months of this year to $8.4 billion, including $3.0 billion for strategies that did not exist two years ago."

The firm's Oaktree Real Estate Opportunities Fund VI held a close on $2.3 billion in September and its European Private Debt strategy closed on $753 million in November. Oaktree's Strategic Credit strategy has reached $1.8 billion in commitments, according to the report. An additional $459 million has been raised for its emerging markets debt strategy.

In October, the San Bernardino County Employees' Retirement Association approved a separate account that will include $82 million of SBCERA's existing investments in Oaktree's convertibles strategy plus an annual commitment of at least $30 million per year over the next five years, according to a term sheet made available to *PDI* by the retirement association.

MEZZANINE

Indigo hits €200m first close

French mezzanine firm Indigo Capital France has held a first close for its latest fund on €200 million as it eyes a €250 million target. It launched the fundraising in September last year, and hopes to hold a final close by the end of Q1 next year.

Investors in the fund include pension funds, insurance companies and government agencies as well as family offices and private investors, it said. Two thirds of the commitments received to date come from LPs based outside France, with the majority being European.

Indigo Capital France was founded by Monique Deloire and Cyril de Galea, who spun out from Indigo Capital two years ago. The firm has a team of eight, reinforced this week with the addition of a third partner, Nathalie Bleunven.

Bleunven joins from Société Générale, where she had worked since 2000 as managing director and co-head of buyout leverage finance and mid-market-focused corporate acquisition finance.

FPCI Indigo Capital will pursue a similar strategy to its predecessors (raised pre-spinout), targeting mezzanine investments in growth companies in France and Europe generally.

USA

Keystone launches Fund VI

Keystone National Group has launched its sixth private market opportunities fund just months after coming to a final close on Fund V.

Keystone Private Market Opportunities VI has already raised at least $5.4 million towards a $150 million target, according to an SEC filing. Managing partner and co-founder John Earl declined to comment on the vehicle.

The San Ramon, California-based firm closed its fifth fund on $100.1 million in April. The new fund will invest in senior secured loans, secondary loan pools, consumer and industrial loans, distressed debt and bankruptcy claims, among other strategies. Fund V was already 50 percent invested as of April, and as of 15 February was generating a 10 percent net IRR. Its fourth fund had netted a 10.6 percent IRR as of the same date.

Keystone is led by chairman Roger Widmann and managing partners John Earl and Brandon Nielson. The firm specialises in private credit markets that are generally underserved by larger institutional players, according to its website.

INVESTOR

LACERS considers Apollo VIII

The Los Angeles City Employees' Retirement System is contemplating a $40 million commitment to Apollo Global Management's eighth fund, according to documents available through the retirement system's website.

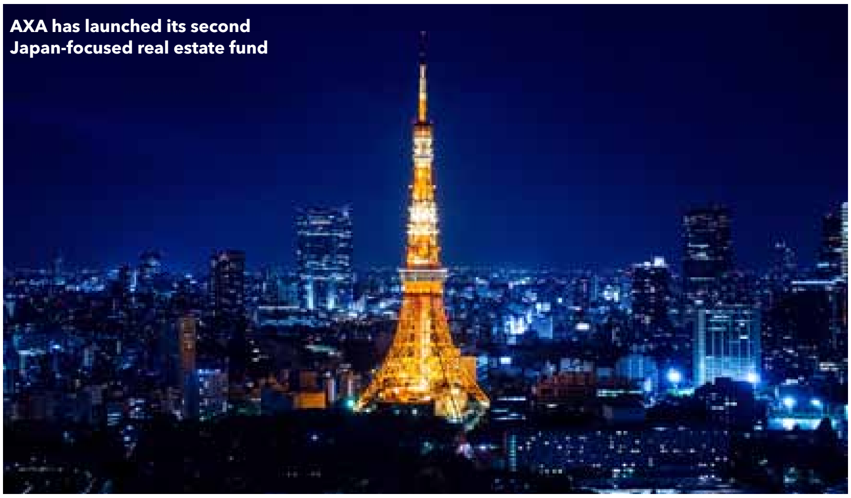
Apollo has already cleared its $12 billion target for Investment Fund VIII and is reportedly in talks with LPs to raise as much as $15 billion. The firm's previous fund – Apollo Investment Fund VII – has generated 24.55 percent net IRR. Apollo will likely dedicate approximately 75 percent of Fund VIII to North American investments, 20 percent to Western European deals and 5 percent to Asia, according to a report prepared by LACERS investment officer Jimmy Wang.

"This strategy allows Apollo to opportunistically deploy capital up and down a company's balance sheet to structure attractive deals in both expansionary markets and depressed markets, "Wang's report said. "Post-acquisition value-add enhancements include operational efficiency improvements as well as capital structure optimization."

Apollo has offered LACERS a management fee structure that will charge 1.5 percent of aggregate commitments up to, and including, $7 billion and 1 percent of aggregate commitments above $7 billion. The post-investment period management fee will total 0.75 percent of invested capital. ■

NEWS ROUND-UP

FUNDRAISING: REAL ESTATE DEBT



AXA has launched its second Japan-focused real estate fund

JAPAN

AXA raises ¥26bn RE debt vehicle

AXA Real Estate, the real estate asset management arm of French insurer AXA, has launched a second Japan-focused real estate debt vehicle with ¥26 billion (€192 million; $259 million) committed from two Japan-based AXA insurance companies, according to a firm statement.

Following its ¥15 billion debt vehicle launched in 2011, AXA has now brought its Japanese debt platform to approximately ¥40 billion of capital commitments. The first vehicle is now fully invested, according to Tetsuya Karasawa, AXA Real Estate's deputy head of Japan, and should have about four more years before it is fully realized.

Debt from the second vehicle is expected to be loaned to owners of office, retail and logistics properties within the greater Tokyo area. It is expected that the fund will contain between seven and eight loans when fully invested, Karasawa said. The fund's target interest rate will be about 180 basis points, while the minimum is 150 basis points. The average loan will have a life of 4 years to 5 years.

AXA is expected to deploy the capital of the new vehicle over the next three years with the first loan made before the end of the year.

INVESTOR

IMRF helps Torchlight IV towards $1bn target

The Illinois Municipal Retirement Fund's (IMRF) Board of Trustees has increased its total commitment to Torchlight Debt Opportunity Fund IV to $65 million, according to a statement. The $32.3 billion retirement fund previously committed $30 million to the vehicle in October 2012.

The re-up comes at a good time for Torchlight Investors, which is said to be very close to hitting its $1 billion target for Fund IV, a source with knowledge of the fundraise said. The vehicle will invest in commercial real estate securities such as CMBS, mezzanine debt, B-notes, preferred notes and financing for distressed mortgages.

Torchlight has already invested in several deals through Fund IV. In November, the firm announced it had provided $22 million in first mortgages for apartment complexes in Florida and Texas.

IMRF made its commitment to Torchlight through its real estate allocation.

USA

Principal raises $258m for RE debt

Principal Real Estate Investors has raised at least $257.8 million for its latest real estate debt fund. The firm has not disclosed a target.

Principal Real Estate Investors is a subsidiary of Principal Global Investors, a Des Moines, Iowa-based asset management company with $294 billion under management.

Principal Real Estate Debt Fund will target investments in subordinated debt, bridge loans and higher loan-to-value senior loans, according to the July meeting minutes of the Adams County Retirement Board. The 7-year fund has a three year investment period.

In February, Principal Real Estate Debt Fund also received a $50 million commitment from the Iowa Public Employees' Retirement System, however, that investment was contingent on the fund's ability to raise $250 million by June. It is unclear whether IPERS ultimately committed that amount to the fund.

EMEA

Pramerica closes on €820m

Pramerica Real Estate Investors has closed on €820 million for its fourth real estate capital fund, a spokesperson has confirmed.

Pramerica Real Estate Capital IV will target investments in offices, retail, industrial and retail in Europe and the Middle East. The firm operates a separate family of funds for investments in the United States and North America.

The firm recently named Eric Adler as its chief executive officer. Adler succeeds Allen Smith, who was stepped down to take the chief executive role at Four Seasons Hotels and Resorts after 26 years with the firm.

Pramerica Real Estate Investors is the real estate investment management arm of Prudential. The firm had $38.7 billion in net assets under management as of press time. In February, Pramerica acquired companies whose properties include 118 avenue des Champs Elysées in Paris. That transaction was completed through one of the firm's single client accounts. ■

NEWS ROUND-UP

FUNDRAISING: INFRASTRUCTURE DEBT

GCP has partnered with Dubai-based Exotix

MENA

GCP launches Gulf infrastructure debt fund

London based-Gravis Capital Partners has launched an infrastructure debt fund focused on utility-scale infrastructure projects in the Gulf, in partnership with Dubai-based bank Exotix, which will be responsible for identifying and originating investments. The fund has a $250 million target.

It will seek to replicate the strategy followed by GCP's existing funds, which aimed at allowing UK infrastructure developers to free up capital by providing refinancing solutions post-construction phase. Upon completion of the investment phase, the fund will target a return of 6-7 percentage points over Libor, and aims for an annualised dividend yield of 5 percent for its first financial period to 31 December 2014.

Stephen Ellis, a partner at GCP, said big power and water projects abounded in the region. "You have enough political support for these projects to get them built, but once you are through the construction phase, there's nowhere to go to refinance what is essentially a de-risked project," he said.

The fund will seek to plug this gap by providing subordinated, long-term debt to contractors, allowing them to re-allocate equity. The debt will be secured against the 25-year, government-backed cash flows generated by the projects.

The fund is focusing on six states in the GCC: Saudi Arabia, UAE, Qatar, Bahrain, Kuwait and Oman. The fund has already agreed to terms for seven projects, worth an aggregate $350 million. GCP expects the vehicle to be fully deployed within the next four to six months, after which it could return to the market to raise more money.

BENELUX

DG Infra targets €400m in direct investments

Benelux-based DG Infra has received a boost from its sponsors to accelerate its investments in infrastructure projects, it announced in a statement.

The fund manager, a joint venture formed in 2007 by Belgian infrastructure lender Belfius and private equity firm Gimv, will aim to invest €400 million over the next five years. The additional funds will be made up of fresh allocations from both sponsors as well as contributions from external investors.

The new investments will be funded via the fund manager's balance sheet, with a view to subsequent valuation. They will continue to focus on the Belgian and Dutch markets – although the firm intends to step up its presence in France and Germany – and will consist of equity capital or mezzanine financing within the €5 million to €50 million range.

The deals will add to the 20 'participations' already managed by the firm through its two existing funds, DG Infra+ and DG Infra Yield, which have a combined investment capacity of €300 million. DG Infra+ specialises in providing development capital to new, riskier projects while DG Infra targets more mature, cash-yielding infrastructure and real estate projects.

CLO

Aviva, NIBC close £620m infra CLO

Dutch bank NIBC and UK insurer Aviva have successfully placed the Adriana Collateralised Loan Obligation (CLO) vehicle. The CLO comprises £621 million (€733 million; $996 million) of loans to operational public-private partnership (PPP) projects in the UK that were originated by NIBC and are denominated in pounds sterling.

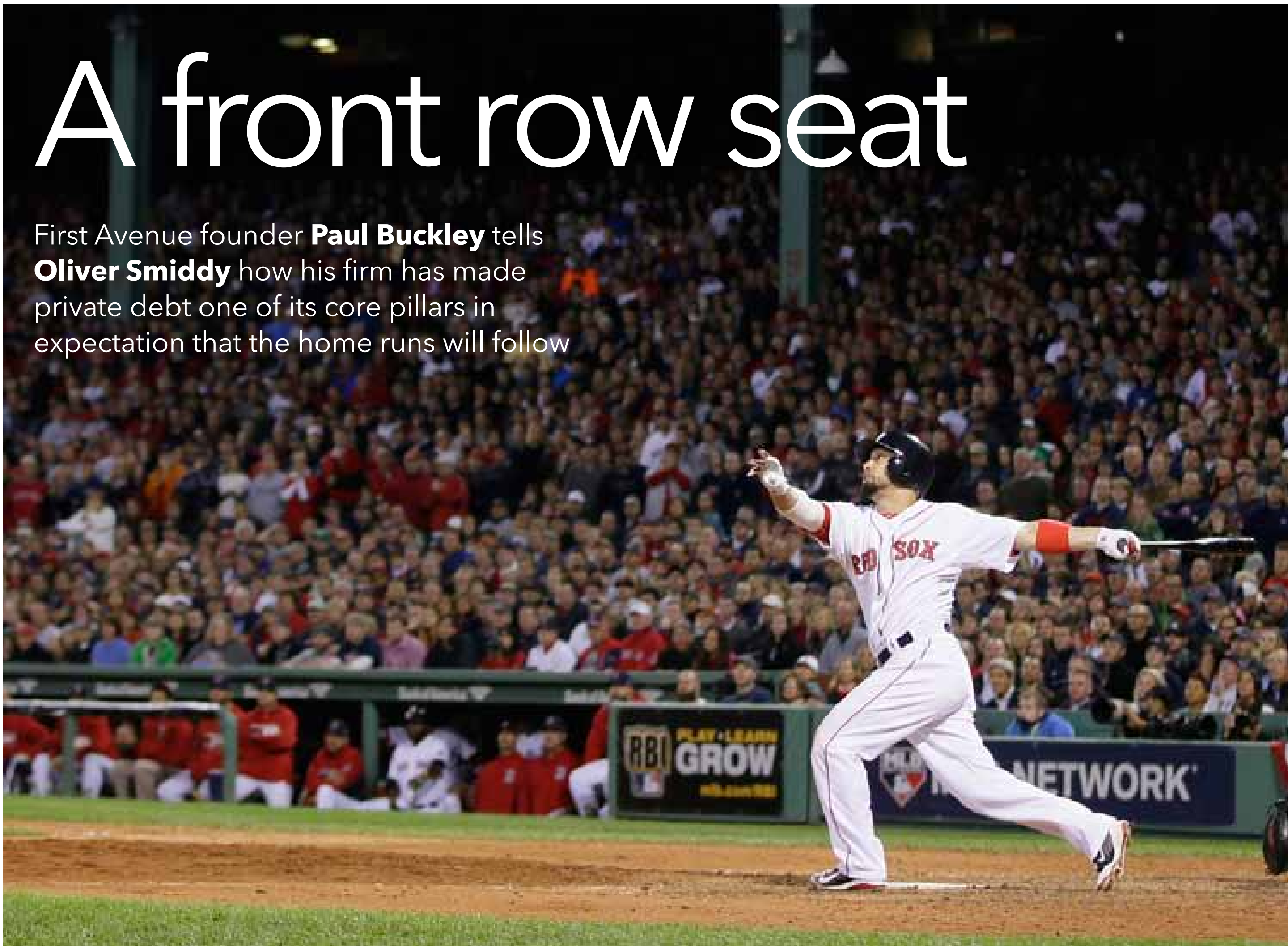
Seventy-seven percent of the total notes of Adriana are Aaa-rated with a weighted average life (WAL) of approximately ten years. A total of £477.8 million of class A1 notes have been placed with Aviva, with NIBC acting as sole arranger and sole lead manager. The class A1 notes have a coupon of six-month GBP LIBOR +120 basis points.

The CLO is another example of the innovative structures being put together to ensure transfer of infrastructure assets from the balance sheets of banks to the long-term home offered by institutional investors.

In October, Aviva bought €84.5 million of senior secured notes in a private placement by Dutch telecoms firm Reggefiber. ■

A front row seat

First Avenue founder **Paul Buckley** tells **Oliver Smiddy** how his firm has made private debt one of its core pillars in expectation that the home runs will follow



"Credit in my view is the most complex asset class. So when a placement agent takes it on, you have two challenges. One is to interface with the GP, and speak his or her language. Credit guys are all pessimists – they're worrying about what's going to go wrong. Equity guys are all optimists; they always think good things are going to happen. So getting used to that dynamic is important. And second, most salesmen at placement agents don't have credit experience because they all came from corporate finance shops. Investors generally don't have much credit experience either. So there's often a lot of work involved."

Paul Buckley, co-founder and chief executive of placement agent First Avenue Partners, should know. His firm has worked with 10 different private debt managers, on 16 funds, across 12 different sub-sectors of the asset class. He and his team have placed a lot of chips on private debt becoming the next big thing, making it a core pillar of their business alongside the 'traditional' alternatives: private equity, real estate, and real assets (including infrastructure, energy and natural resources).

So why the enthusiasm for credit? The firm launched in late 2006 – "The worst moment to found a business in a hundred years", Buckley jokes – and found private debt fund managers beating a path to his door. "There wasn't anyone doing credit [fund placement] at that time, and credit was becoming a total return asset class," he says.

Buckley's whole career has been based around credit, dating back to 1989 when he joined Credit Suisse. "I worked on virtually every credit asset class from money markets to securitisations, CDOs to high yield and even a little bit of leveraged loans. And I had the benefit of participating in those markets when they were in formation."

That breadth of experience underpins Buckley's belief that credit is set to enjoy a boom.

"The private equity boom that came to a spectacular bust in 2008 was driven out of a major allocation out of public equities into private ones in search of growth. There was a hiatus from 2008 to 2010 while people got their bearings, but now we're at the

"WE'RE AT THE BEGINNING OF A LONG INNING"

beginning of a more relevant secular trend, which is the allocation of capital out of high grade fixed interest [assets], like government and corporate debt, which is viewed as too low in yield, and too volatile in credit quality," Buckley says.

"Just look at what happened recently in Washington – the biggest, highest quality creditor in the world is no longer viewed as risk-free. Investors who historically looked at their government bond portfolio as something with little or no risk, now worry that it won't generate the necessary current yield to meet their liabilities, and there may be some credit risk there too.

Investors have decided to diversify out of those fixed interest portfolios and into assets that do three things, Buckley says: "Generate an interesting level – say high single digits, net – of current yield; offer a level of inflation protection; and have assessable hard asset value that can be pinned down in a worst case scenario."

Hence the boom in private credit (which gives current income), infrastructure (which ticks the hard assets box), and energy (which provides inflation protection). "Despite a comeback for the asset classes that have traditionally delivered growth – private equity and real estate – the new normal is that those asset classes will remain difficult. Those industries are in a period of consolidation with the best GPs rising to the top and raising all the money," he argues.

Private Debt Investor's inaugural PDI 30 study, published back in May, showed the 30 largest managers had together raised $322 billion for private debt funds over the last five years. "That's a really big number for a new asset class," Buckley observes.

"PDI's study shows that we're at the tip of the iceberg. One of the larger pension consultants also produced a report which estimated there will be a trillion dollars flowing out of government debt and into private credit over the next few years. Investors have decided that if they can find an asset class that offers downside protection, which is what senior and subordinate credit do, that also gives them current income, that's a smart play and they're very happy to take illiquidity risk to capitalise on it."

Investors, like managers, have had a tough time of it. Buckley believes many were 'disorientated' in the period between 2008 and 2010 when it came to deciding on allocations. Some had overcommitted deliberately in the pre-crisis period and were burnt as a result, and some were overweight on alternatives after their equities portfolios lost value. Regulations like Solvency II and Basel III created further problems. "It wasn't until 2010 that investors began to get an understanding of where they wanted to deploy money," he says.

THE ART OF FUND STRUCTURING

If there's one characteristic of the private debt industry that sticks out, it's its variety. Just as the investments vary enormously, so too do the structures, from Business Development Companies to hedge funds, managed accounts to traditional blind pool, closed-ended funds. The latter remain the default structure, however.

"Credit has become all about raising money in illiquid structures with long lock-ins so you can capture that illiquidity premium," Buckley says. "We've generally found investors don't want what you'd imagine they would want, which is a fund structure that offers them almost immediate liquidity. They're very prepared to take that illiquidity risk."

Fees are a constant source of tension, with GP and LP alike having to feel their way through negotiations. Buckley observes that the higher the return expectations, the lower the pressure on fees.

For funds with a return target approaching double digits, a 1.25 – 1.5 percent management fee is appropriate, Buckley believes. "For pure mezz, you might get away with private equity fees. You still get 20 above 8 with an 80:20 catch-up. 20 above 8, or perhaps 15 above 8, will be the norm going forward, and I think the catch-up will come under pressure – it'll get to 50:50 pretty quickly," he says.

"On the senior side, because of the proximity to historical fixed income returns, if you get away with a 1 percent management fee on drawn capital, you've done well. So 0.75-1 percent on drawn capital is the norm. 15 above 6, 15 above 7, 50:50 catch-up, although there's a growing minority of investors who believe there should be no catch-up at all."

A canny placement agent has tools to ease that downward pressure on fees, however. "One way is to deploy some capital and show people what they're investing in and that it has compelling ongoing returns. Or offer unique co-investment rights or access to a legacy portfolio at reduced or no fees, so the blended fees look better.

"Finally, it's become the norm to offer a 10 percent management fee discount for first closes or large tickets. So if someone puts in $100 million there'll generally be some level of discount. From a manager's perspective, if someone commits early or in size, it's more palatable to make those concessions," he adds.

There have been an increasing number of managed accounts cropping up, particularly amongst larger US institutional LPs. Does he see this as a threat? "The bulk of third party capital is managed in separate accounts, let's not lose sight of that," Buckley counters. "Public debt and equities – most of it doesn't come in the form of a fund, it comes via segregated or managed accounts. My view is that the larger investors will increasingly insist on it for all credit asset classes and that will give them the ability to tailor-make their mandate against the return and risk bogeys. The very big guys have a more consultative relationship with the GP."

Buckley believes segregated accounts will become the norm at the senior end of the spectrum, which will allow GPs to scale their capital regularly outside of fund constraints.

"INVESTORS HAVE DECIDED THAT IF THEY CAN FIND AN ASSET CLASS THAT OFFERS DOWNSIDE PROTECTION THAT ALSO GIVES THEM CURRENT INCOME, THAT'S A SMART PLAY"

POCKETS OF CAPITAL

The key skill when raising capital is knowing where to look for it. Buckley notes that investor appetite for credit has been constantly evolving since the credit crisis, but First Avenue has had a front row seat to observe the changes.

The US investor community, unsurprisingly, has been the most progressive. "A number of big public plans have set aside fixed allocations to private credit, and in many cases have appointed someone to be responsible for that," Buckley notes.

In Europe, there's a clear divide between north and south. Investors from the UK, Germany, Scandinavia and Holland 'get' private debt, Buckley says.

Further afield, China looms large. "The Chinese government has allowed insurers to have 20 percent of their assets abroad. That investor base will become more important over the next few years as they ramp up their private credit exposure. The story in recent times has been about putting capital to work in China, but the capital coming out of the country could be more important than you think going forward," Buckley believes.

"Japan is targeting senior debt – with an ageing population there's less appetite for risk and pensioners want fixed annuities. Korea is more focused on growth, so there's greater appetite for mezz and junior credit. There's a lot of money coming out of both those markets," he adds.

Australia has failed to live up to expectations, however, despite the massive consolidation of its superannuation funds which has created fewer, but larger, pots of capital. Buckley observes that it's "Notably very fee sensitive" too, and demand tends to be for flexible products that can play up and down the capital stack.

Investors are warming to senior debt funds at present. "With mezz you need to deliver extremely attractive returns else investors will just go to equity instead. Senior gives you secured income – real estate debt is particularly well-suited. Infrastructure debt is also attractive, but it's two years behind real estate debt. You have secured, very long-dated assets which are very appropriate for investors like pension funds. It's non-cyclical and is very often supported by governments and contractual revenues, and beyond that, the hard asset value of the underlying project. I suspect infrastructure debt will grow and grow," he predicts.

THE WAY FORWARD

Savvy GPs are exploring other market segments too, Buckley says. "In Europe, there's a forgotten middle between pure syndicated senior debt and distressed debt at the other end – lightly or moderately stressed debt, where you can get an interesting double digit return associated with doing hard credit work. Your goal isn't loan-to-own, but simply to identify a situation where issues can be fixed and covenants restored."

Pure distressed debt, he believes, has more in common with private equity due to its return targets and skillset. But just like private equity, the winners and losers in this segment are well known, and the winners have raised a significant amount of capital. They have however found it tough to deploy. "I suspect too much money has been raised for that space," Buckley says.

One area that is ripe for growth is emerging markets debt. None of the PDI 30 firms is focused on emerging markets. The case is compelling, Buckley believes. "In emerging markets, credit is extremely rationed – it goes from the banks to large corporates, governments and quasi-governments. Senior private debt in those markets appears to have a substantive risk premium when you measure it against public emerging market debt and its Western equivalent. I think there's a gaping hole for someone to come in and apply this private debt model to emerging markets."

Buckley's certainly a believer in the private debt model, and confidently predicts it will enjoy the sort of boom enjoyed by private equity in the early 2000s as it dominates this fundraising cycle. "We're in the beginning of a long inning, where 10 years from now you'll know who the winners are. The disintermediation process of the banks, which you saw happen in the US from the mid-1970s to mid-1980s, over at least a 10 year if not 20 year timeframe, is now happening in Europe over a much shorter period. That's driven by the poor capitalisation of the banks and increased regulation – these things will force the growth of the European private credit GP much quicker than in the US." ■

The right structure

Macfarlanes' **Damien Crossley** and **Alex Amos** discuss the key considerations when choosing the most appropriate structure for a private debt vehicle.

Two of the key components of a successful fund raise are getting the terms and the structure of the fund right. As credit funds span a wide spectrum both in respect of their investment strategies and their target investors, it is particularly important that the terms and structure chosen are fit for purpose.

OPEN OR CLOSED ENDED?

The first question to consider with a credit fund (like any fund) is whether it will be open or closed ended, listed or private. These decisions are largely dictated by the liquidity and ease of valuation of investments and the target investor base. While there are a number of listed credit funds and very many hedge funds investing in credit, in this article we will focus predominantly on closed ended private funds as these funds typically offer more flexibility in their terms and structure.

TYPICAL CLOSED END STRATEGIES

In the closed ended credit space, we see three core strategies:

- Special Opportunities – funds investing in distressed, stressed and/or mispriced situations, typically but not solely via the secondary market. These funds usually target mid-teen returns and sometimes more at the more distressed end.
- Junior Credit – funds investing predominately in junior or specialised debt with varying levels of equity exposure. These funds are typically investing via the primary market and targeting returns between 10 per cent-15 per cent.
- Senior Secured Credit - funds investing in either the primary and secondary markets whose target returns are generally in single digits.

Damien Crossley

Clearly, there is overlap and many funds invest in more specialised and liquid products. However, these three strategies encompass the majority of the funds in the market.

MANAGEMENT FEES AND PROMOTE

Put simply, the higher the target returns of the fund, the more private equity-esque (i.e. 2 and 20) the economic terms of the fund tend to be. However, even for high target return credit funds, 2 per cent on committed capital during the investment period and 20 per cent carried interest with full catch-up is rare. In this space, to reflect lower target returns, not only are one or both headline numbers often lower, but we also increasingly see some or all of the management fee charged on invested rather than committed capital with carried interest not benefitting from a catch-up for lower target return funds. Having said that, even with funds with lower target returns, some level of promote is still the norm.

Aside from pure economics, closed ended private credit funds tend to resemble private equity funds in their terms and structure with a number of variations. The material ones are summarised below.

FUND VEHICLE

The general preference for a closed ended credit fund is a limited partnership. Not only does this vehicle usually lend itself to the commercial terms of the fund, it is also the most efficient vehicle for tax-paying participators (including carried interest holders) and is also generally what investors will expect to see.

FUND JURISDICTION

The choices for limited partnership jurisdictions are (i) UK; (ii) Luxembourg; (iii) far offshore (for example, Cayman Islands and BVI); and (iv) near offshore (Guernsey and Jersey). Previously, the choice was principally tax driven. However, now regulatory factors and investor requirements are equally important.

For example, if the fund manager wishes to benefit from the marketing passport under AIFMD, both the fund and the manager will need to be EU-based. Furthermore, many European institutional investors are requiring onshore structures for tax, regulatory and/or reputational reasons.

With this increased desire for onshore limited partnership fund structures, and with UK structures posing VAT and remittance issues for the fund manager and any UK resident non-domiciled individual investors respectively, the Luxembourg limited partnership has become increasingly popular and it has been made more attractive by the recent introduction of an unregulated limited partnership regime. However, for managers who are less concerned with the European investor market, the Cayman Islands remains the most popular jurisdiction. Finally, some managers are putting in place parallel vehicles in different jurisdictions to meet conflicting investor demand.

For completeness, Ireland is often not an attractive jurisdiction in many cases as it does not offer a viable limited partnership fund structure and Irish QIFs are still not permitted to originate LMA-style (non-bond) loans.

CONTINUOUS FUNDRAISING?

One of the great things about credit as an asset class for both fund managers and (dare we say) their advisers is its scalability. As a result, managers raising credit funds often look to leave themselves the flexibility to raise other funds in a different credit strategy and/or to bolt on managed accounts or "funds of one" alongside the principal fund. This requires the loosening of key man and subsequent fund restrictions from the private equity norm. However, in return for this flexibility, investors will require strict allocation policies to avoid "cherry picking" and a conflicts policy in case different funds of the same manager end up in different parts of a capital structure.

INVESTMENT PERIODS AND RECYCLING

Credit funds generally have shorter investment periods than private equity funds but allow full reinvestment of capital proceeds (but usually not income) during that period. This ability to reinvest profits means that management fees will be different depending on whether they are based on invested capital rather than drawn capital, especially where fund level leverage is used.

TREATMENT OF FEES AND RECHARGING OF EXPENSES

While the norm in private equity is for all deal related fees to benefit the fund, the

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position with credit funds is more complex. While fees representing a finance cost should go to the fund, depending on the market, it may be possible for the manager to justify retention of certain arrangement or agency fees in return for it performing additional functions. Another issue, particularly for primary funds, is the extent to which the manager's expenses should be funded out of the management fee and which expenses justify additional fund recharges, for example, costs of "in-housed" services that would normally be outsourced.

SUBSEQUENT INVESTOR EQUALISATION

Private equity funds typically charge subsequent close investors an equalisation fee of c.2-4 per cent above EURIBOR of invested capital on the basis that no distributions will be made by the fund during its open period. However, with credit funds, any equalisation charge will need to reflect not only lower returns (if that is the case) but also the fact that part of the return of the fund may be current pay interest which subsequent investors will not have received. It is necessary to consider the likely profile of pre-final close investments to ensure the proposed equalisation strikes the right balance.

LEVERAGE AT FUND LEVEL

Although an investor-call bridge facility is common in any alternative closed-ended fund, fund level leverage that offers greater flexibility can be particularly useful to credit funds in order to boost returns (particularly in the context of senior secured strategies), smooth investor drawdowns given the asset class and for working capital purposes.

ASSET HOLDING STRUCTURE

If loans were made and held directly in a limited partnership fund vehicle, the fund would suffer interest withholding tax (WHT) on many credit investments (outside the structured space). Investors will expect the fund to structure its investments to avoid interest WHT at source. Indeed, investors are increasingly requiring underlying withholding tax to be treated as a fund expense.

The usual way for credit funds to avoid interest WHT at source is to make and hold loans through a Luxembourg subsidiary company. Care should be taken in the funding of any such 'Luxco' to ensure that its beneficial ownership of underlying investments is not compromised and to ensure that underlying capital gains are not converted into income for UK tax purposes through the structure. ■

Damien Crossley

He advises on a broad range of tax and structuring issues and specialises in fund and financial service related tax matters, particularly on the establishment of the full range of private funds and their carried interest and co-investment arrangements, and on structuring pan-European investment transactions. He is a chartered tax adviser and regularly speaks and writes on tax matters.

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A partner in the investment funds and financial services group, he advises a wide range of asset managers and investors on their investment management arrangements, team incentive schemes and the structuring and establishment of, and investment in, alternative funds. He is a member of the Association of Partnership Practitioners.

DATA ROOM

PRIVATE DEBT INVESTOR | FUNDRAISING IN 2013

Private Debt Investor's research and analytics division brings you a list of the largest commitments to private debt this year, which shows that these 78 LPs committed a total of $6.35bn to the asset class globally this year.

LARGEST COMMITMENTS TO PRIVATE DEBT FUNDS YTD

INSTITUTION NAME	FUND NAME	FUND MANAGER	COMMITMENT AMOUNT ($m)
Oregon Investment Council (OIC)	Lone Star Fund VIII	Lone Star Funds	400
Oregon Investment Council (OIC)	Lone Star Real Estate Fund III	Lone Star Funds	300
Teacher Retirement System of Texas	Lone Star Real Estate Fund III	Lone Star Funds	300
Irish National Pensions Reserve Fund (NPRF)	BlueBay Ireland Corporate Credit I	BlueBay Asset Management	272
Pennsylvania Public School Employees' Retirement System	Sankaty Middle Market Opportunities Fund II	Bain Capital	250
Pennsylvania Public School Employees' Retirement System	Summit Partners Credit Fund II	Summit Partners	200
Florida State Board of Administration (SBA)	KPS Special Situations Fund IV	KPS Capital Partners	200
New Jersey Division of Investment	KPS Special Situations Fund IV	KPS Capital Partners	200
GIC Private Limited	Laxfield UK Commercial Mortgage Programme	Laxfield Capital	200
Florida State Board of Administration (SBA)	Providence Debt Fund III	Providence Equity Partners	150
Teacher Retirement System of Texas	Apollo Credit Opportunity Fund III	Apollo Global Management	150
Iowa Public Employees' Retirement System	Blackstone Real Estate Debt Strategies II	The Blackstone Group	150
South Dakota Investment Council	Lone Star Real Estate Fund III	Lone Star Funds	150
Teachers' Retirement System of Illinois	Lone Star Real Estate Fund III	Lone Star Funds	150
Teachers' Retirement System of Illinois	PIMCO BRAVO Fund II	Pacific Investment Management Co. (PIMCO)	125
New Mexico State Investment Council	EIG Energy Fund XVI	EIG Global Energy Partners	100
Virginia Retirement System	EIG Energy Fund XVI	EIG Global Energy Partners	100
Los Angeles County Employees' Retirement Association (LACERA)	Marlin Equity IV	Marlin Equity Partners	100
Massachusetts Pension Reserves Investment Management Board (MassPRIM)	KPS Special Situations Fund IV	KPS Capital Partners	100
New Jersey Division of Investment	Marlin Equity IV	Marlin Equity Partners	100
Tennessee Consolidated Retirement System	KPS Special Situations Fund IV	KPS Capital Partners	100
Illinois Municipal Retirement Fund	Blackstone Real Estate Debt Strategies II	The Blackstone Group	100
Pennsylvania Public School Employees' Retirement System	Blackstone Real Estate Debt Strategies II	The Blackstone Group	100
Teachers' Retirement System of Illinois	Oaktree Real Estate Debt Fund	Oaktree Capital Management	100
Connecticut Retirement Plans and Trust Fund	Levine Leichtman Capital Partners V	Levine Leichtman Capital Partners	75
Teachers' Retirement System of Louisiana	American Securities Opportunities Fund III	American Securities	75
Teachers' Retirement System of Louisiana	EIG Energy Fund XVI	EIG Global Energy Partners	75
Teachers' Retirement System of Louisiana	Tower Square Capital Partners IV	Babson Capital Management	75
New Mexico State Investment Council	KPS Special Situations Fund IV	KPS Capital Partners	75
Teachers' Retirement System of Louisiana	KPS Special Situations Fund IV	KPS Capital Partners	75
Texas County and District Retirement System	Davidson Kempner Long-Term Distressed Opportunities Fund II	Davidson Kempner Capital Management LLC	75
Irish National Pensions Reserve Fund (NPRF)	Better Capital (Ireland)	Better Capital	68
Maine Public Employees Retirement System (MainePERS)	Summit Partners Credit Fund II	Summit Partners	60
New Mexico Educational Retirement Board (NMERB)	EIG Energy Fund XVI	EIG Global Energy Partners	60
European Investment Fund	Beechbrook Mezzanine II	Beechbrook Capital	54
European Investment Fund	Oquendo Mezzanine II	Oquendo Capital	54
CDC Group	Cordiant Emerging Loan Fund IV	Cordiant Capital	50
City of Philadelphia Board of Pensions & Investment	Levine Leichtman Capital Partners V	Levine Leichtman Capital Partners	50
Illinois Municipal Retirement Fund	Vista Credit Opportunities Fund I	Vista Equity Partners	50
Kentucky Teachers' Retirement System (KTRS)	Oaktree European Dislocation Fund	Oaktree Capital Management	50
New Hampshire Retirement System	Monroe Capital Senior Secured Direct Loan Fund	Monroe Capital	50
New Mexico Educational Retirement Board (NMERB)	Lone Star Fund VIII	Lone Star Funds	50
North Carolina State Treasury	Magnetar Constellation Fund IV	Magnetar Capital	50
Ohio Public Employees Retirement System	Levine Leichtman Capital Partners V	Levine Leichtman Capital Partners	50
School Employees' Retirement System of Ohio	Levine Leichtman Capital Partners V	Levine Leichtman Capital Partners	50
Pennsylvania State Employees' Retirement System	KPS Special Situations Fund IV	KPS Capital Partners	50
New Mexico Educational Retirement Board (NMERB)	Lone Star Fund VIII	Lone Star Funds	50
New Mexico Educational Retirement Board (NMERB)	Raith Real Estate Fund I	Raith Capital Partners	50
Sacramento County Employees' Retirement System (SCERS)	DRC Capital European Debt Fund II	DRC Capital	50
Texas County and District Retirement System	Lone Star Real Estate Fund III	Lone Star Funds	50
North Carolina State Treasury	Marlin Equity IV	Marlin Equity Partners	49
San Bernardino County Employees' Retirement Association	Tennenbaum Waterman Fund	Tennenbaum Capital Partners	45
Fondo Italiano di Investimento SGR SpA	Emisys Development	Emisys Capital	41

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PRIVATE DEBT INVESTOR | FUNDRAISING IN 2013

LARGEST COMMITMENTS TO PRIVATE DEBT FUNDS YTD

INSTITUTION NAME	FUND NAME	FUND MANAGER	COMMITMENT AMOUNT ($m)
Teachers' Retirement System of Illinois	NXT Capital Senior Loan Fund II	NXT Capital	40
New Mexico Educational Retirement Board (NMERB)	Marlin Equity IV	Marlin Equity Partners	40
Texas County and District Retirement System	Marlin Equity IV	Marlin Equity Partners	35
CDC Group	Investec Africa Credit Opportunities Fund 1	Investec Asset Management	30
Los Angeles City Employees' Retirement System (LACERS)	American Securities Opportunities Fund III	American Securities	30
Metropolitan Government of Nashville and Davidson County Employees' Benefit Trust Fund	Sankaty Middle Market Opportunities Fund II	Bain Capital	30
Texas County and District Retirement System	KPS Special Situations Fund IV	KPS Capital Partners	30
Metropolitan Government of Nashville and Davidson County Employees' Benefit Trust Fund	PIMCO BRAVO Fund II	Pacific Investment Management Co. (PIMCO)	30
International Finance Corporation (IFC)	Gávea Crédito Estruturado	Gávea Investimentos	27
Dallas Police and Fire Pension System	Levine Leichtman Capital Partners V	Levine Leichtman Capital Partners	25
Dallas Police and Fire Pension System	Lone Star Fund VIII	Lone Star Funds	25
University of Michigan	BioPharma Secured Investments III	Pharmakon Advisors	25
Arkansas Teacher Retirement System (ATRS)	KPS Special Situations Fund IV	KPS Capital Partners	25
Los Angeles City Employees' Retirement System (LACERS)	KPS Special Situations Fund IV	KPS Capital Partners	25
Dallas Police and Fire Pension System	Lone Star Real Estate Fund III	Lone Star Funds	25
Arkansas Teacher Retirement System (ATRS)	Levine Leichtman Capital Partners V	Levine Leichtman Capital Partners	20
Houston Firefighters' Relief and Retirement Fund	Lone Star Fund VIII	Lone Star Funds	20
Houston Police Officers' Pension System (HPOPS)	Levine Leichtman Capital Partners V	Levine Leichtman Capital Partners	20
Los Angeles City Employees' Retirement System (LACERS)	Levine Leichtman Capital Partners V	Levine Leichtman Capital Partners	20
The Fire and Police Pension Association of Colorado (FPPA)	EIG Energy Fund XVI	EIG Global Energy Partners	20
Illinois State Board of Investment	KPS Special Situations Fund IV	KPS Capital Partners	20
San Antonio Fire and Police Pension Fund	Levine Leichtman Capital Partners V	Levine Leichtman Capital Partners	15
Montgomery County Employees' Retirement System	KPS Special Situations Fund IV	KPS Capital Partners	15
El Paso Firemen & Policemen's Pension Fund	KPS Special Situations Fund IV	KPS Capital Partners	3
China Private Equity Investment Holdings (CPE)	Adamas Asset Management Fund II (Greater China Credit Fund)	Adamas Asset Management	1,000,000

Among the separate or managed accounts agreed this year agreed by institutional LPs and private debt managers were these nine, totalling $2.9bn.

SEPARATE ACCOUNTS

Institution	Name of Separate Account/ Joint Venture	Manager	COMMITMENT AMOUNT ($m)
New Zealand Superannuation Fund	Sankaty Managed Account (NZSF) - Separate Account	Bain Capital	211
Los Angeles County Employees' Retirement Association (LACERA)	Ares/LACERA Opportunistic Credit - Separate Account	Ares Management	200
Los Angeles County Employees' Retirement Association (LACERA)	Beach Point Capital/LACERA Opportunistic Credit - Separate Account	Beach Point Capital Management	200
Los Angeles County Employees' Retirement Association (LACERA)	Oak Hill Advisors/LACERA Opportunistic Credit - Separate Account	Oak Hill Advisors	200
Los Angeles County Employees' Retirement Association (LACERA)	Sankaty/LACERA Opportunistic Credit - Separate Account	Bain Capital	200
California Public Employees' Retirement System (CalPERS)	GSO Energy Partners - Separate Account	The Blackstone Group	400
Tennessee Consolidated Retirement System	TCRS/Beach Point Capital - Separate Account	Beach Point Capital Management	500
Tennessee Consolidated Retirement System	TCRS/Brigade - Separate Account	Brigade Capital Management	500
Friends Life	Pricoa Friends Life CRE Loan Fund - Joint Venture	Pricoa Capital Group	500

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PRIVATE DEBT INVESTOR | FUNDRAISING IN 2013

Private Debt Investor brings you a sample of successful fund closes in the year to date, showing that $63.7bn has been raised by the 66 funds and separate accounts featured.

GLOBAL FUND CLOSES

CORPORATE-FOCUSED DEBT FUNDS

Fund Name	Head Office	Target ($m)	Actual Amount ($m)	Sector Focus
Lone Star Fund VIII	United States	5000	5100	General
GSO Capital Solutions Fund II	United States	4000	5050	General
Highbridge Principal Strategies - Mezzanine Partners II	United States	3500	5000	General
ICG Europe Fund V	United Kingdom	2000	3365	General
Highbridge Principal Strategies - Specialty Loan Fund III	United States	N/A	3000	General
CVI Credit Value Fund II	United States	2500	2320	General
Oaktree Emerging Market Opportunities Fund	United States	500	700	General

REAL ESTATE DEBT FUNDS

Fund Name	Head Office	Target ($m)	Actual Amount ($m)	Sector Focus
Lone Star Real Estate Fund III	United States	6000	6600	Commercial
Blackstone Real Estate Debt Strategies II	United States	3000	3500	Diversified

NORTH AMERICAN FUND CLOSES

CORPORATE-FOCUSED DEBT FUNDS

Fund Name	Head Office	Target ($m)	Actual Amount ($m)	Sector Focus
Crescent Mezzanine Partners VI	United States	2500	3440	General
Wayzata Opportunities Fund III	United States	2500	2720	General
Drug Royalty III	Canada	1000	1450	Healthcare
Capital Royalty Partners II	United States	800	805	Healthcare
Energy Capital Partners Mezzanine Opportunities Fund	United States	500	805	Energy
Medley Opportunity Fund II	United States	N/A	581	Banking, Finance
Atalaya Special Opportunities Fund V	United States	500	575	General
Aurora Resurgence Fund II	United States	550	550	General
TCRS/Beach Point Capital - Separate Account	United States	N/A	500	General
TCRS/Brigade - Separate Account	United States	N/A	500	General
Golub Capital Partners VIII	United States	250	455	General
Fundamental Partners II	United States	500	450	Energy, Real Estate

REAL ESTATE DEBT FUNDS

Fund Name	Head Office	Target ($m)	Actual Amount ($m)	Sector Focus
OHA Newbury Partners	United States	1200	1200	Residential
Fortress MSR Opportunities Fund II	United States	1100	1100	Residential
AllianceBernstein Commercial Real Estate Debt Fund	United States	N/A	700	Diversified
Prime Finance Partners III	United States	600	621	Diversified
Blackstone Special Situations Fund I	United States	N/A	406	Diversified
Sullivan Debt Fund	United States	300	350	Diversified
Mariner Real Estate Partners III	United States	250	175	Commercial, Residential
Knighthead Special Situations Real Estate Fund	United States	155	155	Diversified
Columbia Pacific Income Fund I	United States	150	140	Diversified
JCR Commercial Real Estate Finance Fund II	United States	100	106	Commercial
Fundamental Partners II	United States	500	450	Energy, Real Estate

DATA ROOM

PRIVATE DEBT INVESTOR | FUNDRAISING IN 2013

ASIAN FUND CLOSES

CORPORATE-FOCUSED DEBT FUNDS

Fund Name	Head Office	Target ($m)	Actual Amount ($m)	Sector Focus
Gateway Mezzanine Partners I	United States	367	64	Australia
Hony Mezzanine Fund I	China	1000	164	China
India Infoline Income Opportunities Fund (IIFL IOF)	India	N/A	100	India
Shoreline China Value II	Virgin Islands (British)	400	303	China
Yamaguchi Business Restoration Fund	Japan	3000	30	Japan

REAL ESTATE DEBT FUNDS

Fund Name	Head Office	Target ($m)	Actual Amount ($m)	Sector Focus
Blue Ocean Fund	United Kingdom	295	295	China

EUROPEAN FUND CLOSES

CORPORATE-FOCUSED DEBT FUNDS

Fund Name	Head Office	Target ($m)	Actual Amount ($m)	Sector Focus
BlueBay Direct Lending Fund I	United Kingdom	1009	1077	Europe
BlueBay Ireland Corporate Credit I	United Kingdom	606	606	Ireland
Capzanine III	France	404	471	Europe
CIC Mezzanine III	France	162	242	France
Greater Manchester Loan Fund	United Kingdom	32	32	United Kingdom
HayFin Special Opportunities Credit Fund	United Kingdom	1009	1817	General
EQT Credit Fund II	Sweden	1009	1137	General
HIG Bayside Loan Opportunity Fund III (Europe)	United States	1000	1100	General
Metric Capital Partners I	United Kingdom	404	404	Europe
PHD Equity Partners Debt SPV No 1	United Kingdom	N/A	8	United Kingdom
The Northwest Fund for Mezzanine	United Kingdom	24	24	United Kingdom
Tikehau SME loan Fund	France	N/A	N/A	France

REAL ESTATE DEBT FUNDS

Fund Name	Head Office	Target ($m)	Actual Amount ($m)	Sector Focus
Pramerica Real Estate Capital IV	United Kingdom	N/A	820	Europe
Longbow UK Real Estate Debt Investments III	United Kingdom	806	1128	United States
Pramerica Real Estate Capital III Tranche 1	United Kingdom	350	350	Germany, United Kingdom
Pramerica Real Estate Capital III Tranche 2	United Kingdom	260	260	Germany, United Kingdom
LaSalle Residential Finance I	United States	N/A	384	United Kingdom
Project Aspen	United States	269	269	Europe

Fund not listed? If you have questions or suggestions regarding our fundraising data, please contact PEI research manager Eduardo Romain at Eduardo.R@peimedia.com