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# Global Private Debt Report

2020 Annual

Sponsored by TREE LINE CAPITAL PARTNERS

# Contents




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# Introduction

**Driven by uncertainty associated with the COVID-19 pandemic and the fact that some of the largest funds had finished raising funds in the preceding couple of years, private debt fundraising declined substantially in 2020.** Direct lending—which accounts for the majority of capital in the space—was the hardest hit sub-strategy in terms of capital commitments. While the global economy is certainly not out of the woods yet, we believe a few different factors—namely low interest rates, the yield premium offered in private debt, and the continued growth of private equity—will drive a rebound in the strategy's growth in 2021.

**Other sub-strategies—those that tend to benefit from bear markets or are viewed as capital preservation funds—presented a silver lining and experienced an increase in commitments last year.** Distressed debt, real estate debt, infrastructure debt, and special situations funds all posted YoY increases in capital commitments. The latter two even set new annual highs. These funds are benefitting from the broader tailwinds of near-zero interest rates, which are leading many investors to look for replacements for their traditional fixed income allocations.

**The economic turmoil that began in Q1 2020 took its toll on the valuation of private debt funds.** Though payment defaults were not widespread early in the pandemic, mark-to-market values for these funds declined considerably due to a rise in expected future defaults. The quarterly IRR in Q1 2020 was -6.2%, the worst of any quarter since the global financial crisis (GFC). Early indications point to a modest recovery in subsequent quarters, but the full extent of the damage to portfolios won't be known until later in 2021.


**Dylan Cox**
Lead Analyst, EMEA
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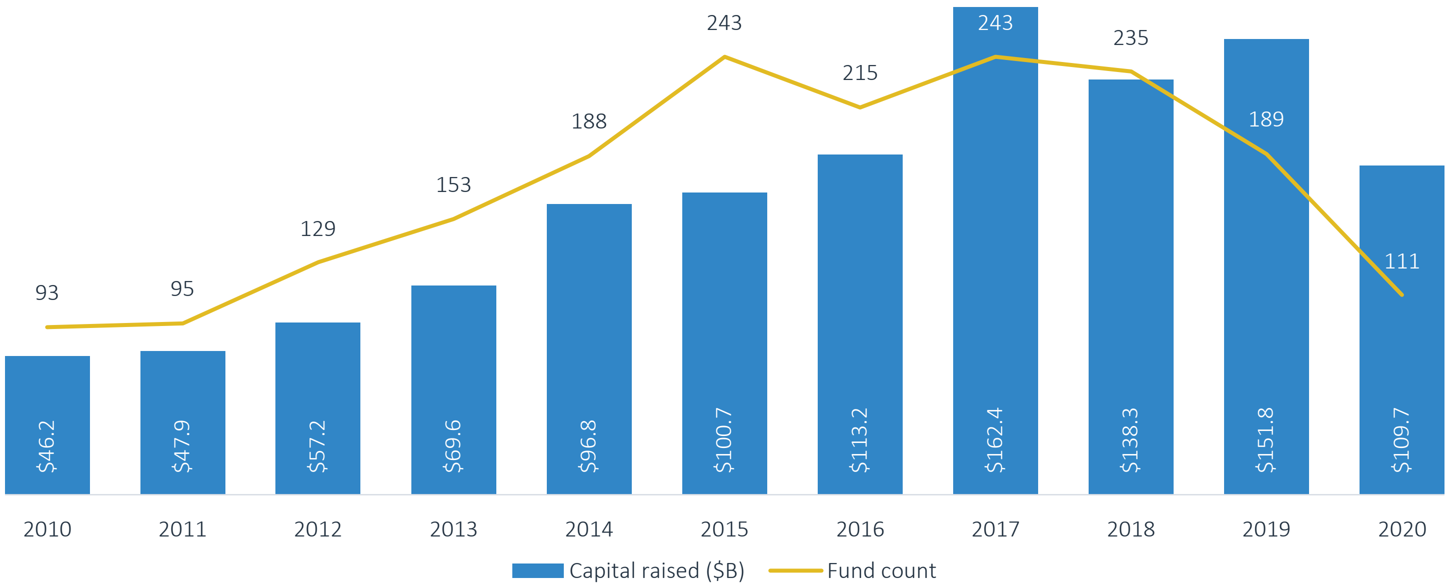
# Fundraising

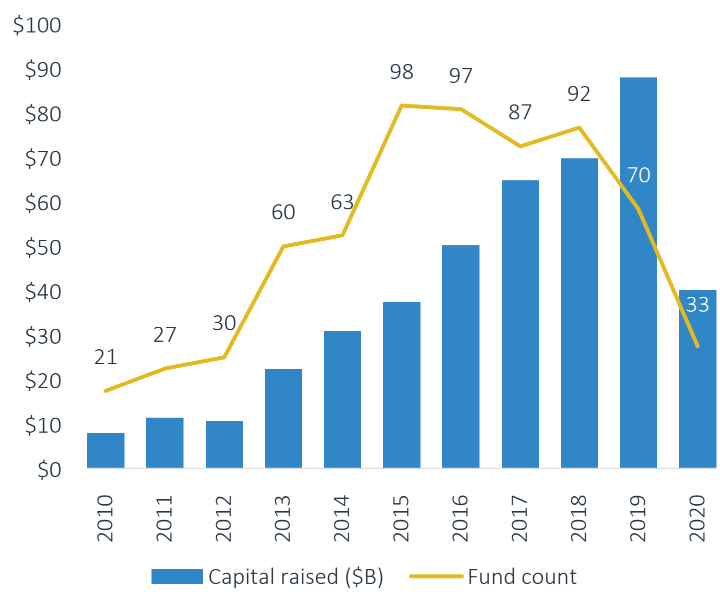
## Private debt fundraising activity




Source: PitchBook | Geography: Global

Driven by the economic slowdown caused by the COVID-19 pandemic and the fact that some of the largest funds had finished fundraising in the preceding couple of years, private debt fundraising slumped dramatically in 2020. New commitments to private debt funds totaled just $109.7 billion across 111 vehicles globally, YoY decreases of 27.8% and 41.3%, respectively. To put things in context, managers raised about as much capital as in 2016, while only about half as many funds held a final close in 2020. This marks the first substantial decline following a near decade-long upward march for the strategy. Private debt, which grew largely out of post-financial-crisis banking regulation, has experienced increases in AUM and fundraising figures almost every year since the GFC. While the global economy is certainly not yet clear of the risks presented by COVID-19, we believe a few different factors—namely low interest rates, the yield premium offered in private debt, and the continued growth of private equity—will propel the strategy's growth in 2021.

## Direct lending fundraising activity




Source: PitchBook | Geography: Global

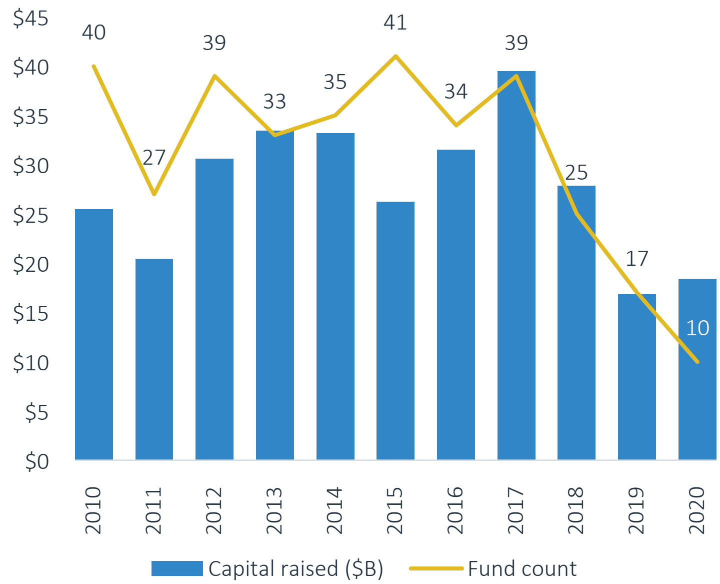
When the pandemic began to shake markets in March 2020, deal flow slowed due to a concurrent slowdown in leveraged buyouts (LBOs) and related transactions. At the same time, because of the widespread business disruptions and risk of default, private debt managers turned their focus to credits already in the portfolio. Prudent managers always model downside scenarios, but few—if any—had anticipated revenues dropping to zero for any amount of time. Fearing liquidity constraints resembling 2009's, many portfolio companies were quick to draw down their revolving credit lines. However, a lack of liquidity never materialized to the extent that many expected—though there were a few notable exceptions in struggling industries, such as Silver Lake's investment in Airbnb

(NASDAQ: ABNB). Instead, private debt managers doubled down on certain portfolio companies, sometimes offering short-term bridge financing or extending payment schedules to keep portfolio companies afloat. Simultaneously, larger issuers benefited from the massive influx of capital into more liquid credit markets. Central banks cut interest rates and began buying large swaths of both investment-grade and high-yield debt, thereby buoying prices in the leveraged loan and high-yield bond markets, while also allowing companies to issue bonds and syndicated loans at relatively attractive prices. In hindsight, a broad dispersion of outcomes existed depending on the industry in which portfolio companies operated. In industries such as travel and hospitality, revenues remain hard to come by. Other industries, such as those facilitating telecommuting, have benefited from the shutdown. The former are still waiting for the other shoe to drop, which will likely occur when it becomes more difficult to raise capital.

In terms of fundraising, direct lending was the hardest hit sub-strategy of private debt in 2020. These funds rely predominantly on private equity sponsors for their own deal flow, and institutional interest in new vehicles dwindled amid the slowdown in buyouts in Q2 and Q3. Potential investors also pivoted to other sub-strategies that tend to do well in bear markets, such as distressed debt and special situations funds. Contributions to direct lending funds were more than halved (-54.4%) from 2019's figures. In fact, 2020 fundraising posted its slowest year since 2015. Similar to trends we've observed in other private capital strategies, larger managers experienced relative success in a remote-only fundraising environment. In fact, Apollo (NYSE: APO), GSO (Blackstone, NYSE: BX), Ardian, and Antares all closed direct lending vehicles in 2020, each of them the largest in their respective fund families. Looking ahead to 2021, direct lending fundraising appears primed for a rebound. Ardian is seeking at least $11 billion for its latest European fund, which would account for about 25% of 2020's totals.

While overall fundraising figures slumped due to direct lending's slowdown, most of the other sub-strategies experienced relative success. In fact, distressed debt, real estate debt, infrastructure debt, and special situations funds all posted YoY increases in capital commitments. The latter two even set new annual highs. Private debt funds, almost regardless of sub-strategy, are benefitting from the broader tailwinds of near-zero interest rates, which are leading many investors to continue searching for replacements for their traditional fixed income allocations. Private debt is often at the top of that list.

## Distressed debt fundraising activity

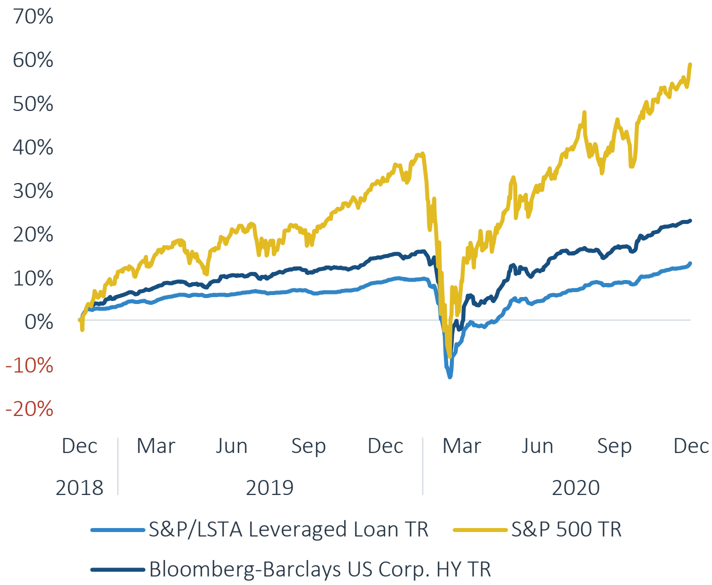



**Source:** PitchBook | **Geography:** Global

The surge in infrastructure debt fundraising is due largely to the activity of just two large funds: Macquarie Global Infrastructure Debt II and Brookfield Infrastructure Debt II. Macquarie's fund raised $3.4 billion in June 2020. The firm invests in transportation, utilities, and energy infrastructure, with more than 25% of the fund invested in solar or wind assets so far. Macquarie followed up by raising another smaller fund focused on sub-investment-grade infrastructure debt in H2—a telling sign that the reach for yield is not only pushing investors into alternative investments, but also into higher-yielding strategies therein. Totaling $2.7 billion in commitments, Brookfield's fund is more than 3x larger than its predecessor and exemplifies growing demand for yield outside of corporate credit. Both infrastructure debt funds and real estate debt funds are viewed primarily as capital preservation and income generation strategies with relative immunity to market downturns.

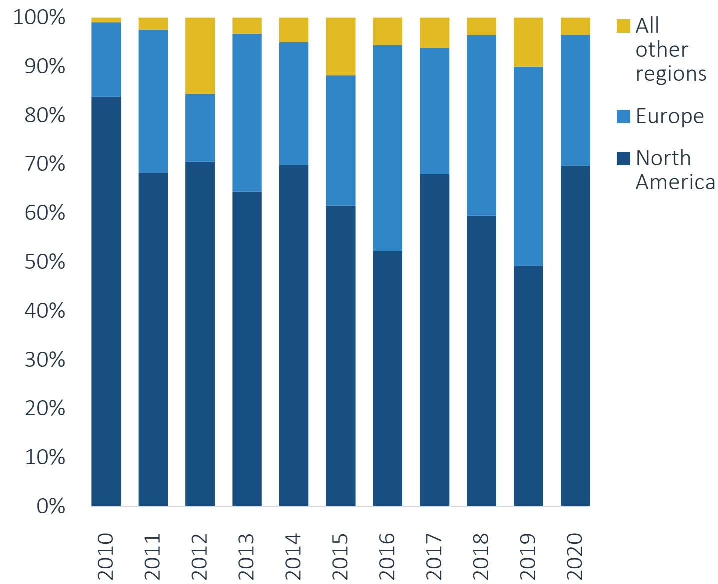
Distressed debt funds also experienced increased interest due to the anticipated economic downturn from the pandemic, but deployment opportunities have been few and far between. The rationale for raising

## Recovery of major indexes following March 2020 sell-off




**Source:** PitchBook | **Geography:** Global

## Private debt funds ($) by region

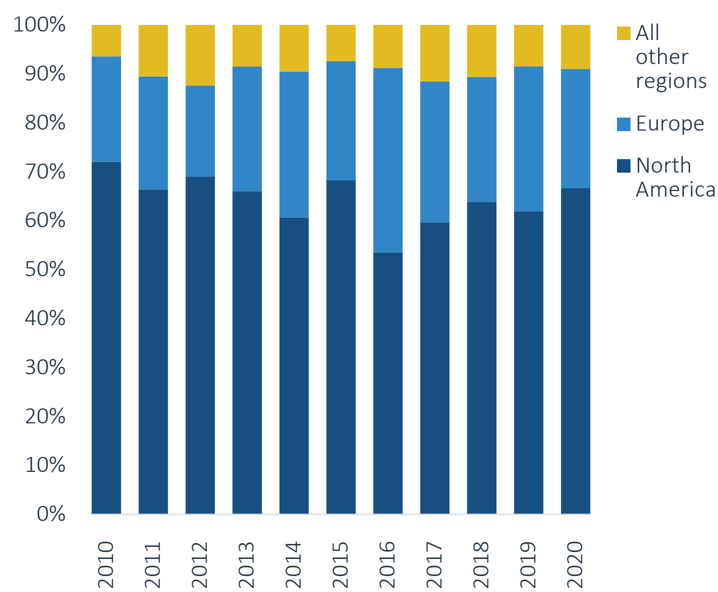



**Source:** PitchBook | **Geography:** Global

a distressed fund made sense in March and April. Most countries seemed headed for a recession, and markets were pricing in significant economic disruption. Mispriced assets were certainly available, and managers expected that more would come as they year progressed. However, that outcome failed to materialize. Central banks cut rates, the Fed pursued a widespread asset purchase program, and capital remained easily available. As a result of the lower cost of capital, more companies than expected were able to issue both equity and debt to remain solvent during the shutdown. Most indexes—whether they tracked leveraged loans, high-yield bonds, or equities—regained their COVID-19-related losses in a matter of months, and the dislocation for which many distressed funds were searching all but disappeared.

The global nature of private debt fundraising was also on full display in 2020. Funds based in North America actually raised 2.4% more capital YoY, a respectable feat given the year's tumultuous environment. European fundraising decreased by more than half (-52.7%), while all other regions declined by about three quarters (-74.8%) in aggregate. These declines reflect the less developed nature of private capital ecosystems in those places, where the absence of just a few larger funds can have a drastic impact on annual figures. We expect other regions—Europe and Asia in particular—

## Private debt funds (#) by region




**Source:** PitchBook | **Geography:** Global

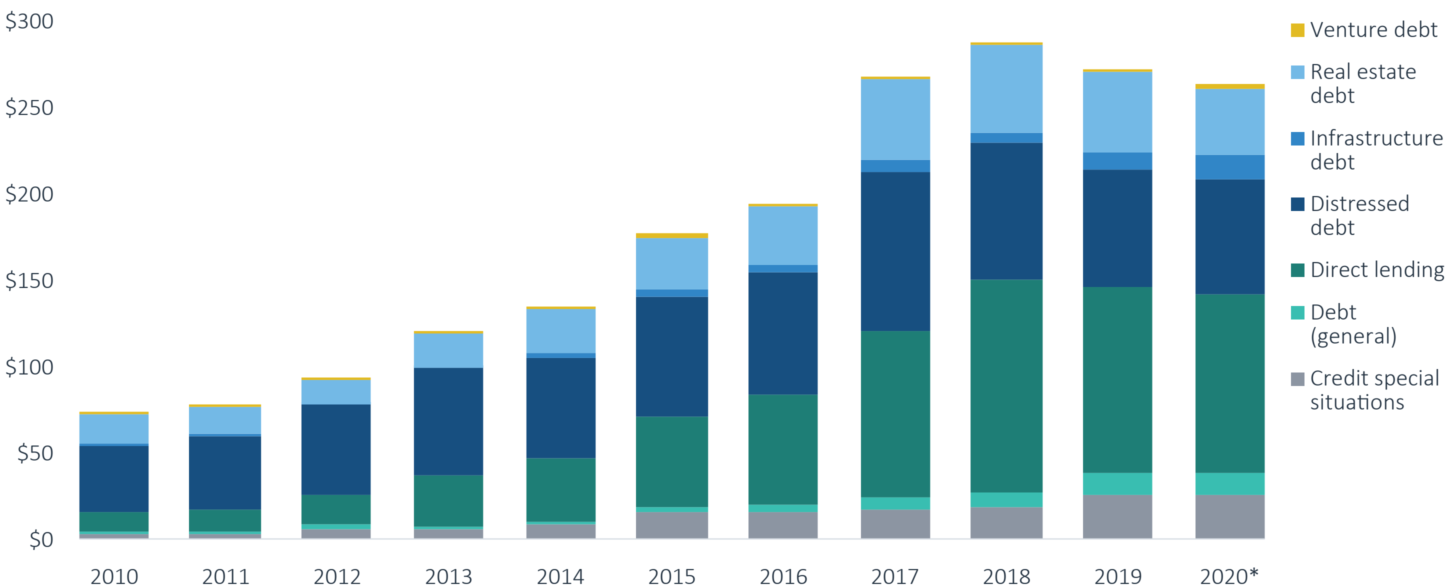
to rebound in 2021 as the relatively nascent strategy continues to gain acceptance among institutional allocators in those regions. For example, until recently, many Japanese pension systems were banned from investing outside of investment-grade bonds but are now looking afield for higher-yielding alternatives.

## Top private debt fund closings from 2020 by fund size

| Fund name | Fund type | Size ($M) | Location |
|---|---|---|---|
| Apollo Strategic Origination Partners | Direct lending | $12,000.0 | New York, NY |
| Blackstone Real Estate Debt Strategies IV | Real estate debt | $8,000.0 | New York, NY |
| GSO European Senior Debt II | Direct lending | $4,546.5 | London, UK |
| Monarch Capital Partners V | Distressed debt | $3,699.3 | New York, NY |
| Ares Special Opportunities | Credit special situations | $3,518.0 | Los Angeles, CA |
| Macquarie Global Infrastructure Debt II | Infrastructure debt | $3,374.7 | London, UK |
| Ardian Private Debt IV | Direct lending | $3,341.1 | London, UK |
| Bain Capital Distressed and Special Situations 2019 | Distressed debt | $3,200.0 | Boston, MA |
| Antares Senior Loan | Direct lending | $3,000.0 | Chicago, IL |
| KKR Dislocation Opportunities | Distressed debt | $2,790.1 | New York, NY |
| Brookfield Infrastructure Debt II | Infrastructure debt | $2,700.8 | New York, NY |
| Apollo Accord III | Credit special situations | $2,647.0 | Purchase, NY |
| Varde Dislocation | Distressed debt | $2,528.9 | Minneapolis, MN |
| Blue Ocean | Direct lending | $2,100.0 | New York, NY |
| Arrow Credit Opportunities | Credit special situations | $2,001.6 | Manchester, UK |
| Churchill Middle Market Senior Loan II | Direct lending | $2,000.0 | New York, NY |

**Source**: PitchBook | **Geography**: Global

## Capital overhang ($B) by fund type




**Source**: PitchBook | **Geography**: Global
*As of June 30, 2020

# Q&A: Tree Line Capital Partners

## Direct lending is poised for a quick return to growth in 2021.


**Tom Quimby**
*Co-Founding and Managing Partner*
*(left)*

**Frank Cupido**
*Partner*
*(right)*

*Tree Line Capital Partners is a private credit firm focused on senior-secured lending to the lower middle market with $1.5 billion AUM. Tom and Frank have worked together since 2007 through multiple cycles. Tree Line strives to deliver to investors yield in disciplined structures through a direct relationship approach targeting the growing lower-middle-market private equity community. Tree Line is headquartered in San Francisco, with offices in New York, Los Angeles, and Austin.*

**After an extraordinary 2020 with unprecedented challenges to all asset classes, how would you summarize the year?**

**TQ:** First, we must acknowledge the incredible hardships that so many people have dealt with as a result of COVID-19. As we discuss market performance and growth, it is not lost on us how difficult of a year 2020 has been for so many. 2020 was ultimately a tale of two halves. During the first half, we saw origination grind to a halt in March, when all focus shifted to the portfolio. We performed intensive portfolio work and witnessed firsthand the value of our direct relationships and data-driven approach. Tree Line serves as an agent and/or a lead lender across 94% of our portfolio, and the direct access we were afforded during H1 enabled us to engage in critical, real-time analysis. The second half of the year stood in stark contrast to the first half, with market activity building toward a crescendo in Q4. Due to the strength of our portfolio, Tree Line emerged from the first half of 2020 healthy, liquid, and in a position to grow.

**FC:** 2020 provided us with an opportunity to prove our thesis that senior secured lending in disciplined structures can withstand significant economic challenges. We have emphasized that originating senior secured, low-leverage, high-free-cash, full-covenant, sponsor-backed loans is a winning and enduring formula. As a result of COVID-19, Tree Line experienced zero payment defaults or bankruptcies, funded zero rescue dollars, and currently receives cash interest payments from 100% of our portfolio. The work we did at the peak of the cycle yielded a portfolio that proved resilient and put Tree Line in a position to unlock material origination growth in the second half of the year. In 2020 we completed 26 transactions, which included loans to 10 new sponsor relationships.

**It seems private credit enjoyed a strong recovery in 2020. Where do credit markets stand today?**

**TQ:** Looking at the macro data across the leverage lending industry through Q4 2020, a steady decline emerges in defaults by both amount and issuer count. Quarterly EBITDA losses are abating in most industries other than oil & gas. In our view, the combination of robust liquidity, a steadily improving credit market, and managers seeking to make up for lost deployment in H1 2020 set up an extremely active close to the year.

**FC:** Yes. In Q3, there was some evidence of wider spreads and closing fees, but as we approached Q4, the highest quality credits returned to pre-COVID-19 pricing levels. However, in the lower middle market, we experienced a net improvement to risk-adjusted return as we lend into lower-leverage, higher-free-cash, and lower loan-to-value (LTV) structures. The 2020/2021 vintage that is taking shape is quite attractive. Our H2 2020 vintage delivered weighted average leverage, fixed charge coverage, and LTVs of 3.2x, 2.6x, and 43%, respectively. Our market's consistency proved to be meaningfully valuable and partly explains the outperformance we are experiencing versus the middle market and broadly syndicated loan (BSL) market.

**TQ:** We are not seeing private credit take a protracted, 2009-esque recovery. We believe the middle and BSL markets will snap back to peak leverage and covenant-light levels faster than anyone would have projected back in the spring of 2020.

**You mention 2009, which was when markets were last tested during the GFC. How would you compare the impact of COVID-19 in 2020 to the last major correction in 2009?**

**TQ:** Looking back to the spring of 2020, the prognosticators predicted a catastrophic impact to the markets with projections of 20% unemployment or higher. At that time, many were turning to the 2009 distressed playbook. Ultimately, it was only a matter of weeks before it became clear that, with both the assistance of the Fed and significant liquidity entering the market, the economy was going to recover more quickly than anticipated—at least on Wall Street. As it pertains to direct lending, stark differences exist between the current economic environment and what occurred in 2009. In 2009, regulated banks were predominately in the distressed position to liquidate assets. With banks exiting the leveraged loan market through consolidation, it took years to rebuild this lending infrastructure. Today, we are in a markedly different place, as direct lenders have built significant infrastructure over the past 10 years and are no longer forced sellers.

**FC:** We would certainly expect to see a wide range in terms of performance on this vintage, but the notion that direct lending would somehow collapse was way off the mark. Private credit platforms are built to work out their own paper, which gives these platforms—even those that materially underperform—a long runway before they would have to admit defeat. Many in the distressed world expected direct lending to deliver a large opportunity set but misunderstood that the catalyst from 2009—primarily regulatory pressure—was absent across much of the private credit industry this time around.

**What do you believe investors will take away from the year as they look at private credit investing today and in the future?**

**FC:** We are encouraging investors to use 2020 to confirm the thesis that private credit is durable and senior-secured lending is highly durable. It has performed across multiple cycles and has delivered consistent current return to investors. Many investors who were cautiously on the sidelines in 2018 and 2019 have expressed interest in direct lending after witnessing its resilient performance in 2020. Overall, the asset class did very well, and in the current yield environment, this performance is hard to overlook.

**TQ:** Taking it one step further: Beyond gaining comfort with the asset class as a whole, a real opportunity exists for investors to utilize recent performance data to better understand performance by market segment and to differentiate across GPs.

**Some have suggested that the lower middle market would suffer disproportionately in the face of an economic downturn. How do you think a year like 2020 could shift investor allocation, and what do you see on the horizon in 2021?**

**TQ:** We certainly hope investors look carefully at both the data and the performance trends. A great way to do that is by studying total return across different direct lenders. Total return measures gross investment income +/- realized gains/(losses) +/- unrealized gains/(losses), all divided by the amortized cost of a portfolio. This provides an excellent apples-to-apples view on how successful a GP is at lending dollars and generating yield for investors. Tree Line is proud of the results we have generated—meaningfully outperforming market indexes and some of the biggest business development companies in the industry. We have been adamant for years that investors need to look beyond the size of a borrower or platform.

**FC:** We feel we have a real advantage with our lower-middle-market focus. Significant PE growth drives our rapidly growing market, yet we can still structure historically conservative senior-secured loan structures. Our lower-leverage and higher-fixed-charge coverage levels deliver a lower likelihood of default and concurrent higher recoveries. Further, we are nimble and highly selective in our portfolio construction. Larger platforms have immense pressure to deploy, which often leads to participation in aggressive structures across all industries.

**TQ:** Looking ahead, Tree Line is healthy, liquid, and growing. We continue to build market share with new sponsors while also delivering a stable lending relationship to existing sponsors to help drive further portfolio company growth. We will capitalize on our approach taken at the peak of the cycle, which delivered a highly durable senior-secured portfolio to our investors. While we remain in a fluid macroeconomic environment, we are encouraged by the opportunities that we are sourcing today. We expect to continue delivering to our investors consistent, current return where we combine yield with discipline.

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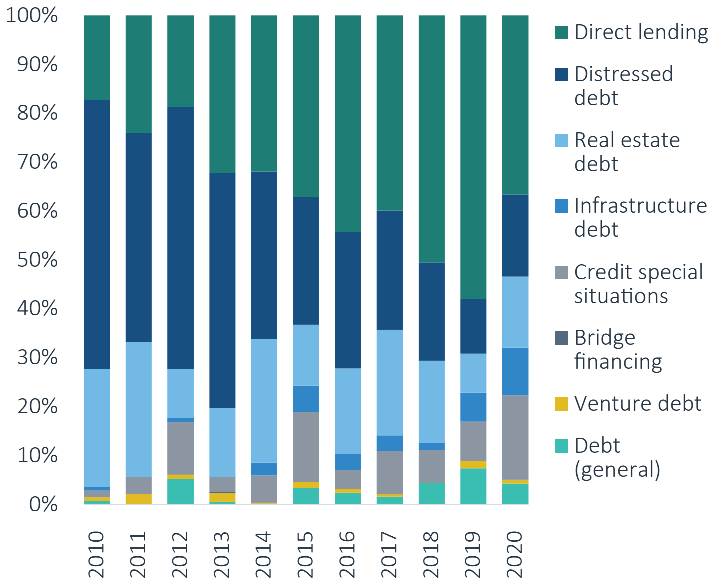
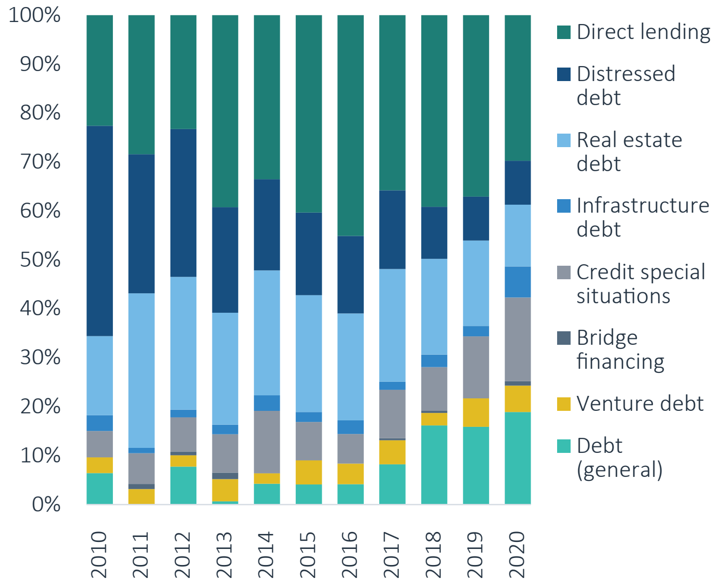
# Funds by type and size

## Private debt funds ($) by type




**Source:** PitchBook | **Geography:** Global

## Private debt funds (#) by type

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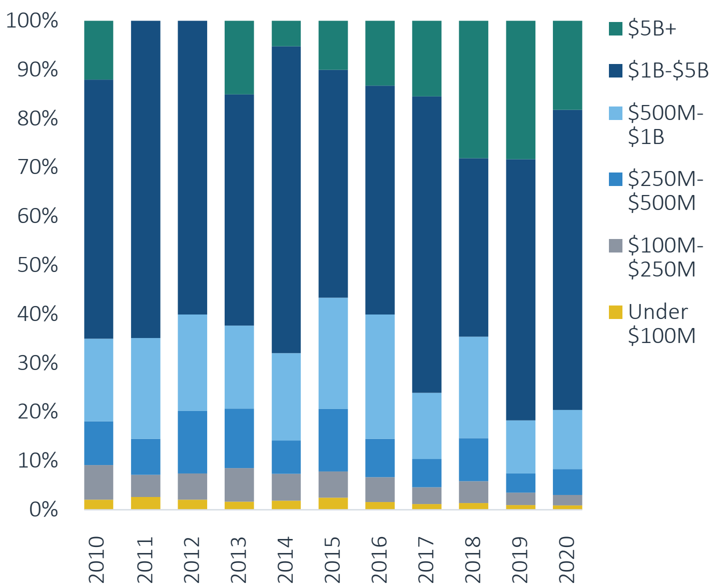
## Private debt funds ($) by size

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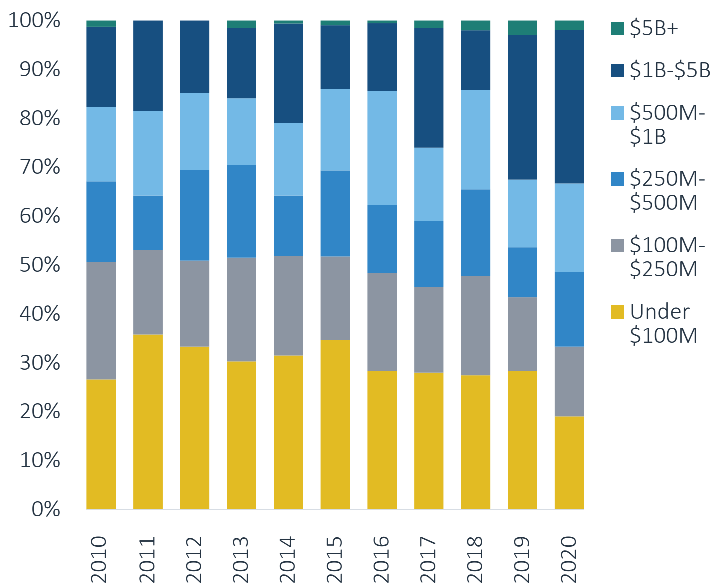
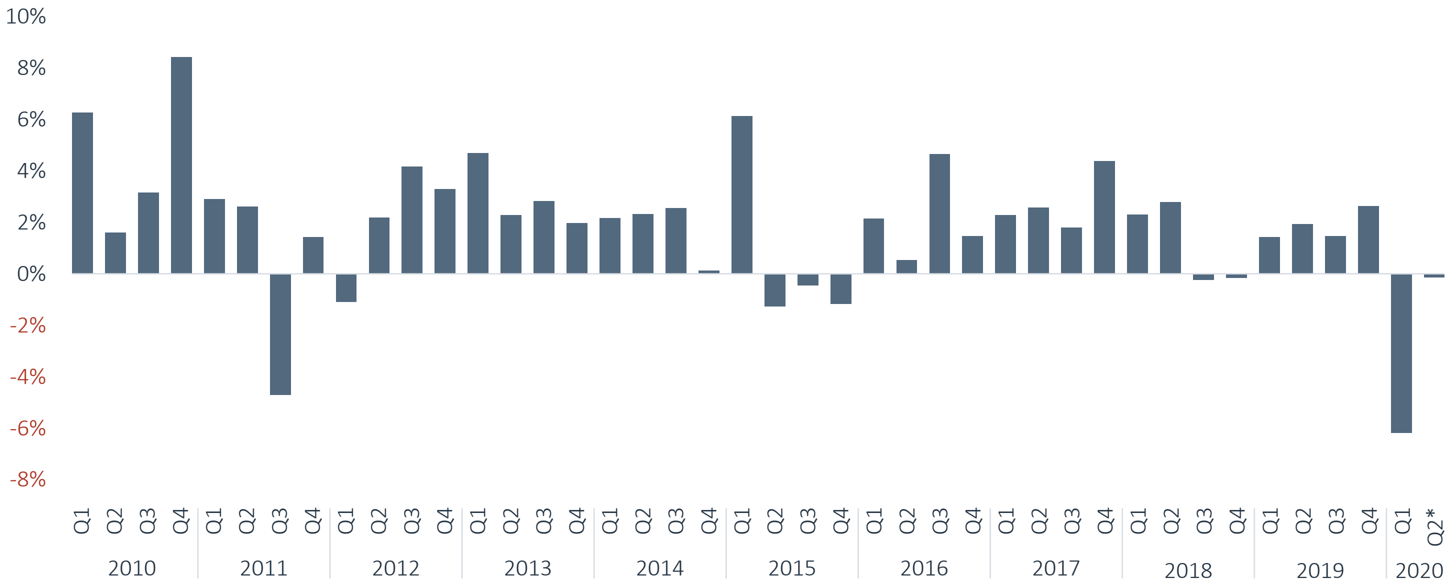
## Private debt funds (#) by size




**Source:** PitchBook | **Geography:** Global

# Performance and cash flows

## IRR for private debt funds

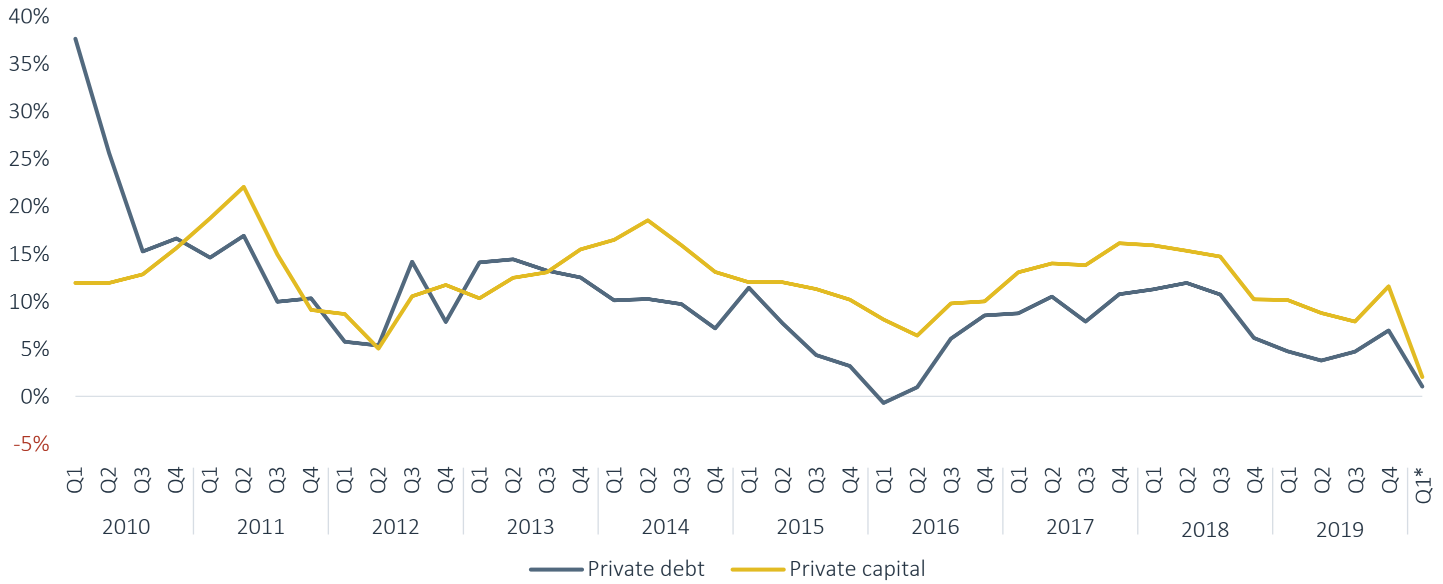



**Source**: PitchBook | **Geography**: Global
*As of June 30, 2020 (preliminary figure)

As expected, the public market volatility on display in Q1 2020 resulted in markdowns for private debt funds. Though payment defaults were not widespread early in the pandemic, mark-to-market values for these funds declined considerably in anticipation of coming distress. The quarterly IRR in Q1 2020 was -6.2%, the worst of any quarter since the GFC, when reliable performance data for the strategy did not yet exist. Preliminary data for Q2 shows just about flat performance (0.1%), but we expect data for H2 2020 to improve akin to more liquid credit indexes over that time. The one-year IRR in Q1 2020 dropped to just 1.0%, indicating that the gains from the runup to the pandemic still outweighed the losses—both realized and unrealized—experienced in March 2020.

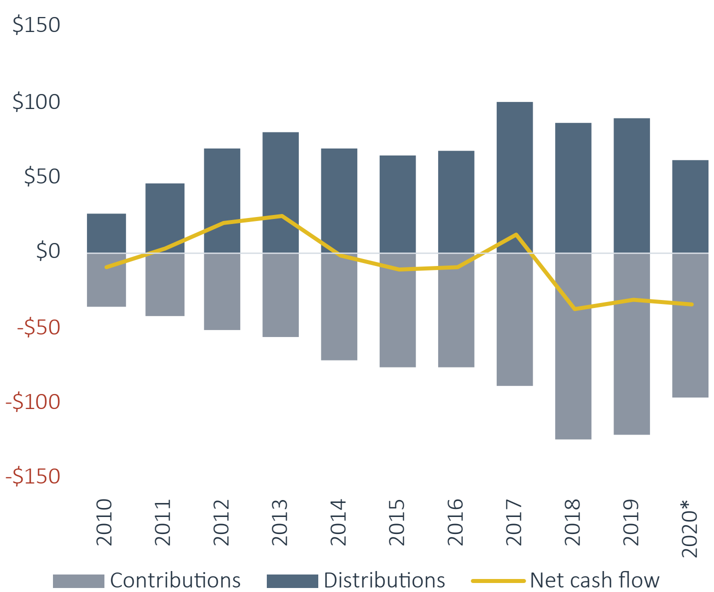
Despite slowed fundraising and a decline in short-term performance indicators, private debt's growth over the preceding decades is still reflected in aggregate cash flows to and from LPs. Managers distributed $90.3 billion to investors in 2019, the second highest year on record. H1 2020's figures are on track to exceed this pace, an indication that debt repayments continued largely as planned in the early months of the pandemic. In terms of contributions, deployment opportunities in the form of refinancings and rescue capital more than made up for the lack of new LBO financings. This is reflected in H1 2020's contribution figure ($95.2 billion), which exceeds the full-year figures for most of the last decade.

## Rolling one-year horizon IRR for private debt funds



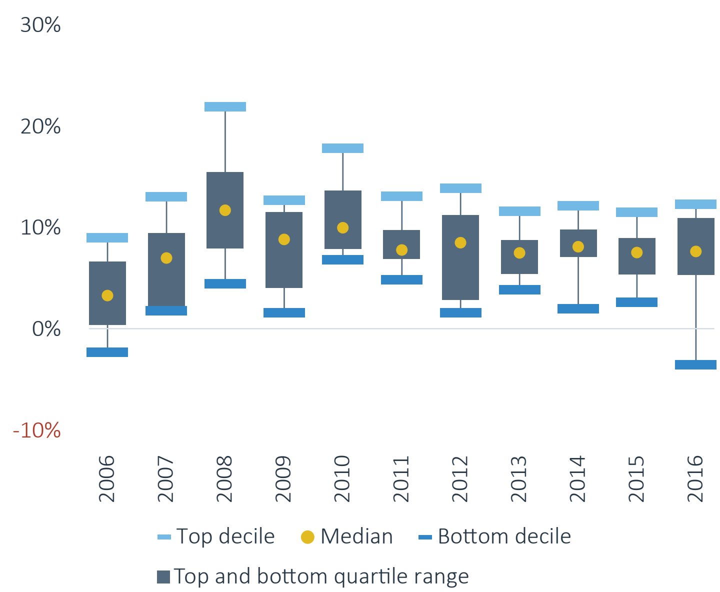

Source: PitchBook | Geography: Global
*As of March 31, 2020

## Private debt cash flows ($B)




Source: PitchBook | Geography: Global
*As of June 30, 2020

## Private debt fund performance (IRR) dispersion by vintage year*




Source: PitchBook | Geography: Global
*As of March 31, 2020