EXPERT Q&A

Private credit has grown dramatically into a $1.4 trillion market since the GFC and is set to expand significantly, say Nuveen CEO Jose Minaya and Churchill Asset Management president and CEO Ken Kencel

The decade ahead for private credit

In 2013, private credit was a fledgling industry just starting to take market share from banking incumbents, and institutions were still trying to determine whether and where to allocate to it. Today, it has not only become an established part of the institutional investor allocation mix, but private credit is increasingly seen as the primary source of financing for middle market companies and their private equity owners.

Having proven its worth to the market, the industry is set for further change and growth, but what will that look like? And what attributes will private credit firms need to capitalise on the next decade's opportunities? We spoke to Nuveen CEO Jose Minaya and Ken Kencel, president and CEO of Nuveen affiliate Churchill Asset Management, to get their views on what comes next.

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Q With the acquisition of Arcmont completed, what's next for Nuveen's private capital platform?

Jose Minaya: The Arcmont deal is part of a longer evolution for our private credit platform. A decade ago, as both asset owner and asset manager, we were looking to accelerate our growth and exposure to private credit. We saw how attractive the asset class could be through our commitments to leading private equity funds and we were also a large investor in investment-grade private credit. That's how the relationship with Churchill began in 2015. We were looking for people who could create the right culture to form the basis of our new alternative credit platform, and we found that in Churchill.

Having gone from zero to $46 billion in committed capital across US private credit, we wanted to expand into Europe to better serve our investors and private equity clients. We looked for several years because we were clear that we wanted to find an organisation with the right cultural fit

– we see this as more important than strategy. Arcmont is that perfect fit, and a great complement to our business with a strong team and track record..

The combination of Churchill and Arcmont has created Nuveen Private Capital, with $67 billion of committed capital and more than 600 institutional investors globally. Our aim now is to double the size of our private capital platform in the next five years, which we believe is highly achievable.

We've also added platforms and capabilities that will enable us to better meet the increasing global demand for environmentally responsible investments that provide alternative sources of attractive returns. For example, C-PACE through Nuveen Green Capital to address demand from investors for alternative ESG income; European energy transition credit through our affiliate Glennmont Partners; and the launch of our North American energy infrastructure credit platform to extend our existing infrastructure debt capabilities and keep us committed to growing our debt-investing platform globally.

Ken Kencel: In addition, Arcmont's business has very little investor overlap with Churchill, which offers us a tremendous opportunity to grow our combined investor base. We are starting from a very strong place. Since the onset of covid, Churchill and Arcmont have collectively raised over $40 billion in third-party capital based on strong performance.

The businesses are very complementary, with distinct geographic investment focuses. Both are top-three private credit platforms in their respective markets, collectively deploying $17 billion annually. This will only grow as private credit continues to take share from the broadly syndicated loan market.

Q Some say we're in a 'golden age' for private credit. Would you agree?

KK: I believe we are in one of the most attractive private credit investment environments in recent history. The yield today on senior-secured loans for high quality mid-market companies is over 12 percent. A year ago, it was half that. As base rates have risen and spreads widened, we are seeing leverage levels decrease up to a full turn, along with tighter and better structured overall terms, including covenants.

In addition, the companies seeking private credit are better quality and larger than a year or two ago. In part, this is because these businesses would previously have gone to the BSL market. It's also because private equity firms are not investing in companies that are challenged by the current environment, but instead solely focused on businesses that are performing well and thriving today.

JM: From a fundraising perspective, it's also a good time. Investors now understand private credit and how it behaves, and many are underweight in the asset class. That means there's an attractive demand-supply dynamic, especially when there are high barriers to entry today because you need scale to deliver the diversification and returns that investors expect.

Q How will the shift from the BSL market, combined with banking turmoil, affect private credit in coming years?

KK: Private credit has evolved to become the dominant form of financing to private equity-backed mid-market companies. We saw this more than ever over the past year as the BSL market effectively closed for new issuance, and larger companies and private equity firms continue to turn to private credit. Leading platforms can now underwrite and hold $500 million or more per transaction, as the ratio of direct lending to BSL transactions peaked in Q4 of 2022 at 8:1. Even today, it's nearly 5:1.

One primary reason is that private credit is much simpler and more streamlined to arrange. There are no roadshows or rating agencies to deal with. One or two lenders can complete a financing in a timely and more confidential manner. Instead of having 15 to 30 lenders involved in a transaction, a sponsor can work with a small handful of private credit managers, who can act as financing partners in growing the business.

With regards to banking turmoil, we are seeing many smaller, regional banks face liquidity issues, so they will now likely avoid investing in smaller credits at the lower end of the mid-market. Overall, this means we're seeing growth

potential for private credit at both the larger and smaller ends of the spectrum.

Q That range of investors is broadening to include individual and retail investors. How will that affect the industry?

JM: Private credit brings investors a broadened set of opportunities. There is a greater range of issuers they can gain exposure to and so it's an attractive proposition. And as the industry gains more clients and means of distribution, scale will bring greater efficiency. However, it has become more important than ever for investors to pick the right managers. We haven't yet seen a full cycle since the financial crisis because of the monetary policy environment. Losses have been very low in private credit over the past decade or so. We're unlikely to revert to that and I think the high interest rate environment will see a winnowing out of managers.

KK: Ten years ago, private credit was a new asset class for institutional investors. That has changed markedly, and today, most institutional investors allocate to a wide range of alternative credit strategies. As many now question whether the 60/40 model works over the long term, private credit has been instrumental in helping institutional investors diversify away from public markets volatility. The industry has become accepted by institutions, paving the way for growth in the wealth and retail space as individuals seek attractive investment income to support their retirement.

That winnowing out of managers Jose mentioned makes it critical for firms to stick to their knitting. For us, that means making conservative investments that offer stable returns. That's particularly vital for investors like TIAA that provide retirement income to their participants. It's also key that firms ensure individual investors understand the largely illiquid nature of private markets investments, while also creating structures that provide for adequate liquidity to meet their needs.

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Q You see scale as important for private credit. What are the other main ingredients firms will need over the coming decade?

JM: Having TIAA as our parent company and largest investor gives us a tremendous competitive advantage. It means we have stability. As one of the largest investors in private credit globally, TIAA makes ongoing annual commitments to our platform alongside third-party investors, so we can move when others can't. It's why we're seeing other managers look to acquire insurance companies. They provide stickiness and a capacity to go on offence as opposed to being defensive. TIAA also has a 50-year history of leadership and commitment to ESG, an area that is very important to our investors.

KK: Additionally, TIAA's $13 billion of LP commitments to nearly 300 US private equity firms – that Churchill now manages on their behalf – gives us a highly differentiated deal sourcing edge. We now sit on the advisory boards of more than 200 GPs, and 75 percent of the senior lending investments we provide are in support of sponsors TIAA is significantly invested in. We have known many of these firms for decades, but this additional level of connectivity, partnership and trust is incredibly powerful, and certainly allows us to compete on something other than price.

Scale and being able to deliver a full suite of financing solutions are table stakes in today's market. We are seeing the largest private credit managers taking greater share of the market relative to the smaller firms that lack the infrastructure, resources and alignment to compete.

A strong culture that values diversity is another important ingredient because more diverse teams make better decisions. You need an organisation that thrives on that dynamic, supports new talent and offers its people clear opportunities for development and progression. Alongside that diversity, there needs to be a common approach and culture that fosters strong, long-term relationships with clients. Everyone needs to be laser focused on being consistent, on being reliable, and ultimately, on delivering for our private equity clients and investors. ■

Source:Nuveen 2023. Private equity and private debt investments, like alternative investments are not suitable for all investors given they are speculative, subject to substantial risks including the risks associated with limited liquidity, the potential use of leverage, potential short sales, concentrated investments and may involve complex tax structures and investment strategies.

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