INVESTMENT EUROPE

Alcentra sees European lending their way to income

By Jonathan Boyd

As the ability of European banks to lend is cut off by stricter Core Tier 1 ratio requirements, there is a golden opportunity for investors to profit by pooling money to lend against assets on a secured basis, says BNY Mellon's boutique Alcentra.

The provider recently launched a prospectus for a Guernsey domiciled, closed-ended investment company fund that looks to raise £150m via a London stock market listing. The fund intends to use the money to invest in secured debt and high yield debt of European and some North American companies.

At least 80% of the fund's net asset value is intended to be in senior-secured, floating rate debt, as well as secured subordinated debt, some unsecured floating rate and secured or unsecured fixed-rate high-yield bonds.

This will be one of the first vehicles of its type in the European context to offer retail access to this part of the lending market. Historically, it has been the preserve of institutional investors – a key difference compared to the US market, where there are a number of mutual funds available for investors who want to profit from lending money to corporate borrowers.

Although Alcentra's vehicle is initially targeting UK investors, it may incidentally revive continental European interest in the British investment company structure.

At the institutional investor level, clients such as pension funds face similar challenges of meeting rising liabilities from an ageing population, and are looking to alternatives and new types of income-generating products in order to facilitate risk management.

David Forbes-Nixon, chairman and chief executive officer of Alcentra, says that there was already a certain level of interest in this type of vehicle, from non-sterling investors. The investment company's prospectus notes that that the “minimum size of the sterling share class will be £20m and the minimum size of the euro share class will be €20m”.

Among the demand drivers for this type of fund is the prevailing environment of low expectations around equity assets and associated volatility, says Simon Perry, Alcentra's managing director of business development.

The performance of credit indices, such as the CS High Yield, CS Western Euro High Yield and CS Western Euro Leveraged Loan indices, in the period between 2009 to mid-2011 suggest that investors in credit could obtain returns at up to a third less risk than investing in equity.

For the future, one of the risks to the fund noted is a protracted bull market in equities, which would affect relative performance (credit and loans would then look less interesting).

Still, Alcentra believes that the market offers investors the ability to profit not only from discounts generated because of fears over default levels, which it says are overdone, but also from income streams generated by the lending.

Alcentra's new fund targets an annual total return of 7% to 10%, while paying a quarterly dividend equivalent to 5.5% annually. This is feasible in an environment in which coupons are paying Libor+5%, it adds.

The macro-economic challenges facing Southern European markets mean that the fund is more likely to look for assets in Northern Europe. As the fund invests in secured lending, its investments are also done with an eye to how jurisdictions and their courts treat creditors.