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Japan: A hot place for infra debt managers

Infrastructure debt continues to attract conservative but income-seeking Japanese institutions like Dai-ichi Life Insurance and Development Bank of Japan

By Adalla Kim | 13 May 2019

The Infrastructure Investor Tokyo Summit hosted by sister title Infrastructure Investor, Japanese investors, their managers and advisors shared their views on infrastructure assets and their work.

Overall, the asset class is perceived as "an attractive alternative to fixed income products" to LPs including Dai-ichi Life Insurance Company and Development Bank of Japan. Here are our key takeaways from those big LPs:

Dai-ichi Life Insurance Company

As PDI reported, the insurer launched its new investment department dedicated to structured finance in April with a view to strengthening its expertise in project finance.

According to Masashi Kataoka, a general manager of the alternative investment department at Dai-ichi Life Insurance, who spoke at a panel, the lifer's two departments are having internal discussions about various approaches to infrastructure debt.

The team finds it difficult to make direct debt commitments to infrastructure projects as it is hard for them to conduct due diligence processes on underlying debt instruments within a given timeframe, Kataoka said.

Notably, the insurance firm only invests in ESG-compliant infrastructure assets. "I never heard about fund managers without [an] ESG [matrix in place]," he added.

There was no sign of the insurer stopping infrastructure debt investments as the asset class offers a way to diversify its portfolio with limited downside risks.

Development Bank of Japan

The bank was established by the Japanese Government and is known for its co-investment vehicle with the world's largest pension fund, Government Pension Investment Fund. It is a conservative infrastructure investor, focusing on senior debt tranches, according to Shigefumi Kuroki, a Tokyo-based general manager and head of global infrastructure investments and structured finance department.

However, at the investment department, Kuroki is focusing more on the mezzanine and sub-investment grade debt this year, looking for a typical return structure of '[floating] base rate plus up to 5 percent cash yields' from the debt investments.

As the bank is looking to diversify further their geographic exposures, tax implications and foreign currency hedging costs have emerged as bigger issues. Notably, European infrastructure debt is considered as a niche strategy and floating rate-based debt instruments are preferred now due to the market expectation on interest rate rise from the US in the next few years.■

Debt investors seek higher yields as property cycle enters latter stages

While the risks may be rising for putative property investors, alternative fixed-income investors such as Allianz and Dai-ichi Life remain focused on obtaining yield.

By Adalla Kim | 1 April 2019

Despite the prevailing consensus that we are at a late stage in the real estate cycle, some US property debt investors are looking for ways to enhance yield amid reduced returns from the asset class.

Property cycles, which are determined by a combination of demographic, economic and emotional factors, are widely recognised as having two 'up' periods: recovery and expansion. They are also recognised as being characterised by two 'down' periods: oversupply and recession.

Adam Ruggiero, Managing Director at MetLife Investment Management, believes the US commercial real estate cycle has entered its latter stages. He also notes that, in spite of this, some debt investors are taking on greater risks in an effort to achieve higher yields.

He adds that such investors are often not appropriately compensated for taking on higher levels of risk late in the cycle. "History would suggest that higher-risk loans should carry higher yields than they do today," he says. "Looking back 10 or 15 years, many of today's higher-risk deals would have carried another 50 to 100 basis points or more in spread. By comparison, pricing on lower-risk loans still looks attractive."

His observation is based on data compiled by MetLife Investment Management and the American Council of Life Insurers as of Q4 2018. The data suggest that the

spread between AA- and BB-rated commercial mortgage loans has been narrowing: whereas over the last 15 years, it has averaged approximately 70 basis points, it is currently closer to 50.

Allianz Real Estate has launched what its global chief executive officer François Trausch calls "a combined loan" structure to enhance yields. This involves providing development loans for the first two years within a seven-year lending facility.

He told attendees at our sister title PERE's Debt Forum in Hong Kong that the company was "trying to find ways to enhance our portfolios to get additional yield". He added that for Europe-based institutional investors, the most obvious way to diversify portfolios would be to go to the US.

Among Asian investors, Dai–ichi Life Insurance Company announced a $100 million commitment in Q4 2018 to gain exposure to US commercial mortgage loans (CMLs). Its Mercury Series US CML Fund has invested in loans issued by the US-based Protective Life Corporation to commercial properties and to senior housing in the country.

CMLs attain high levels of creditworthiness by securing sufficient real estate collateral against the principal. They can earn higher returns than corporate and other types of bond that have similar levels of creditworthiness.

Nicholas Wong, a partner at Townsend Group, says Asian investors in particular appear to be targeting an increased allocation to US real estate, as well as greater geographical and sectoral diversification. "They are going [towards] debt because of an equity cushion behind it," he told *PDI*.■

Adam Ruggiero to speak at PDI Tokyo Forum

Managing Director,
MetLife Investment Management

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Agri lender takes root in leveraged loans

An unlikely force has emerged as a key driver of the leveraged loans market in the form of Norinchukin Bank. Views vary on the desirability of this.

By Andy Thomson | 1 May 2019

Andy Thomson

Known primarily as a lender to agricultural, fishing and forestry co-operatives, Norinchukin Bank has been hailed by some as the unlikely saviour of the leveraged loan market. Others, however, are more worried about what might happen if it departs the scene.

There was a temporary collapse in leveraged loan activity in December, followed by a recovery in January. Just as the market looked like it might dry up, in stepped the Japanese bank to gobble up pretty much any AAA-rated slice of CLOs. "Thanks to Norinchukin, the CLO market is open," one underwriter at an international bank told us. And, as the largest buyer, it's this market that provides the fuel for the leveraged loan market.

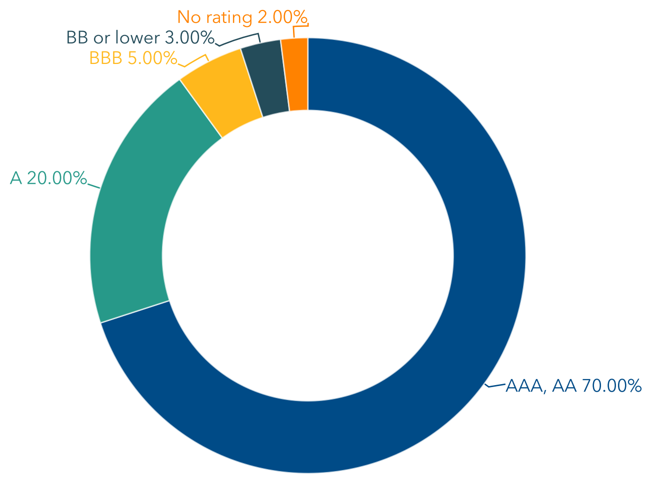
So what's attracting the lender, often referred to as NoChu, to the market? The main reason is decades of negative interest rates in Japan, which have forced the country's banks to search elsewhere for yield. NoChu is not the only Japanese bank to have turned to CLOs, but it has become the most dominant – accounting for $62 billion of global CLO holdings by the end of last year, according to S&P Global.

Although it might be assumed there would be no lack of willing takers for AAA-rated paper, market players tell us appetite is more easily sated for BBB and BB tranches. AAA, says one, "is the trickiest to place", largely due to the sheer volumes. Pricing its deals almost uniformly at 108 basis points over LIBOR (compared with the 114-116 typical of other buyers in Europe), NoChu has CLO issuers waiting in line to bring it deals.

This kind of power is not welcomed by everyone. NoChu can dictate terms and timeframes. Some say its vanilla approach militates against diversity as some types of CLO become marginalised. Perhaps the biggest worry is the impact on the market should NoChu decide to withdraw. When another Japanese CLO buyer, Japan Post, decided to focus on Europe rather than the US towards the end of last year, the decision reportedly had a material effect on the US secondary market.

NOCHU PLAYS IT SAFE

The overwhelming majority of the bank's bonds and credit assets are in the AAA and AA tranches



Source: Norinchukin Bank's 2018 annual report

Though a significant player, Japan Post's CLO exposure is significantly less than NoChu's.

There was speculation that Japan's financial regulator might force withdrawals from the market. Concerned about risks associated with exposure to complex debt products, it suggested it was inclined to insist on the application of risk retention for Japanese institutions investing in CLOs. Not a problem in Europe, where everyone has to abide by those rules, but potentially a big problem in the US, where trade body pressure resulted in an exclusion from the rules for US CLOs.

The FSA subsequently insisted only that thorough due diligence be undertaken and a comprehensive understanding gained of CLO managers' processes. Japan's exit from the US leveraged loan market appears to have been averted – for now, at least. But it has brought into focus the narrow buying base for leveraged loans on both sides of the Atlantic.■

Behind Tikehau Capital's Asia push

The Temasek-backed French asset manager is focusing on Japan in pursuit of partnerships and a new LP base.

By Adalla Kim | 24 May 2019

Tikehau Capital is in the process of opening a Tokyo office as part of a wider push into Asia. A spokesman for the French asset manager confirmed on 17 May that it has appointed Sergei Diakov to head the office and plans to make another appointment in the coming months.

The firm said its main objectives for the office are to diversify its LP base, speed up its investment pace in the region and pursue investment partnerships or joint ventures with Asian players.

Japan has become one of the firm's key priorities in the region as it believes the country's investors are looking to diversify outside their domestic market.

"We are strong believers in the fact that if we want to be an efficient and strong performer and investor in private debt, we need to be very local," Jean-Baptiste Feat, co-head of Asia, told PDI. "Being on the ground, with a network of local offices throughout Europe, enables us to capture the best investment opportunities for our investors."

In line with the strategic shift towards Asian investors, Tikehau Capital launched its first fund of funds vehicle dedicated to investing in Asia, as sister publication Private Equity International reported.

Tikehau Fund of Funds I held a first close on $100 million with a plan to raise up to $150 million by 2020. Fund I will be mandated to invest in Asian private debt and venture capital funds, as well as private equity vehicles.

Sharing his view on the growing number of private debt fund managers in Europe, Feat noted that Tikehau's direct lending strategy focuses on lending to European mid-market companies.

He added that the positioning of the firm enables it to remain competitive in the challenging environment facing a growing number of new fund managers in Europe.

For its direct lending strategy, Tikehau is targeting European mid-market companies that have between €100 million and €2 billion in revenue. Tikehau's direct lending deals mainly come from PE-sponsored companies and banks.

Singapore's sovereign body Temasek holds 5 percent of the listed French asset manager, according to Q1 2019 presentation materials seen by PDI. Most recently, Morgan Stanley acquired a 5.5 per cent stake in Tikehau Capital Advisors, which is the main shareholder in Tikehau Capital, as PEI reported.

According to its earnings as of 31 March, Tikehau Capital SCA had €22.4 billion of assets under management in Q1 2019, with private debt the largest asset class at €8.3 billion.■

Infra debt chosen for stable cash yields and lower fees

Now that infrastructure debt has become a popular asset class among Japanese institutions, fee and fund structures are drawing their attention.

By Adalla Kim | 23 April 2018

Infrastructure is in demand among Japanese institutions as they favour the stable characteristics of the asset class and higher yielding cash coupons compared to public fixed-income assets, three Japanese institutional investors said during a panel at *Infrastructure Investor Tokyo Summit 2018*.

To cope with the low yielding environment from public bonds and loans, more Japanese insurance companies and pension funds are increasing their exposure to the infrastructure debt strategy, with a focus on projects based in the US and Europe.

Yasuhiro Ono, a Tokyo-based director of the private equity investment department at Japan Post Bank, overseeing both the infrastructure and corporate private debt investment portfolios of the organisation, said that the firm is seeking cash yield components from its investments.

"For an infrastructure core strategy, we expect five to six percent returns from cash yielding, but for mezzanine and distressed, [we expect] around 10 percent," he added.

Hisamitsu Iida, a Tokyo-based section manager of the investment and loan department at Sompo Japan Nipponkoa Insurance, added that the total return is better in an infrastructure debt strategy as long-term investors in Japan can mitigate j-curve effects to a degree.

AISIN Employees' Pension Fund, a Tokyo-based corporate pension fund for the Japanese manufacturer, has committed $10 million to an offshore infrastructure debt strategy this year, according to Takeshi Ito, a Tokyo-based senior investment officer at the pension fund.

He also told PDI that the fund plans to commit further capital to the strategy. "We will increase [our exposure to infrastructure debt] to about $50 million this year," he said.

Japanese asset managers also see this trend among insurance companies and pension funds. "Infrastructure is increasingly popular among Japanese investors", said Takako Koizumi, head of infrastructure investments at Tokio Marine Asset Management.

This popularity has pushed asset prices up in recent years. "Trophy assets are expensive," said Ono, adding that he has seen more capital inflows in the infrastructure investment strategy.

However, infrastructure is still a newer asset class to most of the Japanese investors. For instance, Japan Post Bank started investing in the asset class in 2016, according to Ono.

"People have been waiting for Japan to wake up, and I think this is what happened over the past few years," Kay Sano, a Tokyo-based representative director of Monument Group, a Boston-based private placement firm said, adding that there will be higher demand from Japanese limited partners for select offshore managers targeting infrastructure investment opportunities.

Investors' manager selection process is likely to be more focused on assessing fee and fund structures given the nature of the infrastructure debt strategy where investors find less upside potential.

"The fee [structure] is something that we have to pay attention to," said Masashi Kataoka, a Tokyo-based general manager of the alternative investment group at Dai-ichi Life Insurance.

Hear more from Takeshi Ito

Senior Investment Officer & Chief Operation Officer, AISIN

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He added that there is not so much upside in credit investments for infrastructure assets and the spread is tight now. "If the fee is too high, it is conducive to reduced returns," Kataoka noted.

Additionally, investors will look thoroughly at the revenue and cost structure of the underlying assets as well as the deal pipelines of funds to assess infrastructure managers' relative strengths, according to Tadasu Matsuo, head of alternative investment at Japan Post Insurance. ■

Ask the investors: how to budget for risks

Here are our findings on selective Korean and Japanese investors' risk appetites and favoured sub-strategies for the asset class this year.

By Adalla Kim | 22 May 2019

Investor sentiment towards private equity infrastructure assets is approaching record levels. This has left Asian investors asking whether they should continue their search for infrastructure or look at other asset classes.

The sentiment is backed by data on private infrastructure equity fundraising volumes, which this year are on track to reach their second largest total in the last seven years. Our sister publication Infrastructure Investor has produced data which suggest that fundraising in Q1 2019 showed a continuation of the momentum seen last year, with $19.96 billion raised across six funds.

At this month's Investor Summit in Seoul and Tokyo, investment professionals from six institutions shared their current risk appetites and preferences in private infrastructure debt markets.

South Korean investors are adding to their mezzanine allocations. These investors are showing a willingness to move further towards junior structures and away from senior debt. Some are even prepared to take the equity portion of an investment target.

Their Japanese peers are limiting their exposure to specific risks, including country risk and operational risk. Many are worried about staying invested in certain countries where they regard the payment risk as too high.

South Korea

Mezzanine debt is preferred over senior debt, according to Jiroo Eoh, head of the infrastructure and real assets investment team at ABL Life Insurance. He added that this was because the firm, part of China's Anbang Insurance Group, aims to obtain additional yields from offshore investments.

Those with higher funding costs are also willing to look at asset-backed securities with underlying infrastructure projects. Hyungon Kim, senior manager at Korea Teachers' Credit Union, told PDI his team was willing to consider collateralised loan obligations and commercial mortgage-backed securities linked to infrastructure projects. It is understood that KTCU's cost of funding is as much as 4.5 percent for 2019, up from 4 percent during 2018.

Others are considering emerging markets to source higher-yielding deals. One such investor is Samsung Life Insurance, whose head of project finance, Si Wan Lee, said that securing internal investment committee and

risk assessment approvals for such deals would still be challenging.

Japan

Plenty of Japanese investors appeared to shun the country risks associated with certain infrastructure projects.

Shigefumi Kuroki, a Tokyo-based general manager and head of global infrastructure investments in the structured finance department at the Development Bank of Japan, believes the US's sophisticated capital markets can offer him various financial products linked to infrastructure projects and assets.

He noted that as yields from domestic project financing deals had flattened, Japanese investors had gone offshore in search of increased spreads. He added that assets in the UK were not desirable now because political risks are rising and there is uncertainty around Brexit.

As PDI reported in 2018, it was clear that Japanese investors liked the asset class and were looking for cash yields from the debt strategy. Among the topics discussed by investors at last year's summit were how to select the best manager and how best to amass an infrastructure debt portfolio.

This year's main topic appeared to confirm the changing nature of Japan's institutional market.

Tadasu Matsuo, head of alternative investment at Japan Post Insurance, last year focused on assessing infrastructure managers' relative strengths by examining the structures of their underlying assets and looking at their funds' deal pipelines.

This year, he was discussing how to secure accurate and up-to-date information on the assets contained in offshore infrastructure debt funds. "But even in case of the onsite visits for infrastructure assets, the information that we can get is very limited," he noted. "It is disseminated widely."

Masashi Kataoka, a general manager in the alternative investment department at Dai-ichi Life Insurance Company, added,"Infrastructure debt or project finance, they are a basis of banks. But because of the [banking] regulations, [private] funds are now getting into this space. So, there is room for further growth in infrastructure debt."

To be continued

Amid the prevailing low-to-negative yields for traditional fixed-income assets, Asian investors are increasingly pursuing private infrastructure debt strategies.

Many Asian investors also expect such investments to provide them with the benefits of portfolio diversification. According to research published by Schroders Investment Management private infrastructure covers a range of maturities (from 5 to 30 years), payment terms (fixed or floating rates), credit risks (investment grade or high yield), regions and sectors.

Recent PDI infrastructure debt fundraising data support that view. Some of the year's big fundraisers over the past 12 months are Global Infrastructure Partners, Edmond de Rothschild Asset Management, and Schroders Investment Management, whose fundraising target totalled more than $3.5 billion as of 9 May.

Both Korean and Japanese institutions have become active players in global infrastructure debt markets. The six limited partners mentioned above – ABL Life Insurance, Korea Teachers' Credit Union, Samsung Life Insurance, Development Bank of Japan, Japan Post Insurance, and Dai-ichi Life Insurance Company – collectively represented around $1.5 trillion of assets under management as of the end of Q1 2019.

Others, however, think that the concept of private infrastructure debt fund investment is unique and special, Masashi Kataoka at Dai-ichi Life Insurance Company added.■