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Private debt's Seoul searching

Building a good rapport with Korean investors takes time, but the effort may well pay off. Andrew Hedlund reports

By Andrew Hedlund | 31 January 2019

South Korean investors have run headlong into private debt, and at the inaugural PDI Seoul Forum, it was clear the country's limited partners have no plans to stop.

Many of the LPs at the event like the asset class because it seems tailor-made for their needs: a consistent stream of distributions, unlike buyout funds, so investors can meet their obligations. Many pension funds also view private debt as a better risk-adjusted alternative to fixed income.

While other LPs around the world share similar sentiments, Koreans think about the asset class differently to many European or US investors. Here are our key takeaways:

It's all about outbound…

Korean investors' interest in direct lending continues to be keen, but most commitments are to credit funds investing in other parts of the world, as Korea is dealing with a sluggish domestic economy and low interest rates.

But investing in the US is coming at a rather expensive premium and currency hedging costs are bringing Europe into focus. When making US dollar-denominated commitments, Korea LPs may need to shave 1.5 percentage points off net returns because of currency hedging arrangements, said Janghwan Lee, head of the alternative investment management team at Lotte Non-Life Insurance Company.

Jurisdictional issues (insolvency regimes and bankruptcy laws) are at the heart of educating Korean investors when it comes to European direct lending, said Pemberton Asset Management's head of Asia-Pacific business development, Shintaro Mori.

European countries have taken steps in recent years to bolster their restructuring statutes, Pemberton managing partner Symon Drake-Brockman added, to ensure businesses can seek court protection and emerge as a going concern with a right-sized balance sheet.

Germany reformed its insolvency laws to allow secured creditors to have a say earlier in the case and debtors gained additional protections to help them keep their doors open. In recent years, Spain added incentives for lenders to offer bankruptcy loans to help a business get to the finish line in a restructuring.

Senior debt-focused credit managers have received a warm welcome from Korean LPs, given the inherent downside protection being at the top of the capital structure provides, one delegate said.

Commitments have largely remained in senior and junior debt, with relatively little attention given to distressed debt and niche strategies. Several LPs said it may be a good time to start looking at special situations vehicles.

...but not necessarily real estate

The portfolio that Lee oversees holds roughly $2 billion in real estate investments, only $50 million of which is in debt. Both the US and Europe are tough areas to invest in at the moment.

"In case of the US, it is hard to meet our target returns by investing in private real estate debt at this moment, after converting the returns into South Korean won. And because of the low interest rate environment, it is hard to meet our target returns in European countries also," Lee added, explaining the reluctance to deploy more capital in real estate debt strategies.

Real estate debt fundraising plunged last year, dropping by almost half from 2017, according to data from sister title PERE. The strategy seemed strong in the first half of 2018, in which it locked down $15.7 billion. The second half was weaker, when it raised only slightly more than $5 billion. The majority, some $14 billion, was dedicated to North America.

Funds in market are seeking more than $55 billion, targeting all geographies. However, only $13.9 billion is targeting either multiple regions or areas other than North America and Europe. There is a possibility that the capital available for real estate debt could diminish. The South Korean financial regulator is set to implement a new international accounting standard for insurance contracts and new capital standards, which could cause some insurers to lower their overall real estate allocation.

A Seoul office would help

Two Korean institutional investors with real estate strategies told the audience at the Seoul conference for PERE that investment firms should set up shop in the country and hire local investment professionals.

"Business will not happen overnight or only after one meeting," said Woncheol Suh, head of private markets at the Government Employees Pension Service. "[Managers] will have to make more efforts to build a relationship through trust and rapport. That is why we are asking that you open a Korea office."

Hear more from Jang-hwan Lee

Executive Director, Team Leader of Alternative Investment, Lotte Insurance

Learn more Korean investor at PDI Seoul Forum 2019:
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Lotte Non-Life Insurance's Lee said a key consideration is whether the credit manager is willing to educate investment staff about the asset class and help them build contacts in the space. In addition, a source at an advisory firm noted that the goal of many Korean investors is to end up on a fund's LP advisory committee.

All of these are measures that require extensive time and resources – particularly establishing a Seoul office. But LPs often respond well to personal introductions or recommendations from people they know.

"We are [strongly] controlled [by the government] and limited by our budget," Suh explained. "We are [also] under [a] severe manpower shortage. We have people wearing many different hats [at work]. Have more patience while dealing with us."

The Korean private credit market may be less mature than the US or European equivalents, but it is a bright spot in Asia. Fund managers may spend significant sums of money and rack up frequent flyer miles into the hundreds of thousands. But the pay-offs could be plentiful as the asset class evolves within the larger Asia-Pacific region.■

South Korea: the end of the infra spree?

Korean insurers are making changes as they see diminishing returns from infrastructure debt.

By Adalla Kim | 8 May 2019

Three insurers from South Korea told *PDI* sister title Infrastructure Investor's Seoul Summit on 7 May that the country's institutions are facing a particularly tough time as they suffer diminishing returns from infrastructure loans.

LPs around the world are struggling with long-term investment mandates amid an ever-changing global investment environment. Yet executives we spoke to at the summit, including DGB Life Insurance's chief investment officer Byung Kyu Cheon, still view infrastructure debt as a better risk-adjusted alternative to traditional fixed-income investment products.

One panellist said institutional investors want a consistent stream of cashflows that match their long-term investment durations, and which have satisfactory risk-adjusted return profiles.

Korean insurers have maintained a keen interest in infrastructure debt, notwithstanding the continuing low-yield environment.

Jason Hyunjae Kim, head of one of the infrastructure teams at Samsung Fire & Marine Insurance, told *PDI*: "PPP-type projects are preferred [among Korean investors]. But senior loans from these are only yielding two percent in Europe. That is not enough [for us] to go into that market."

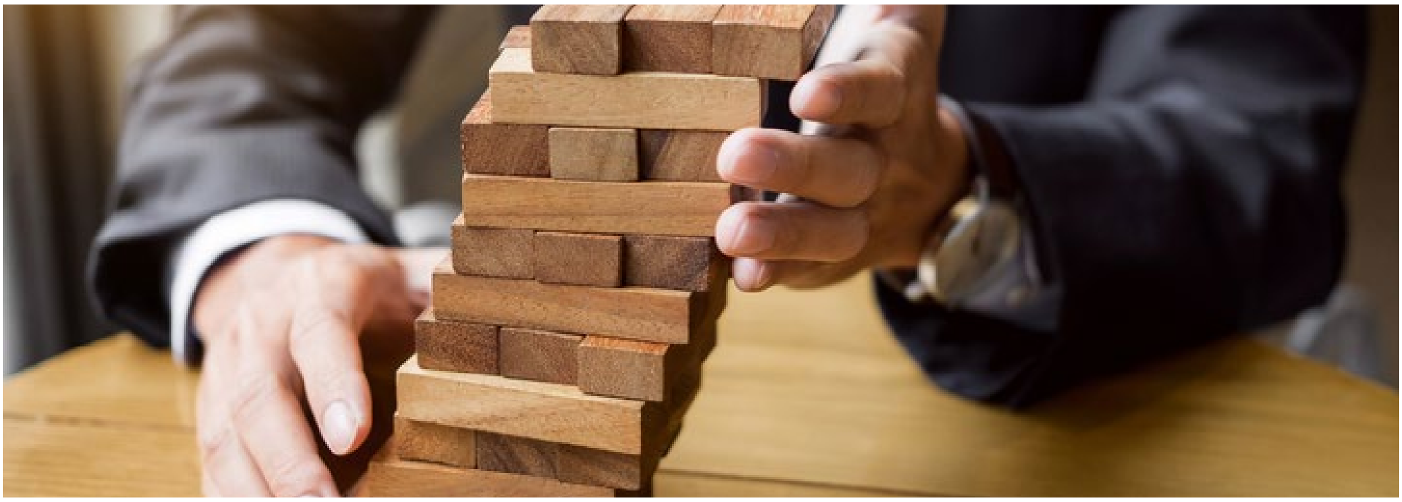
Some investors are willing to move to a riskier capital structure. Cheon said that this was an emerging phenomenon among LPs because of the lack of opportunity to source deals and the increased competition among GPs.

Whether investors will make the switch will depend on whether they have enough risk appetite to invest further down the capital structure in areas such as mezzanine. It will also depend on whether investors feel comfortable using leverage on a deal or fund level – considering that risk capital is subject to more stringent adequacy guidelines, as *PDI* first reported in 2017.

Si Wan Lee, head of project finance at Samsung Life Insurance, said his team was trying to invest in equity and mezzanine. Although it previously had significant exposure to infrastructure equity, Lee said it was now looking at the asset class with a view to gaining a cashflow component.

According to Lee, some infrastructure debt fund managers choose to source higher-yielding deals from less familiar countries or by putting more leverage on their fund structures. "We have a strong [investment] guideline which includes sovereign ratings of BBB and above for the infrastructure asset class," he said. "We can venture into Latin America and other exotic countries … like Mexico, Peru, or Chile. It is tough due to our internal credit team's concerns [on investing in these countries]."

Commitments have largely been shifted towards mezzanine debt and equity, according to the three panellists from the Korean insurance firms. Little attention has been given to availability-based PPP project loans and senior secured loan funds with return profiles of LIBOR plus 250 basis points.■



Regulations push Korean insurers to explore credit enhancement measures

Investors are seeking ways of reducing the capital burden on their alternative investments

By Adalla Kim | 12 March 2019

New capital standards that will be in place in South Korea within two years are causing insurance firms in the country to search for new yield and credit enhancement methods.

As *PDI* reported, a tighter method of assessing required capital, also known as the K-Insurance Capital Standards, is affecting LPs' preferences regarding capital structures and vehicle formats.

The first guidelines, drafted by the country's Financial Supervisory Service in 2018, indicated that insurers' investments may be subject to greater regulatory scrutiny. The regulator plans to examine the structure of each commitment to alternative assets in order to reveal associated risk factors.

Jiroo Eoh, the head of infrastructure and real asset investments at ABL Life Insurance, a member of China-based Anbang Insurance Group, said that risk charges are the main factor for his team when considering investment decisions across assets.

He told delegates at *PERE Asia 2019*, a conference organised by PDI's sister title PERE in Hong Kong, that if GPs invest in assets with risk charges of 3-6 percent, LPs may require returns of up to 8 percent.

"We really need GPs to actually discuss with us to find a solution to enhance the credit and find ways to deduct the risk-based charges plus enhance the returns," said Eoh, who added: "We have to invest in debt."

As part of their debt investment strategy, some insurers are pursuing structured products where they can pick and choose the top tranches with the highest credit ratings.

Doyle Kim, head of overseas real estate investment at Samsung Fire and Marine Insurance, told the conference that his company was among those investors considering direct lending with a structured finance component against single assets.

Kim noted that his peers prefer debt sourced in developed markets, including the US, Europe and Australia, as these markets can offer structured products such as first lien commercial mortgage-backed securities, as well as B and C notes. He said that these products can help investors to ease risk-based capital charges to a degree: "We tend to consider the risk burden first, rather than expected returns and yields."■

BNP AM begins 'natural next step' with €2bn infra debt Korean partnership

The expansion into junior debt by the French group could lead to the launch of a dedicated fund in the near future.

By Zak Bentley | 11 March 2019

BNP Paribas AM has made its first move into infrastructure junior debt following a partnership with Korea Investment & Securities worth up to €2 billion.

The move will see BNP source and execute transactions on behalf of KIS over the next two to three years, focusing on junior debt transactions in Western Europe. The partnership has already made its first investment, subscribing to a £150 million ($197.3 million; €174.4 million) private placement to Heathrow Finance, holding company of the UK's Heathrow Airport.

A dual strategy will be employed by KIS for the BNP partnership, according to its energy and infrastructure head avid Guhn-Chang. Low yield and low risk debt will be entirely be passed on to Korean investors; mostly for insurance companies. High yield and high risk debt shall be kept by KIS's own balance sheet on a buy & hold basis.The strategy is targeting returns of about 5 percent.

As PDI's sister title Infrastructure Investor reported, KIS was both a debt and equity underwriter in September for the first transaction for Renewable Energy Income Partnership II, a UK-focused renewable energy fund established by Octopus Group.

KIS chose the debt strategy partly because it "does not believe current valuations is at a sustainable level," Guhn-Chang told Infrastructure Investor.

"KIS does acquire infrastructure equity assets, but only at the reasonable price. Instead of chasing the market valuation, KIS has opened the sub-debt business with BNP in order to have direct access to the trophy asset in the market; such as Heathrow," he said.

The expansion into junior debt is the "natural next step" in BNP's strategy, Karen Azoulay, head of infrastructure debt at the group, told Infrastructure Investor. BNP launched its first senior infrastructure debt fund in 2017 and Azoulay added that a junior debt fund could be launched in the near future, although it remains focused on investing with KIS for now.

BNP's senior debt fund does not invest in the UK due to short-term currency concerns, although Azoulay explained that KIS does not have the same currency restrictions.

BNP said the managed account solution provided is befitting of the requirements of a large global investor such as KIS. At Infrastructure Investor's recent infrastructure debt roundtable, Emma Haight-Cheng, partner of infrastructure debt at AMP Capital, said "for investors with upwards of about $500 million, they may want more control and so would look to bespoke managers to provide bespoke solutions".■

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.■