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Infra debt funds – brown trouser time

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There's an old tale that Admiral Nelson was once asked by a flunky why he wore a red tunic into battle. He coolly replied that, were he to be shot, the blood would not show and the morale of his fighting men would not flag. To this, the attendant replied: "And that's why I wear brown trousers."

With what is emerging from market discussions this week, it would appear that brown-trouser time is just around the corner for the infrastructure debt fund community.

For these chaps, it might not be a bad idea to pop along to Marks & Sparks and check out the autumn range of brown breeks as the grapeshot's starting to rip through the rigging.

It's only a matter of time before the realities of a perpetually-constrained European market start to hit home for the swathe of infra credit funds (brown trousers and red tunics, I fear) and the coming months will see those trailing the herd – limping, mournfully at the rear – start to fall over.

As you read this piece, IJ is 80% through the creation of the single most comprehensive database of funds active in the global infrastructure arena and, drawing from this incomplete (more complete than others) picture, the numbers are… worrying.

Right now, IJ has 60 debt funds operating in the European market, 39 of which are fundraising. Of these:

- 25 are debt only
- 13 a mixture of senior and mezz
- 7 are in for equity and debt (probably preferring mezz for obvious reasons)
- 15 are active (or seek to be) across senior and junior debt, as well as equity

In terms of target regions, 47 aim to invest exclusively across Europe, or selected counties within the region. The remaining 13 have a more general focus: they target OECD countries or other regions alongside a strong European focus.

More of this exciting development in the coming weeks as we plan to launch the infra fund database next month with a shaming amount of self-promotion. It's so much easier to climb atop a soap box when you own a soap factory.

Too big to bail…

When funds start hitting the wall, it will be the smallest players that impact the brickwork first, leaving less splatter… but making up that by wailing like banshees as they go.

It's impossible to say when this will happen (sooner rather than later, we fear) or at what point a credit fund's scale removes it from the danger area, but there will be a direct correlation between how established it is, fund size and amount of dry powder.

Market power does matter in private debt and big players will benefit not only from economies of scale, but also from being part of a larger organisation that can cover the overheads.

In reality, private debt works much the same as old-fashioned banking where there is a strong relationship between creditor and issuer. However, just as with the banks – "old-style stuffy banks" as one fund source calls them – the small guy who relies on little chunks here-and-there will be the first against the wall. When was the last time you saw Nationwide in the market?

So if you're running an office sweepstake on which debt funds won't be operating this time next year, you'd be well advised to pick a fund that paddles in shallow water, lending small-scale in niche sectors.

Having said that, a lifeline might come from the least likely of sources – Macquarie – as it divests assets it does not want to retain from the Green Investment Bank portfolio… but you'd better believe the crown jewels won't make it on to the auction block.

Phrase du jour – illiquidity premium

A bit of industry jargon that is increasingly bandied around is illiquidity premium and it is wielded with joyous abandon.

However, one senior infra fund figure gets straight to the point on this matter: "One issuer asked me: 'What is the value of illiquidity to me – as the person paying that premium?'

"I replied that there is no value *per se* of your debt not being liquid, but it is the value that comes from the other things you get with it – not being traded widely, relationships with people, privity of contract, having an engaged interface if you do need to change a covenant, to name but a few."

However, a senior banking source adds: "People are looking for illiquidity premium, but the premium is just going to disappear – so there is no point in investing in these things when they drive the returns down to what you can get from the bond market."

Understanding the attraction for illiquidity is clear – assets being sold on to pension funds, knowing the debt will sit on their books until maturity. However, with growing desperation for assets and funds being launched to add to the existing wall of cash, they are all going to end up bidding for the same assets…. and the price will collapse.

"I hear about illiquidity premium all the time at these pension conferences," says another senior source. "But I just bite my tongue as I don't want to appear too negative."

Wall of money – lack of prospects

And this is the real issue: lack of prospects. Since 2010, there has been so little activity in the European greenfield space that there is precious little for them to target in new projects coming to market (if they can take construction risk – which is pretty rare), let alone in brownfield… but increasing amounts of money chasing what is there.

Sure, there has been plenty of activity in the refi space and that will continue, but there are only so many times you can rearrange the Titanic deck chairs. Heck, stretching that metaphor, there are only so many Titanics.

Beyond funds, there are plenty of banks out there looking to book build. Key among them are the new entrants and returning institutions, including (to name but a few):

- ICBC – Clive Carpenter's shop where there is a lot of enthusiasm out of China build a book out of nothing
- Kommunalkredit Austria – home to Deutsche Bank refugees including Bernd Fislage and Joakim Forsberg and building a presence
- Sabadell – Tom Boam, back from the misery of Hamburg to lead the charge for the Spanish
- KDB – Christian Ayres leading the drive with Korea pushing to build a book
- AIB – James Tremaine heading up the charm offensive for Matt Toolan and doing quite nicely, thank you
- DBJ – Koji Sakai and Masato Kitaguchi leading this function

- Norinchukin Bank – ummm, got nothing

And that's just the ones off the top of my head. Add to that the 60 infra debt funds – among which you will see the likes of Aviva, AXA, Blackrock, MetLife throwing their weight around – chasing the same secondary assets and… well, what more needs to be said.

It's a car crash in slow motion.