IJGlobal
A Green Street Company

Interest rates – banking on a better world

Angus Leslie Melville

30/06/2023

In the week that we launched IJGlobal ESG Awards 2023 immediately to receive a submission extension request to the end of August from an organisation in mainland Europe… one's left wondering whether there's anyone out there to read this… but, hey ho, we forge on.

A few discussions this week lead to revisiting a subject that was raised almost a year ago and then left to simmer as not a lot more needed to be said on the subject… and that is rising interest rates.

That Friday Editorial was blasted out around the industry in July 2022, warning those who had started their careers over the last decade (2012-22) that they were transitioning into a very different lending climate – one they had never encountered before.

An old friend at a major lending platform told me at the time that one of his juniors brought the editorial to him… asking for clarification. It didn't compute. There followed lengthy discussion on a free-and-easy lending environment that was crashing around their ears.

Well, we're almost a year down the line from that editorial and it's not getting a whole bunch better. The war in Ukraine rages on, supply chain issues continue to impact the market and inflation is all you ever read about.

What a to-do. What a state the world is in. And how does infra manage to slip between the cracks and continue to operate – pretty much – as though the past year (and some) has not happened?

Chatting to cronies over the course of the week and one recalls "days when the base rate for a model was 10% for 30 years". This was very much in tune with the mood music from the previous week, working remote in Scotland with my brother banging on about how he had to pay 11-12% on his mortgage in the late 80s, spiking to 15% in the mid-90s when "Norman Lamont cocked things up".

But that's before some infra professionals were born… or at least economically aware.

As one industry doyenne says: "The problem is, after years of 0%... 5% seems incredibly high. However, we should be heading into recession later this year when rates will start to fall again."

The industry stalwart adds that "much depends on events like Ukraine", opining: "If we see a Russian retreat in the next couple of months, the global economy could take off again."

But the sanguine sage reckons "it's going to remain unpredictable for some time to come". And that's sufficiently vague to please all sources either side of the fence he perches upon.

Old fart trap

One always has to be wary of falling into the old-fart trap of thumping loose-skinned drums that bear the scars of more encounters than the thumper is willing to admit… but if you ain't got the scars and sagging (possibly drum) skin, you likely don't know what it's all about.

As one lawyer of great infra renown says: "Ten years of low interest rates means you probably need to be over 40 to even contemplate higher interest." The solicitous senior continues on the low interest vein: "It's not just individuals, it's whole industries."

One loose-lipped lender says of their last organisation: "We found this a real issue at (insert name of bank here). A lot of young originators who had only seen the market go one way had a very skewed view of risk – both lending and underwriting risk, of how to structure credits and understand refinancing risk if there was a big shift in rates. Which has now happened."

The battle-weary banker, however, warns this was not the end of it. These youthful infra luminaries-in-the-making are also running financial advisory mandates… and that has a "massive impact on what the market is taking".

The cautious creditor adds: "They were obviously driving best deals for the client, but that became problematic for the bank if we were then asked to backstop and underwrite for the same client on the aggressive terms they'd raised from the market.

"Lenders will take stupid terms from an FA for a strong sponsor, but won't necessarily take the same terms from an underwriter – happy for them to wear it if it's deemed too aggressive."

But let's not point the finger of blame entirely at the Huel-slurping next generation, according to one disillusioned distributor: "It's not limited to young folk. A lot of originators, even those old enough to remember the higher rates environment, have been blinded by a very benign lending environment over the last decade. It's very challenging as a syndicator to get people to properly understand market risk."

Crazy gets done all the time as one Friday-functioning infra fund financier says: "One of my equity colleagues recently was delighted still to be receiving 200bp spread offers on pretty crossover lending opportunities. Bless the banks. Equity has really been the place to be for a couple of decades."

The fund fogy advises: "Banks should learn about mark-to-market on assets... they just aren't worth what you think. The old 'hold to maturity' get-out clause is to ignore market reality."

And then there's Thames Water and the continued media onslaught against Macquarie for being the smartest people in the room.

Maybe more remote working in Scotland is called for. It's all going to hell down here.