MA Financial Group

Private Credit Investment Series

Asset Management

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This series is an introduction to private credit. It explores the diverse opportunities now available for investors to access the defensive asset class prioritising downside capital protection while generating regular and resilient returns.

1. What is private credit?

   Explains the basics of private credit investing including the diverse range of market segments and key benefits.

2. Why private credit in the new era of investing?

   Outlines the appeal of private credit – greater investor control, capital protection, and the ability to tailor investment strategies – and why it is an attractive alternative to improve returns and reduce portfolio risk.

3. The case for real estate credit

   Provides an overview of real estate credit including its basic principles, defensive nature, diversification benefits and inflation-adjusted, reliable income returns.

4. Global private credit solutions

   Explains the compelling opportunities available for Australian investors to access deep, diverse, and mature international private credit markets.

Private Credit Investment Series

What is private credit?

Private credit is a bilateral lending arrangement directly negotiated between a credit provider/non-bank financier to institutional borrowers with bespoke structured terms and covenants. This is distinct from public bond markets or bank lending.

Private credit transactions are by nature proprietary, sourced with pricing and bidding uniquely structured through a tailored and specific arrangement based on the requirements of the investor (lender) and the borrower, and not transacted via a public exchange.

It is generally considered a defensive asset class offering capital protection due to its position in the secured debt section of the capital structure. Private credit is a floating rate asset class, meaning returns are directly linked to the base cash rate, well-positioned to take advantage of a higher inflation/higher interest rate environment while at the same time offering a predictable income stream secured via contractual borrower agreements.

The asset class offers greater investor control and protection due to the ability to engineer the level of seniority in the capital hierarchy or security pool of the lending company or asset, depending on the type of credit. It also offers a wide range of strategies, products, and access points for all types of investors.

Private credit is gaining market share as investors seek a defensive allocation and to diversify away from public market volatility, while delivering solid risk-adjusted returns in investments that are secured, collateralised or otherwise have strong downside protection features.

Private credit market segments offer diverse investment opportunities

Private credit is a deep universe, spanning a complex and diverse spectrum of instruments, borrowers, counterparties, and asset pools across a wide array of sectors.

Private asset-backed credit

- Asset-backed credit is financing secured by diversified portfolios of loans, assets, receivables or other collateral, typically with an originator or finance company with alignment or some level of co-investment. It finances the real-world economy and complements traditional corporate credit (or loans to companies).
- Asset-backed credit includes non-bank lending in areas where banks are no longer competitive (due to regulation, structural or secular market forces) or an efficient provider of capital. Examples include equipment, receivables or supply chain finance, as well as specialty finance such as legal disbursement funding, and insurance premium funding. Loan facilities are typically structured providing additional credit protection to the lender.
- Real estate credit is non-bank lending providing first mortgage loans to finance the purchase or development of Australian commercial and residential real estate. It involves contractual loans where property and/or land is used as collateral or security. This strategy aims to deliver fixed payment dates of interest and return of capital.
- Specialty finance is lending across differentiated asset classes exhibiting unique, uncorrelated or special features typically in a senior secured or structured facility.

Corporate debt

- Corporate debt is lending directly to companies with resilient characteristics, focused on non-cyclical industries on a senior secured or structured basis. Facilities are secured by the business and cash flow generation potential of the corporate borrower.
- This strategy aims to lend to companies that are price makers (not price takers), with a defensible market position, sustainable or growing margins, strong financial backing and at sensible levels of leverage.

Capital solutions

- This covers bespoke credit solutions for borrowers, including for working capital and opportunistic situations.

Growth credit

- Growth credit is lending directly to growth-stage businesses, typically in the form of secured interest-bearing loans with fixed maturities.
- It involves lending to companies that have a baseline of recurring revenues from a diverse client base, leverage a combination of technology and innovation to maintain a competitive advantage, and support a more sustainable future planet and society.
- In addition to fixed returns through interest-bearing loans, the strategy seeks equity-like upside participation through additional warrants and/or other conversion rights.

What are the benefits of including private credit as part of a diversified investment portfolio?

- **Attractive yields** – potential for strong, enhanced yields
- **Low correlation and resilient returns** – historical returns have low to negative correlation to other asset classes
- **Regular and stable income** – potential for regular and predictable income secured via contractual borrower agreements
- **Low volatility** – returns are contractually agreed so generally less volatile than equities
- **Diversification** – highly granular curated portfolios of loans with exposure to a wide variety of borrowers, assets, industries and geographies
- **Robust fundamentals** – private markets enable a fundamentals-first mindset, focusing on borrower quality, collateral strength and the likelihood of being repaid as a lender, rather than influenced by sentiment-driven momentum trades.

The importance of avoiding losers, not picking winners

Unlike an equity investment offering unlimited upside, in a private credit investment upside is capped. The best-case scenario for a credit investor is the principal is repaid, and the investor receives predetermined interest payments over time.

In a portfolio of private credit investments it is considerably more difficult for the failure of one investment to be masked by the success of another.

For receiving a fixed (and capped) return, a private credit investor does also generally receive the benefit of security over assets and seniority to equity holders as protection against loss. It is for these reasons that investing in credit is far more about avoiding the losers than picking the winners.

Successful credit investing requires a sharp focus on strong fundamentals with robust security, asset coverage and downside protection and the rights and controls lenders need to safeguard capital if required.

Why private credit in this new era of investing

After decades of declining and ultra-low interest rates, the velocity and magnitude of global rate rises and tightening credit conditions have dominated the investment landscape.

A direct by-product of the steepness and severity of the monetary tightening cycle, the regional banking turmoil in the US in early 2023 served as a timely reminder of the importance of managing financial risk.

Private credit offers investors the potential to preserve capital and generate resilient and regular income. It provides an opportunity to lend against high-quality assets with equity-like return characteristics, has low correlation to other asset classes and is a compelling and defensive floating-rate option to cope with the future (however that plays out).

What is behind the rise of private credit, why is it a good time to invest and what role can it play in optimising portfolio allocation?

The rise of private credit

Structural shifts in regulatory capital requirements have forced banks to be less active in certain segments of both the corporate and real estate lending market.[1] This has supported the rise of private credit investment solutions.

Major regulatory changes occurred at the same time as institutional investors increased their exposure to private markets more generally in search of income yield in the prevailing ultra-low interest rate environment of the time.

The profound sustained and fundamental changes to the investment landscape is motivating investors of all types to reconsider how to protect and growth wealth and diversify outside the traditional public equity and debt markets.

The historical rules dictating asset allocation no longer necessarily prevail. The concept of a 'risk-free' rate was rocked in 2022/23 by gyrating bond markets. Surges in 10-year bond yields and the UK gilt crisis led to a re-assessment of the role of public market debt in providing capital protection.[2] The US banking crisis in early 2023 added a new layer of opportunity for non-bank lenders.

No longer supported by a low interest rate regime, private credit market investing offers an increasingly attractive alternative to public assets (where price and valuation are increasingly dictated by market sentiment and momentum).

With the suite of private market alternatives expanding (including private credit funds) there are increasing investment opportunities, not just for institutional investors but a wide range of investor groups including high net worth and retail investors.

Floating rate credit is well suited to current conditions

Conditions for floating rate private credit are the best they have been for a generation.

With higher interest rates, private credit benefits from the upward movement of rates occurring at the same time as the regulatory environment exerts pressure on traditional banks to secure their balance sheets.

In the hands of an experienced manager with multi-cycle experience, the position of private debt in the capital structure and its floating rate nature operates to reduce income volatility and downside risk.

Investors should choose an asset manager carefully, based on the scale and depth of their platform, the depth of embedded governance, the experience of the lending team, and an established track record through multiple cycles.

1. The New Dynamics of Private Markets, Winter 2022, PGIM, www.pgim.com
2. Three US banks failed in March 2023, triggering a swift response by regulators. Source: The Evolving Nature of Banking, Bank Culture, and Bank Runs. Speech by US Federal Reserve Governor Michelle Bowman, 12 May 2023, www.federalreserve.gov

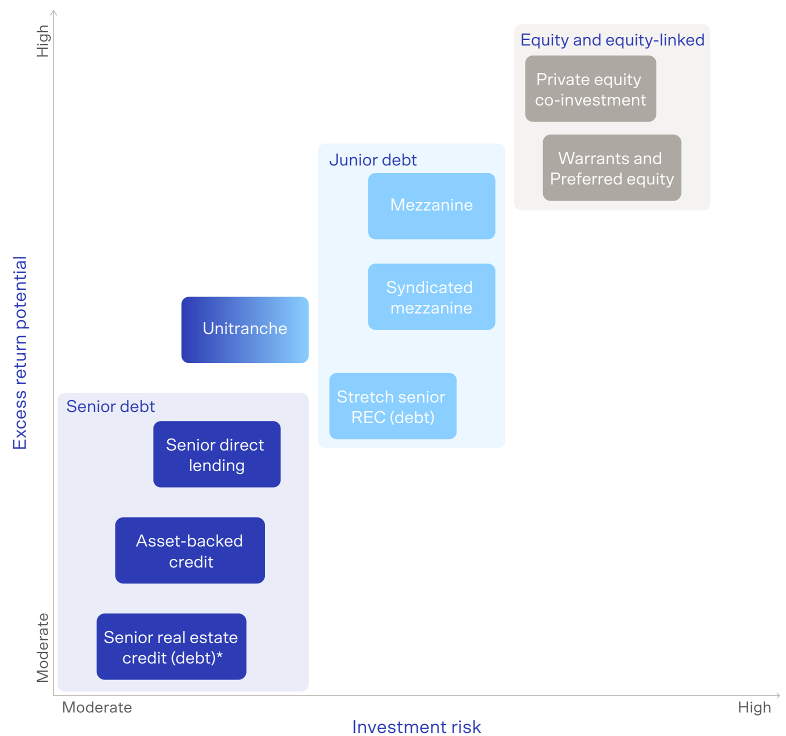
The opportunity in private credit. Challenges remain for publicly traded assets

Long-term investors have faced two major shifts in the investment environment.

One has been steadily building (the rise of private assets to the core of investment portfolios) while the other materialised relatively quickly (rising interest rates and a prolonged period of macro uncertainty).

Both require a fundamental re-think of the asset allocation process.[3] The benchmark portfolio (60% equities, 40% fixed interest) took a significant hit during 2022 heralding a paradigm shift in capital allocation to a more defensive position. Private credit is set to expand its reach to occupy a greater proportion of the capital structure, and a higher allocation within investor portfolios.

Risk/Return profile for private credit



*Maximum LVR (Loan to value ratio) 70–75%

3. MSCI, Building Balanced Portfolios for the Long Run, October 2022, www.msci.com

The case for real estate credit

What is real estate credit?

Real estate credit (also known as real estate debt) is a form of asset-backed credit and a rapidly growing asset class in Australia.

An investment in real estate credit is the provision of a loan to a borrower with the principal security being a first-ranked mortgage over that borrower's real estate asset. The loan gives the lender (investor) rights to a contracted income return (being the interest on the loan) with significant downside capital protection from the security.

Credit security can take many forms, but one of the most secure and defensive positions is the registered first mortgage. This position in the capital structure gives the lender priority to proceeds when the asset is sold or re-financed. Additionally, the lender can take control of the asset if the borrower defaults.

Through what is often a floating interest rate structure (offering a margin above the RBA Cash Rate), investing in real estate credit has increased in relative attractiveness. It is a defensive asset, well-positioned to take advantage of a higher interest rate environment.

Real estate credit, both cyclically and structurally, can offer diversification benefits and compelling relative value. In the hands of an experienced manager with multi-cycle experience, it seeks to provide investors with a reliable income return adjusted for inflation. Importantly, real estate credit also offers the opportunity for capital protection via secure lending structures attached to the underlying investment being the registered first-ranked mortgage.

Strong growth for real estate credit, but a careful approach necessary

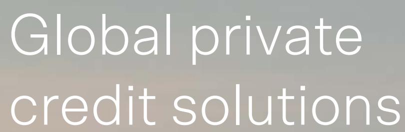
Australia's vast and highly diverse residential real estate market grapples with acute undersupply in the face of soaring demand. Despite the market imbalance, the forecast for residential prices over 2024/25 remains relatively benign as several key variables are in play.

Record levels of immigration, demographic changes, increasing average household size and acute affordability pressures are all impacting both the rental and owner-occupier market.

A wide range of outcomes is possible, depending on location and depth of the market. Values will remain strongest in markets with the most acute demand/supply imbalance, for example metropolitan Sydney.

The key questions for real estate credit investors will be the impact of the increasing affordability crisis on sales and prices, and which pockets of the market will continue to perform and offer opportunity.

Undoubtedly, the opportunities for private lenders to finance the growing demand for real estate credit will continue as they work to complement the major lenders in addressing the critical housing shortage. Sound market fundamentals, security through first lien mortgages and an experienced manager to assess underlying value and exit strategies will remain critical to success.



Global private credit solutions

The long period of easy money is at an end. In a new era of higher interest rates, liquidity and diversification are a primary source of concern for all investors.

Global private credit offers Australian investors the opportunity to access deep, diverse, and mature international credit markets. What makes global private credit a compelling alternative and why is now the right time to invest?

A once in a generation opportunity?

Conditions for floating rate private credit are the best they have been for a generation.

Rising interest rates and banking stress (in the US) led to a minor credit crunch. The full implications of the record increase in the cost of capital will continue to play out across the credit spectrum as the shifting gears of rate rises work through the real economy and credit markets.

Diverging conditions across global credit markets (both structural and cyclical) present a range of unique opportunities for non-bank lenders and investors.

Global private credit offers defensive portfolio diversification and robust characteristics to safeguard capital – asset collateral, security dynamics, bespoke structures, terms and covenants, equity and income buffers, control rights and triggers.

For Australian investors, it provides access to some of the best opportunities in specialty finance, and unique products currently not available in the domestic credit market.

How is global private credit different?

Credit markets operate within similar limits across global regions, although the maturity, depth, and range of securities on offer varies widely. In the US, despite familiar investment fundamentals, there are important structural differences compared with Australia's relatively nascent (but rapidly expanding) private credit sector.

The US operates a vast, mature, and highly liquid credit market with considerable funding efficiency. Non-bank lenders account for 80% of the credit market in some segments.[4] US credit markets are designed around an 'originate to distribute' model. Loan originators sell loans to third party funders (in exchange for fees) with no retention risk.

There is a vast array of US private credit products as well as a diverse selection of more niche asset types. In contrast, the domestic private credit market remains small, with non-bank lending accounting for a relatively minor, but fast-growing, proportion of overall credit in Australia.[5]

The full implication of the differences between US and Australian private credit markets varies depending on the type of credit, although the sheer size, complexity and liquidity in US credit provides significant scope in both traditional lending and specialty finance.

US credit markets in the spotlight

The US is the world's largest private credit market; a vast, innovative, and mature asset class encompassing a wide range of traditional corporate lending, asset-backed lending, and specialty finance opportunities.

Since the US Federal Reserve began raising rates in mid-2022, ~US$1 trillion in deposits have exited the banking system. Combined with tight lending standards, consolidation and credit contraction across the US banking sector has resulted in credit growth shrinking. Credit availability has had its largest decline in 20 years, at the same time as interest costs are at a 15-year high.[6]

The US regional banking turmoil in early 2023 (triggered by mismanagement of interest rate risk as opposed to increasing credit risk) is set to create, to some extent, a credit vacuum for quality, mid-size corporate borrowers and an array of asset-backed, real world economy lending verticals seeking capital for growth as banks re-focus on managing deposits and their balance sheet.

Exacerbating the specific issues facing US regional banks around liability (liquidity) management was the takeover of Credit Suisse in March 2023 and the fallout from the complexities and concerns around risk for specific hybrid debt instruments.

As US regulators reassessed deposit insurance guarantees and banking capital requirements, the appetite for risk from traditional sources of funding, i.e. banks, has declined. Small and medium-sized US banks will face increasing competition and rising funding costs with year-over-year deposit and credit growth turning negative.[7]

In this new era of investing, amidst the rising cost of credit, there are exceptional opportunities for US non-bank financiers to fund the emerging gap in the provision of critical funding to high-quality, middle market borrowers.

The secular shift to global private credit shows no signs of slowing

Rising rates have bolstered relative returns for global private credit at the same time as stress in the US banking sector has increased demand for credit – a demand/supply imbalance means a range of deal metrics are now firmly in the lender's favour.

Astute global private credit investors are positioning for an extended period of macro uncertainty and higher interest rates, curating capital preservation and long-term performance by prioritising high quality borrowers and cash flow.

4. S&P LCD Quarterly Index. Non-bank includes institutional investors as well as non-bank finance companies.
5. MA Financial analysis, RBA D2 – Lending Aggregates (Dec 2022), S&P LCD Quarterly Index. Non-bank includes institutional investors as well as non-bank finance companies.
6. Morgan Stanley, Credit crunch in the US equity markets, 18 April 2023, www.morganstanley.com
7. The Economist, 'Why America will soon see a wave of bank mergers', 20 April 2023, www.economist.com; Morgan Stanley, 'The warning signs investors should not ignore', April 26, 2023, www.morganstanley.com

About MA Financial Group

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We are a global alternative asset manager specialising in private credit, core and operating real estate, hospitality, private equity and venture capital as well as traditional asset classes. We lend to property, corporate and specialty finance sectors and provide corporate advice.

Our investment teams have diverse skill sets and experience across a range of strategies and market conditions and are focused on delivering long-term growth. Our conviction runs deep and as testament to this we co-invest in many of our strategies alongside our clients, aligning our interests with theirs.

More information

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