NEXT EDGE CAPITAL

The Case For Private Lending

An Attractive Fixed Income Solution

Follow Us

PRIVATE LENDING OVERVIEW

Private lending/debt is simply described as private loans that occur outside the traditional bank networks. Although private lending has existed for thousands of years, post the financial crisis of 2008/2009, regulatory changes such as Dodd-Frank and Basel III, changing sentiment, among numerous other circumstances, have substantially shifted the global lending landscape. This has expanded the opportunity set for non-bank lenders to increase their presence and fill a void that has been left behind.

Alongside this, an extended period of low-interest rates has caused many investors to seek alternatives to their low yielding tradition fixed income investments – private lending being one of them. This thirst for yield from investors, along with the need for capital from non-bank lenders, has allowed the sector to emerge and flourish, creating a sister alternative asset class to private equity – private debt – one which has the potential to provide end-investors with attractive returns with low historical levels of volatility.

Once again, private debt has demonstrated its importance and reliability during the COVID-19 pandemic uncertain times, leading total assets to a new high. AUM increased to $887bn as of June 2020, making private debt the third largest among the private capital asset classes, behind private equity and real estate.*

THE BENEFITS OF PRIVATE LENDING

Private lending fund assets have increased significantly over the past decade. Investors rationale for attraction to the area are numerous and include:

- The main focus is on capital preservation
- Strong historical return and cash flow characteristics relative to other fixed-income vehicles
- Low historical correlation to traditional fixed income and equity markets
- Low historical volatility relative to traditional fixed-income investments
- Historical consistency of returns

*Source: 2021 Preqin Global Private Debt Report

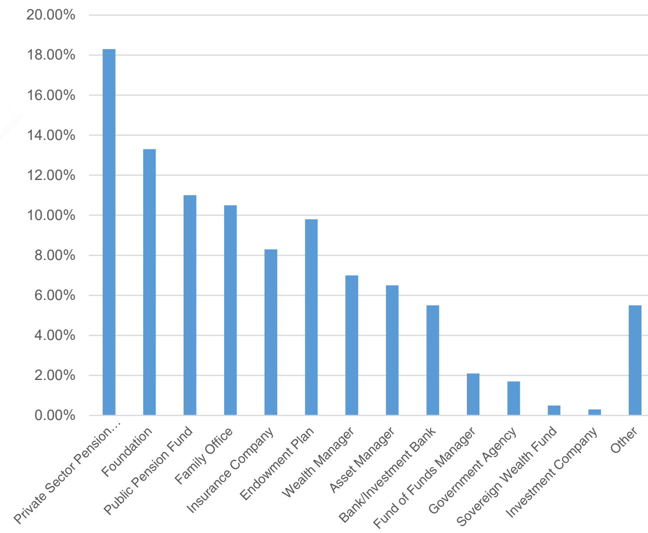
WHO INVESTS IN PRIVATE LENDING?

Institutional investors have broadly adopted private lending within Canada. Canada Pension Plan Investment Board ("CPPIB"), Public Sector Pension ("PSP"), and Ontario Teacher's Pension Plan ("Ontario Teacher's"), to name a few, have all increased contributions to private debt within their portfolios. The nation's biggest pension manager CPPIB has increased its private debt allocation from $20.4B in 2018 to $40.0B in 2020 (CPP Investments 2020 Corporate Overview). Other Canadian investment goliaths like the PSP and Ontario Teacher's followed suit, with PSP increasing its private debt allocation by 11.5% between March 2019 and March 2020 from $15,644 mil to $17,441 mil (Public Sector Pension Investment Board, 2020 Annual Report) and Ontario Teacher's by 5% from 2019-2020 (Ontario Teacher's Pension Plan, 2020 Annual Report).

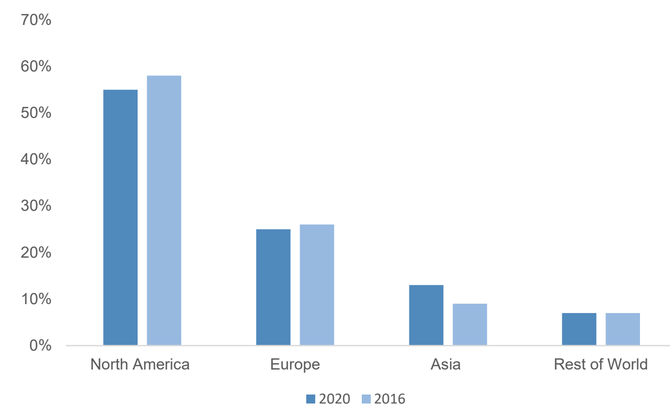
Predictions by AIMA Canada forecast the Private Debt market reaching $1 Trillion by 2020 as investor sentiment and expectations towards private debt remain strong and consistent (AIMA Canada Handbook 2019: A Report on the Canadian Alternative Investment Landscape).

Globally, North America accounts for over 50% of the world's private debt assets and investors (2020 Preqin Global Private Debt Report). So as this asset class continues to gain traction among Canadian institutional investors, ultra-high net-worth and family offices, those within the Canadian retail market aware of this shift can either enter or increase their allocations to private debt as a way to capitalize on their participation.

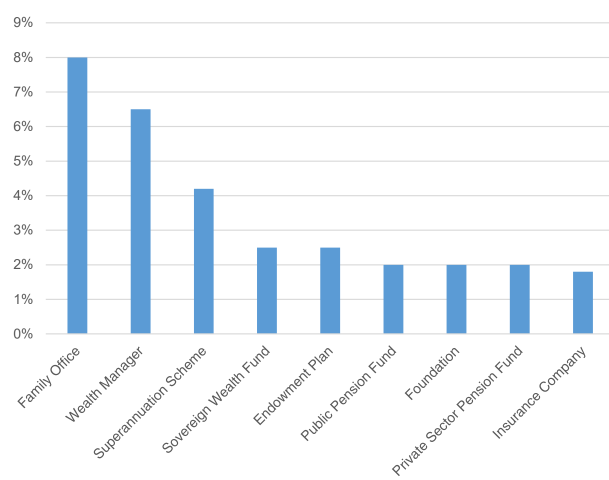
*Source: 2021 Preqin Global Private Debt Report



Investors in Private Debt by Type (%), 2020*



Investors in Private Debt by Location, 2016 vs.2020*



Investors' Median Allocations to Private Debt by Investor Type (As a % of AUM), 2020*

WHERE DOES PRIVATE LENDING FIT WITHIN A PORTFOLIO?

With many funds offering investors different risk/reward profiles that broadly look attractive relative to traditional fixed income options, private lending funds have increasingly made their mark on institutional and retail portfolios alike. Being able to provide investors with more secured positions in the capital stack in addition to other forms of private debt that may have more risk (such as junior unsecured debt), have made private lending an increasingly attractive option for portfolio diversification and varying return potential.

PROPOSED RISK RATING FOR PRIVATE LENDING FUNDS BASED ON S&P & CLIFFWATER INDICES**

LOW TO MEDIUM
Senior/Secured

MEDIUM
Unitranche

MEDIUM TO HIGH
Leveraged
Mezzanine
Distressed
(private credit)
Subordinated

The key consideration for assessing the risks in private lending is the seniority vs. subordination of the loan and the degree to which the loan has covenants that reduce the risk to the lender/investor by requiring disclosures and limiting the financial activities of borrowers. The least risky loans in the private lending industry are those that are senior in the capital structure and secured by collateral such as the equity of the corporate borrower, property, plant, equipment, or receivables. Senior and secured loans will be rated in the low-to-medium risk category, while unitranche loans will be rated in the medium-risk category. Unitranche loans are loans made by a single lender to a borrower that combines senior and subordinated debt into a single tranch (CAIA Association, AIMA/ACC.)

Additional considerations should be included to assess risk and determine suitability; such as the less liquid nature of the private credit marketplace, the average duration of the portfolio's holdings, the experience of the credit team, to name a select few. It is strongly encouraged that you discuss these considerations with your advisor.

**Source: CAIA Association, AIMA/ACC.

IMPORTANT NOTES

This information is communicated and/or distributed by Next Edge Capital Corp. (the "Company") identified above. PRIVATE LENDING FUNDS ARE ONLY AVAILABLE TO ACCREDITED AND/OR ELIGIBLE INVESTORS. This communication is not, and under no circumstances is to be construed as, an invitation to make an investment in a fund(s) nor does it constitute a public offering to sell a fund(s) or any other products described herein. Applications for fund(s) will only be considered on the terms of their respective Offering Documents (i.e. Prospectus, Offering Memorandum or Information Statement). Potential investors should note that private lending can involve significant risks and the value of an investment may go down as well as up. There is no guarantee of trading performance and past or projected performance is not indicative of future results. Investors should review the Offering Documents of the applicable fund(s) in their entirety for a complete description of the fund(s), its risks, and consult their registered dealers before making an investment. Opinions expressed are those of the author and may not be shared by all personnel of Next Edge Capital Corp. These opinions are subject to change without notice, are for information purposes only and do not constitute an offer or invitation to make an investment in any financial instrument or in any product to which the Company and/or its affiliates provide investment advisory or any other financial services. Any organizations, financial instruments or products described in this material are mentioned for reference purposes only, which should not be considered a recommendation for their purchase or sale. Neither the Company nor the authors shall be liable to any person for any action taken on the basis of the information provided. Some statements contained in this material concerning goals, strategies, outlook or other non-historical matters may be forward-looking statements and are based on current indicators and expectations. These forward-looking statements speak only as of the date on which they are made, and the Company undertakes no obligation to update or revise any forward-looking statements. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from those contained in the statements. The Company and/or its affiliates may or may not have a position in any financial instrument mentioned and may or may not be actively trading in any such securities. This material is proprietary information of the Company and its affiliates and may not be reproduced or otherwise disseminated in whole or in part without prior written consent from the Company. The Company believes the content to be accurate. However, accuracy is not warranted or guaranteed. The Company does not assume any liability in the case of incorrectly reported or incomplete information. Unless stated otherwise all information is provided by the Company. Unless stated otherwise this information is communicated by Next Edge Capital Corp.