01:
Wayne Lasky
executive chair
MaxCap Group

An alternative approach

Parting with tradition to navigate uncertainty

There is no denying that private credit, also known as private debt, is having a moment. According to PitchBook, global private debt institutional and retail investors' assets under management totalled US$1.8 trillion at the end of 2022, of which retail investors held US$200 billion. Meanwhile, the Reserve Bank of Australia (RBA) says non-bank lenders currently account for 5% of the Australian financial system's total assets; credit provided by managed investment funds topped $240 billion in 2022, less than 3% of the total credit issued.

According to MaxCap Group executive chair Wayne Lasky, while this figure may seem small now, the fact that traditional portfolio construction methods simply don't cut the mustard anymore will see the asset class boom.

Investors have been forced to source alternative avenues for returns as the traditional 60/40 model struggles against increased volatility, subdued growth, and higher interest rates. This has seen a surge in the number of investors allocating to alternatives, with private credit gaining a great deal of attention.

Diving deeper, it's commercial real estate credit that's emerged as most popular, Lasky says.

"If we think about it in simple terms, when you look at all the different forms of real estate out there, it requires funding in order to execute those different real estate strategies, so commercial real estate credit is the finance to execute those strategies," he explains.

"It's similar to the way the big banks do it, the non banks are offering complementary alternatives in market."

As for the role commercial real estate debt plays in an investor's portfolio, Lasky says it's most akin to a fixed income replacement. This is because it offers a known rate of return, a known maturity date, an absolute focus on capital preservation, and the assets typically generate a reliable income, Lasky says. Further, the more sophisticated managers in the marketplace will often provide a vehicle that allows investors to access some liquidity.

"For a very long period of time it's been hard to get outsized returns or alpha in public markets, so one really needs to look towards private markets... If you distil all those benefits down, I think it's a pretty compelling moment in time for this asset class because you've got quite a low risk profile, relatively speaking, and outsized returns, and there aren't many asset classes that are offering that," Lasky says.

It may surprise you to know that more than 50% of all commercial real estate debt in the US and UK markets is funded by non-bank lenders. The asset class is still very much in its infancy in Australia, but Lasky believes we're at the outset of something big.

The latest dominance of non-bank lenders in this space in overseas markets traces back to the Global Financial Crisis when regulators, focused on structural stability, told the banks that were too big to fail that they needed to deleverage their balance sheets. We saw it first in the US, then later in continental Europe and the UK, Lasky explains.

"What was surprising was that it took until 2017 for regulatory intervention, or the first of the three Basel III guidelines, to really be felt in Australia," he says.

"What this means is that we're much earlier cycle in Australia. The banks continue to deleverage their balance sheets and it's important they do so. The non-bank sector is moving in and starting to become a really important partner of the banks in the ecosystem."

By looking at the experience overseas, one can also see how successful and scalable the opportunity is here in Australia.

However, as we stare down the barrel of perhaps even further volatility and uncertainty in the year ahead, a diligent investor must question whether the asset class' performance can or will persist. In doing so, Lasky says it's best to ignore the immediacy of market gyrations as this can foster recency bias.

"At MaxCap we are much more fundamentally driven, which is to say that we're focused on the long-term drivers that are generational in nature and are highly likely to generate outperformance in a sector," he explains.

For instance, the flagship MaxCap Investment Trust has significant exposures to the living sector or residential market. This includes broadacre sub-divisions, high density living and purpose-built student accommodation. And while it might feel like we only ever hear gloom and doom when it comes to residential property, Lasky says the opportunities here are immense.

"We know that pre-COVID Australia's population growth was very high, much higher than the US and UK. We also know that post-COVID we are hitting new highs in immigration for all the same reasons people wanted to come pre-COVID," Lasky says.

But, as it stands, there's simply not enough housing to go around.

"[The supply has] clearly fallen off the edge of a cliff. We now face the prospect of arguably the largest undersupply of housing since WWII," he says.

There is also a supply issue when it comes to the industrials sector, particularly in logistics.

"Pre-COVID, we saw a big uptick in e-commerce and that was accelerated by the pandemic. However, as the world begins to grapple with deglobalisation, there's a big need for locally based distribution centres and the like, further increasing demand for this type of product," Lasky notes.

Meanwhile, other sectors are largely battling headwinds, he says.

"That's not to say there aren't some exceptional opportunities or some great operators and owners of that type of real estate, but one does need to be a little more circumspect and selective in approaching those sectors at the moment," Lasky says.

The MaxCap Investment Trust is a highly diversified portfolio of institutional grade loans. Investors can choose between two risk profiles, too. The defensive option is 100% first mortgages and targets a gross return of RBA cash rate plus 6.25%, while the high yield product is predominantly first mortgages with a mix of second mortgages aiming for RBA cash rate plus 9.5% gross returns.[1] Investors can also access liquidity, and the fund can rapidly deploy capital.

The product is the result of close to two decades of investor feedback, ensuring it is the intersection of investor needs and what market opportunities present.

To make the most of these opportunities, Lasky adds that it's important to consider Australia's macroeconomic position, saying what's needed is a seamless transmission of credit to credit-worthy borrowers with credit-worthy assets.

"You only need to walk down the street to see the different types of real estate there are and the different stages they're at. They all need different solutions at different moments in time," Lasky says.

"To have just a one-size-fits-all model is never going to work from a basic market perspective, and this is why it's important to have the diversity that the banks and non-banks provide." **FS**

1. As at 20 November 2023.

The quote

I think it's a pretty compelling moment in time for this asset class because you've got quite a low risk profile, relatively speaking, and outsized returns, and there aren't many asset classes that are offering that.

Watch the video on www.fsitv.com