# Annual Australian private debt market update for 2024

**After seeing more modest market growth and lower new loan volumes last year, the outlook for 2024 is more positive for deal activity**

**February 2024**

**Welcome to the 2024 EY Capital & Debt Advisory team's review of the private debt market in Australia. The coming year is expected to see a pick-up in activity after a slower year in M&A, project finance and real estate development-related financing in 2023. With a more stable interest rate and inflationary outlook, improved credit margins and existing private debt portfolios performing well, private debt lenders are poised to play a leading role as activity re-emerges this year. They also remain ready to support the capital needs arising from the economy-wide energy transition and related regulatory changes taking place.**

## The 2024 Australian private debt market in summary

The private debt market in Australia has weathered a challenging environment in 2023 due to a slowdown in 'new money' M&A, project finance and real estate development activity. Given these conditions, it is not surprising that our analysis of market size has seen more modest market growth at 7% compared to 32% in the previous year. However, with loan portfolios performing well, inflationary pressures settling and the end being in sight for the rate hiking cycle, private debt lenders remain well positioned for deal activity to improve this year.

We have estimated the size of the private debt market in Australia to be AU$188bn in assets under management ("AUM") at the end of 2023. This is in comparison to AU$175bn a year earlier and signifies a more modest growth rate. The total AUM result this year can be split into AU$112bn in business-related loans (all mandates excluding commercial real estate) or ~12% of the total business and corporate lending markets and AU$76bn in commercial real estate-related loans or ~16% of this total lending segment. The range of lending mandates and segments covered in our review included leveraged and sponsor lending, direct lending, middle-market, real estate, infrastructure, SME, special situations, distressed and venture debt.

The result this year, as in previous years, is based on a bottom-up analysis of the private debt funds and investors in the Australian market. We based our data on publicly reported or disclosed AUM or confidential private disclosures of AUM. This year's result saw the combination of a small group of new entrants being added to our list of funds and existing managers expanding their mandates and AUM, demonstrating a continued deepening of the market.

Some of the reasons for the more modest growth and slower deal activity included buyers' and sellers' disagreeing on asset valuations and stretched project feasibilities on infrastructure projects and real estate developments. However, as inflationary pressures and interest rates settled in late 2023, the outlook improved, and there is an expectation that activity will increase into 2024, even if off a lower base.

Given these observations and feedback provided to us by private debt lenders we have focused on the following themes in our 2024 review:

- The improvement in borrowing costs as interest rates stabilised and credit margins tightened, reflected in strong support for a number of late second half 2023 large ticket debt raisings.
- The economy-wide energy transition taking place, including the need for capital for investment in energy generation, technology and infrastructure, combined with the increase in climate risk reporting.
- Private debt lenders' portfolios holding-up well through both the recent COVID-19 and interest rate/inflation adjustment periods, combined with growth from new lenders entering the market and ongoing capital raising activity.

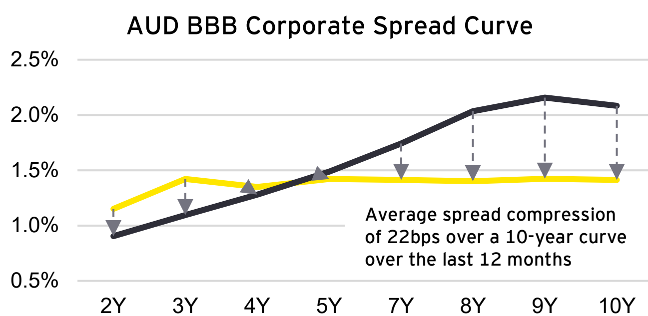
This year's review shows that the private debt market in Australia remains well positioned, even noting the slower and more cautious 2023. As the interest rate and inflationary outlook improves and the level of M&A, project finance and real estate development activity increases, we expect private debt lenders will continue to deploy capital in lending opportunities with strong fundamentals and return to previous growth levels.

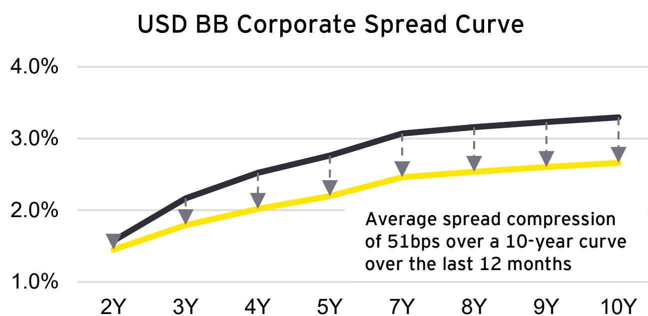
## Improved borrowing costs to assist with activity levels in 2024

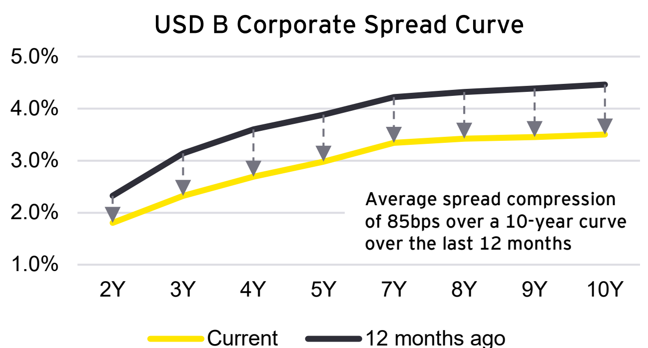
After much of 2023 saw lower 'new money' deal flow, the last few months of the year saw an improvement as interest rate expectations stabilised and credit spreads continued to tighten. This was most evident in public bond markets and institutional-level bank and private debt lending markets, whilst more bespoke, leveraged and middle-market loans still seeing a return premium for the illiquidity and underwriting complexities involved.

As reflected in the all-in AUD BBB, US BB and B rating level corporate bond spreads (or credit risk margin) in the chart below, there has been an improvement of some 20-90 bps in the last 12 months. Whilst only a proxy for bank and private debt lending, it does reflect the trend for the pricing of credit.

### Improved credit pricing




*Source: Bloomberg*

As the year progressed, we also saw increased competition and tighter pricing in the bank lending market, particularly for higher quality middle-market or investment-grade corporate deals. In the private debt markets, many deals still attract a price premium; however, some more attractive deals in preferred sectors backed by good sponsors saw improved terms and pricing. In some deals, there was even a 'fear of missing out' from lenders, particularly as the depth of lenders in the market for these deals continues to grow.

As the year progressed, some examples of these well supported private debt lending opportunities, included:

- **AirTrunk:** The AU$4.665bn sustainability-linked loan for the data centre business included a syndication to private debt lenders.
- **InvoCare:** The Australasian funeral services provider InvoCare was acquired by TPG Capital with an AU$800mn unitranche loan backed by a wide syndication of private debt lenders.
- **AUB Group:** The insurance broking business launched a AU$750mn multi-tranche loan and then increased the loan to AU$850mn. The wide syndication included private debt lenders.

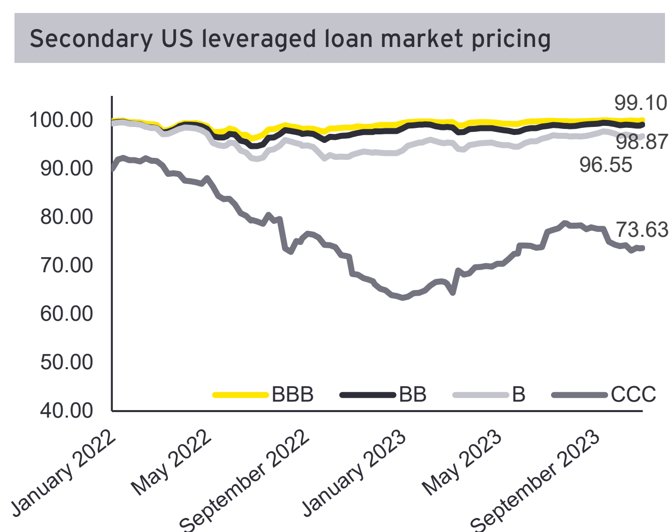
This even included more cyclical and ESG impacted industry sectors, albeit with leverage levels, terms and pricing more conservatively set, with examples including:

- **Zimmermann:** Advent International acquired a AU$1.5bn majority stake in Zimmermann in August, backed by private debt lenders with a AU$230mn unitranche loan.
- **Whitehaven Coal:** The US$1.1bn loan of Whitehaven Coal attracted more than 10 private credit lenders to refinance a US$900mn acquisition bridge loan.

As we look forward to 2024, whilst the economic outlook remains mixed and subject to change, the improved pricing and appetite from lenders should start to build equity sponsor confidence in their ability to complete M&A and proceed on new infrastructure and real estate development activity.

Aligned to this trend is the improvement in secondary loan valuations as reflected in the chart below (based on US leveraged loans). On this basis secondary valuations of performing loans have improved to closer to a par level (or the face value of the loan), whilst non-performing loans remain lower as reflected in the 'CCC' line below.

**Secondary US leveraged loan market pricing**




*Source: Bloomberg*

In Australia there is more limited data on the secondary market and there is less loan trading, so the US provides a useful reference for the valuation improvement observed in Australia (also based on industry feedback and secondary trades completed here). The valuation of secondary loans supports the broader thematic of the increasing depth in the market and less deal activity, seeing greater demand for the existing loans available.

The trend in Australia for trading of stressed loans is in line with the movement in the 'CCC' line above and the returns of special situations and distressed debt investors (in the mid-teens range and above, often with PIK or warrants upside). For distressed loans these are typically valued on a more specific basis to the relevant situation involved, likely below the 'CCC' line, with some increased activity at this end of the lending market.

## The importance of private debt capital to the energy transition

With a major theme of the COP28 conference in Dubai in November 2023 being the material levels of capital needed to finance the economy-wide energy transition, this sees a need for both traditional bank and private debt capital markets to play a role. Debt markets have already shown a willingness to support climate related initiatives and funding needs. To date this has largely been through project financing of renewable projects, ESG outcome linked loans and a shift in lending appetite to match climate impacts. This willingness is likely to continue in the coming years, especially as private capital is needed to complement potentially limited Government funding due to ongoing budgetary pressures.

Separately, a major shift emerging in corporate reporting expected to contribute to this shift will be the draft Australian Sustainability Reporting Standards. Under these new standards large corporate entities (including banks) will be required to report on climate impacts in FY25, with the next two tiers of corporates being included in FY27 and FY28 respectively. Once implemented, these will require significant disclosures of climate-related Governance, Strategy, Risk Management and Metrics & Targets.

Some of the more significant requirements under these reporting standards will include:

- Disclosure of Scope 1 and 2 greenhouse gas emissions in the first year of reporting and Scope 3 in the second year of reporting.
- Scenario analysis including at least 2 different scenarios, one of which is a 1.5 degree change in Global temperatures.
- Evolving independent assurance requirements on auditors, starting with limited assurance over Scope 1 and 2 emissions in the first year of reporting and evolving to require reasonable assurance over all climate-related disclosure over time.

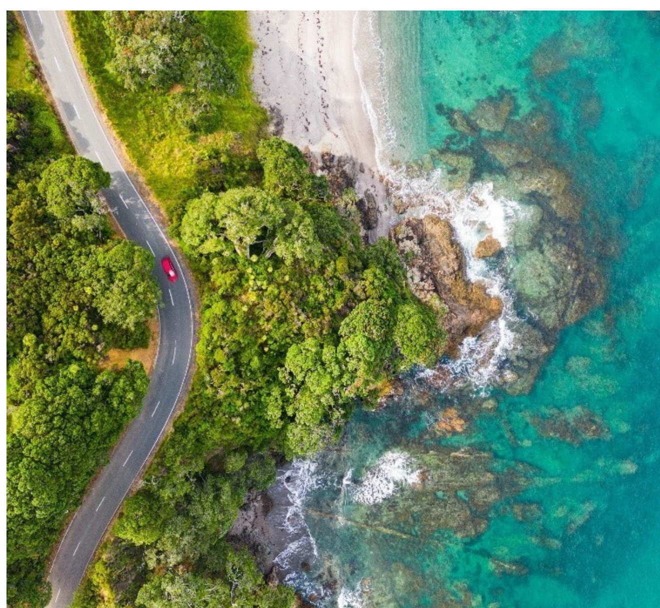
This shift in corporate reporting will further accelerate the current climate related investment targets being set by equity investors and banks. For example, many super funds and institutional investors have already set 'emissions reduction' target dates with respect to their equity investments, including reducing exposure materially by 2030 and to 'Net Zero' beyond this.

Complimentary to this will be the recently implemented Federal Government Safeguard Mechanism, with this mechanism requiring businesses across a broad range of industry sectors (including energy generation, mining, oil and gas extraction, manufacturing, transport, and waste) to cut emissions on average by 4.9% every year.

Combining all of these initiatives, the expected shift in investor and bank appetite in coming years is not to be underestimated. Potential impacts of the initiatives on corporate borrowers could for example include:

- As banks have increased information on the climate exposure within their loan books, this new information may influence lending decisions. The current limits on lending to the coal sector could quickly shift to a reduction in lending based on a customer's level of carbon exposure or emissions.
- As businesses improve their reporting and monitoring of climate risks, and are captured by the Safeguard Mechanism, their investment decisions will change based on a need to reduce emissions and/or exit parts of their operations where targets can't be reached.
- Private debt lenders will have an opportunity to 'fill the gap' in the coming energy transition, by assisting with new investment capital, refinancing needs, and to acquire loan books and lending businesses as banks accelerate their reduction in climate risks.
- The flow-on impacts to refinancing risk and equity valuations as the combined impacts of these shifts in capital availability and reporting measures become clearer and investor views adjust.

There is much to unfold in this area as the draft Australian Sustainability Reporting Standards are finalised and businesses and banks begin the journey of increasing climate-related reporting. However, there is no doubt that the combination of the related regulatory changes, the shift in investor expectations and the considerable levels of capital needed to support the energy transition creates an opportunity for private debt lenders to play a major role in coming years.

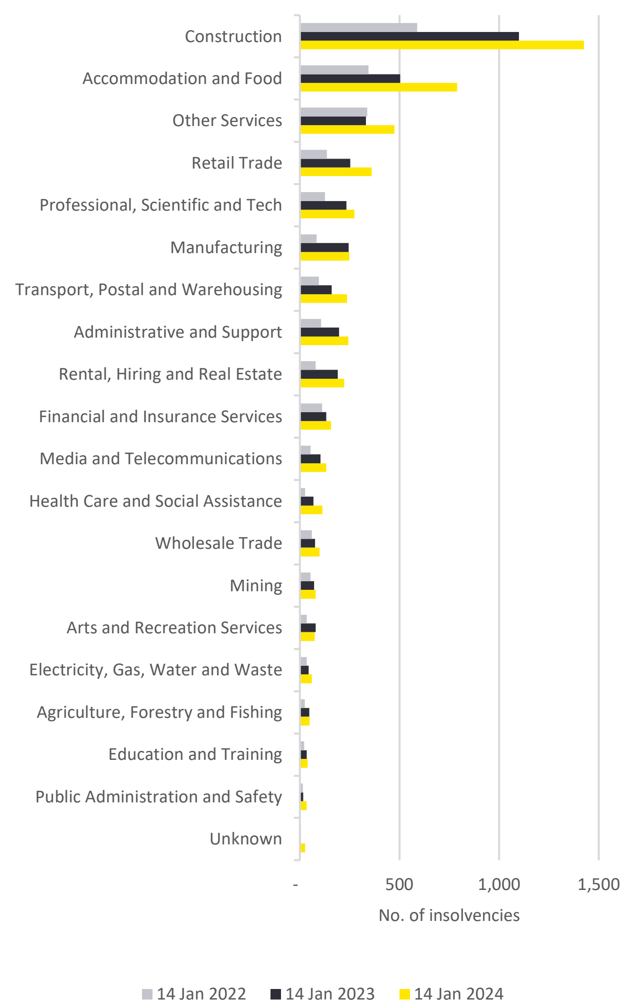


## Portfolio quality supports future market growth

The portfolio performance experienced so far by private debt lenders in Australia is that they have managed well through recent events, such as COVID-19 and the interest rate and inflationary shifts through 2022/2023. Based on industry feedback, existing private debt loan portfolios have performed relatively well with credit issues more localised to specific companies and sectors and financiers less exposed to more cyclical and challenged sectors.

Corporate insolvency trends in Australia also show a significant increase from 2021 through to last year in 2023 as reflected in the chart below. However, industry feedback indicates that much of this increase in volume relates to small companies being wound up by the ATO and other statutory bodies and a "catch-up" of corporate insolvency numbers from the very low levels in 2021 and 2022. The most significant increases have been seen in areas such as construction (mostly builders rather asset owners or developers), accommodation, hospitality and food, business services and retail trade.

### 2022, 2023 and 2024 Australian corporate insolvencies by industry




*Source: ASIC Insolvency Notices*

Where problems have emerged, for example in leveraged loans and real estate development, private lenders have been able to work with sponsors to agree suitable loan amendments, extensions of time, equity contributions and/or deal restructures. Some of these situations have benefited from the more recent moderation in inflation levels and construction costs, along with the better than forecast consumer spending levels and real estate values.

There have still been loan defaults and insolvencies for those unable to work through the challenges within their businesses, although, with these levels remaining manageable and appearing to be in line with the traditional bank lending markets. With the continued economic difficulties heading into 2024, there is still caution needed and we expect private debt lenders to remain selective in this environment.

However, the stable loan portfolio experience to date combined with the growing market space for private debt lenders in Australia certainly provides a positive platform for sustainable growth in coming years.

## The 'silver lining' for 2024

With an improved outlook for M&A, project finance and real estate development activity in 2024, private debt lenders in Australia are poised to continue to play an important role and see the resumption of the long-term growth trends seen in recent years. In addition, the global energy transition creates a range of wide-ranging funding opportunities for these lenders to play a role in this community imperative.

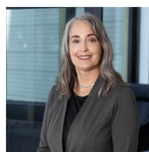
We still expect lenders to remain cautious as economic conditions remain mixed, to ensure they maintain their strong track records. However, as reflected by the deals completed in late 2023, it is likely funds will continue to deploy capital in a range of emerging lending opportunities, demonstrating the continued flexibility of capital available from this market.

If you would like to learn more about the Australian private debt market and what it can offer your business or any of the other topics discussed in this document feel free to contact us.

## EY contacts

Here to help your needs in any financing situation

Sebastian Paphitis
Partner, Capital & Debt Advisory
EY
Mob. 0402 274 804
E. sebastian.paphitis@au.ey.com



Lara Gaede
Partner, Financial Services Climate Change and Sustainability Services
EY
Mob. 0488 008 801
E. lara.gaede@au.ey.com

Lara has shared her insights based on her experience in assisting clients establish ESG governance practices, understanding key stakeholder needs, determining framework(s) and metrics to report and assist in the communication of sustainability information and assurance over ESG metrics and reports.

## EY Capital and Debt Advisory - background

The Australian team includes professionals with working experience within institutional and corporate banking, investment banking and structured financing across the debt capital markets spectrum.

The strong advisory EY capabilities support clients broad deal management from debt and capital raising to capital management as well as tailored advice for a range of funding needs including:

- Refinance of existing debt facilities on improved terms and flexibility
- Structuring and raising debt platforms to help improve and align funding with strategic business objectives
- Exploration of alternative debt markets to diversify capital structure and support growth and acquisition plans
- Review of capital structures alongside credit analysis of loan portfolios as well as short- and long-term shadow credit ratings



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