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Markets

Blackstone Says Private Credit Is Coming for Asset-Based Debt

- Rob Camacho expects lenders' capabilities in the space to grow
- Sees a 'symbiotic relationship' between banks, private credit

by Carmen Arroyo
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Private credit lenders are just getting started in the world of consumer and asset based finance, according to Rob Camacho, Blackstone Inc.'s co-head of asset based finance within the firm's Structured Finance Group.

"Today, we are a very small portion of the whole asset based finance market," he said in an interview. "There's a lot of room to run."

Camacho spoke over a series of interviews that ended on Sept. 6. Here are some highlights of the conversation, which have been condensed and edited for clarity.

Asset based finance has become the hot new thing across credit markets. Why is that?

That's certainly true and has to do with the current environment. A couple of years after the start of my career in 2004, the Federal Reserve brought rates over 5%, so investors were getting real yield in fixed-income. But that was short-lived. We then went through more than a decade of near-zero interest rates. This is the first time we are seeing higher real yields. All of a sudden, you can get high returns for investment-grade paper. That hasn't happened in almost two decades.

Second, some buyers such as insurance companies tend to prefer longer duration to match their liabilities. That dynamic has also made asset based finance much more important for firms such as ourselves, who manage money for insurers.

The regional bank asset sales have also played a role in this. What do you see coming in the next few months?

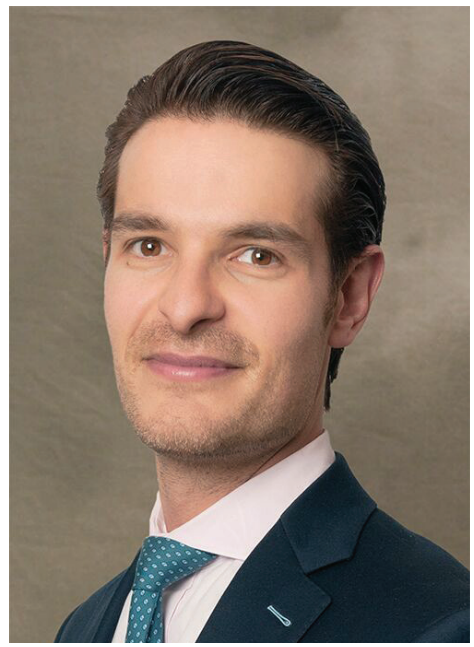
A lot of what we're doing is partnering with regional banks. They have internal loan origination capabilities through relationships with local platforms that make auto loans, home improvement loans and any other product that is important to their deposit base. We can buy those loans, but we can also partner with them to augment their business, meaning they originate the same or more, but don't keep all of it on their balance sheet.

Many banks are calling us to partner with them to continue serving local consumers. This generates fee income for the bank, and provides our clients high quality loans.

As the cost of private capital is higher and there's just less of it around, will consumers end up struggling?

Something that deserves acknowledgment is how smooth this volatility has been for consumers. In 1994, when interest rates spiked, there was a lack of credit that made the Fed cut rates by July of '95. This year, we've had both bank failures and rapid interest rate increases. And now we are seeing a symbiotic relationship between banks and private credit, where lending gaps are being filled instantaneously.

From my perspective, it's been remarkable that we haven't had a larger contraction of credit at the consumer level. That's probably one of the things



Rob Camacho *Source: Blackstone*

encouraging a lot of people to change their calls to a soft landing – if credit was unavailable and with the consumer being two-thirds of the economy, we might have a different outcome.

The volatility of the asset backed securities markets this year and last year also contributed to more companies turning to private lenders. But is the trend here to stay?

The public ABS market is a great option for originators to distribute risk and raise capital. But we are talking with companies and banks who use ABS about how to diversify their funding models. We've bought loans from these firms, be it consumer or other types of loans, when the securitization markets were active.

The volatility in the ABS market last year reinforced what we've supported for a long time: The importance of having a diversity of funding sources such as securitization, forward flow and balance sheet. Partnering with private credit managers that can provide capital from longer-dated insurance liabilities is a great way to achieve this, where there isn't the dynamic of demand deposits that can disappear overnight. We believe that every originator should be thinking this way.

Private credit took on corporate markets first and is now handling multi-billion dollar financings, competing with banks for those transactions. Will we see something similar in asset backed financings?

I am biased, of course, but just as an anecdote: We've done several transactions over the past year close to a billion dollars, and one that brought our commitment over that mark. So, the capabilities of private debt within asset based finance are just going to expand.

Large-scale players who need asset based debt will prefer to work with a single manager able to commit to those transactions. It will become more appealing over time to borrowers and investors, especially if the current yield environment persists. Today, we are a very small portion of the whole asset based finance market. There's a lot of room to run.

Right now, most of the companies that borrow this type of debt are small- or mid-sized firms with barely any corporate debt, right?

You're hitting the nail on the head. A loan originator's largest liability is their ability to sell loans and continue their business. Therefore, originators tend to have very conservative capital structures. We're partnering with them over time and it's important they can service their customers. That's really what we care about. Our customers are insurance companies and pension funds. Their customers are the consumers, and we need those consumers to have a good experience.

But to be clear, it's not just consumer loans – it's everything. We have aircraft loans, fund finance and renewables like commercial and industrial solar. We have quite a large business of financing critical infrastructure such as cell towers as well as intellectual property.

We're financing all those things, and we really have just scratched the surface. As interest rates continue to remain where they are, more and more companies are going to be more efficient with their balance sheet, so many more assets are going to become financeable.

Do you think we will see bigger originators, even ones that tap the investment-grade corporate bond markets, look for this type of financing from private lenders?

A lot of folks that utilize asset based finance are companies that don't have access to the broadly syndicated corporate bond market. However, I think you will see investment-grade companies tapping the asset based debt market. We certainly would love to engage in conversations with corporates and seek out places where we can provide flexibility. The corporate bond market is very standardized and that's what makes it great and low cost.

Still, there are companies that obviously have very specific assets on their balance sheet or a specific need where a financing solution can be customized. We can offer that.

I think we are going to see some companies be quite strategic around financing and start to say, 'Instead of issuing this huge corporate bond and risk our credit rating, why don't we call private lenders and get customized solutions for these assets?'