IPM monthly blog

Our monthly insights into private markets – **June 2024**

Real estate

Commencement of interest rate cuts to support market

Outside of Japan, central banks are cautiously looking to roll back the higher interest rates they have used to counter the inflationary surge. Several have started to cut interest rates, including the Bank of Canada, the Swedish Riksbank and, most notably, the European Central Bank. By contrast, the US Federal Reserve may now only make one rate cut this year, with more expected in 2025.

In the UK, in April and May real estate capital values were stable according to MSCI data. Further falls in office values were offset by rises in the other sectors of the market. This followed declines across sectors in 1Q24, of 0.8% QoQ for the market overall. If the stabilization in values does mark the bottom of the UK market, as we expect, others look set to follow.

Falling interest rates and a levelling off in capital values should boost investor sentiment and provide a pathway to increased real estate transaction activity in the second half of the year and moving into 2025. Moreover, a levelling off in the market should present attractive opportunities for investors and give them confidence to deploy new capital into real estate.

Infrastructure

Upcoming US elections and the risk to clean energy

In our *2024 Infrastructure Outlook*, we highlighted how negative headlines and pushback against clean energy around the world are not new. It is simply a continuation of headwinds that the industry has always faced and tackled. Every time something negative happens (e.g., end of feed-in-tariffs in some European markets, US import tariffs on solar panels etc.), sentiment turns doom-and-gloom, yet the industry always finds ways to adapt and innovate.

With the upcoming US elections, that sense of uncertainty has returned. One of the biggest questions in our industry now is whether a Trump presidency would negatively impact clean energy in the US, especially through the potential repeal of the Inflation Reduction Act (IRA), which is the most important clean energy legislation in US history. We believe investors can find some comfort in the following.

First, clean energy receives bipartisan support in the country, and the IRA disproportionately benefits the red (Republican) states. According to Bloomberg, Florida and Texas are the largest beneficiaries, while red states will attract over USD 300 billion in solar, wind and storage investments (*Link*) through the end of the decade due to the IRA. Any repeal of the IRA will therefore face severe local resistance, especially given the amount of investments that have already begun.

Second, the IRA is as much industrial policy as it is energy policy. A key feature of the IRA is that it supports domestic manufacturing facilities through tax credits, a policy that is popular across all political parties. It would therefore be difficult to just get rid of the IRA based on this feature alone.

Finally, the US political system is almost intentionally designed for inaction. Aside from the presidency, Republicans will also need to control the Senate and the House of Representatives in order to push through any major changes. Current forecasts show that Democrats have a higher probability to control the House of Representatives. Even if these forecasts turn out to be wrong, the previously mentioned points will likely still prevent an outright repeal of the IRA (although parts may be slimmed down).

We therefore maintain an optimistic outlook on the clean energy industry. At the end of the day, the industry has shown significant resilience to macro and policy changes in the last few decades, and with demand for clean energy remaining strong, we believe infrastructure investors with long term investment horizons can look past the short-term political uncertainty.

Private equity

Private equity performance steady into mid-year

Private companies continue to deliver solid fundamental performance in the first half of 2024, despite some macro headwinds which could slow growth in the coming quarters. These headwinds include borrowing costs, persistent inflation, cost pressures, and weaker consumer spending. Similar challenges have been noted in recent public company earnings discussions. However, PE-backed companies benefit from the typical value creation levers of improved management, enhanced processes, and technology upgrades (including AI), as well as a long-term perspective.

One significant overhang for private equity is interest rates: cuts are now looking less likely in 2024, with the side effects of post-COVID rate hikes lingering into next year. Interest rates are a key input in private equity valuations. Since return targets are relatively constant, higher borrowing costs reduce underwriting expectations, prompting buyers to seek lower entry prices to compensate.

As a higher-for-longer rate picture comes into focus, we anticipate a growing acceptance of a valuation reset for private companies. This will bring short-term pain for funds which have maintained elevated marks, but could serve as a catalyst for more companies to change hands in the medium term, creating much needed liquidity.

The fundraising backdrop is becoming more challenging as the number of funds in market has grown considerably in the past year. Absolute capital raising is still healthy in a historical context, but has been concentrated in the largest funds. Unlike the access-constrained 2020–2021 environment, sponsors are now competing fiercely for capital commitments. Secondary markets are active in both GP-led and LP-led transactions, and we expect attractive deal flow in the coming quarters as the exit environment for private companies remains muted.

Pivate credit

Market update: Pluralsight

Earlier this month, the relatively benign corporate credit cycle to date was jolted by the private credit industry's first high profile credit event in 2024 – Pluralsight. Pluralsight is an education tech company that offers online upskilling courses across a variety of industries. In June 2024, Vista Equity Partners wrote off their equity position in Pluralsight to zero following a USD 3.5 billion take-private acquisition in 2021. Per Axios and other industry reports, Vista wrote off their position due to company underperformance resulting in them being unable to effectively service their debt.

Over the past few years, Pluralsight has faced headwinds with rounds of layoffs and recently replacing its founder and CEO in April. The original acquisition was funded with USD 1.3–1.5 billion in debt financing that was syndicated to a number of large-scale direct lenders with the debt placed in various business development companies (BDCs). Per a KBRA note released on 5 June 2024, USD 700 million in first lien loans are held across seven BDCs (position sizes ranging from 1% to 2.5%). As reported by Pitchbook, lenders on the loan include Blue Owl Capital, Ares Management, Golub Capital, Goldman Sachs Asset Management, Oaktree Capital Management, BlackRock and Benefit Street Partners.

The potential impact on these BDCs is yet to be determined, though some lenders have already started to remark their loan positions. For lenders, the situation continues to develop. as it appears that loose covenants have allowed Pluralsight to move IP collateral into a new subsidiary, and use those assets to get fresh financing from Vista, in what is known as a drop-down transaction where collateral is reappropriated away from existing lenders. The situation is less than ideal as Vista has engaged in an aggressive stop-gap refinancing at the expense of creditors, and has alarmed private credit investors. To date, this type of transaction has occurred numerous times in the syndicated loan market but has been a far less common occurrence in the private credit market.

So, what does this mean for the broader private credit industry? Early indications seem to point to this being largely an idiosyncratic event with limited repercussions outside of the lenders involved. For this deal, the exact impacts will be seen in the coming months as positions are remarked and investors react to potential principal impairments. However, we have observed increasing competition between the syndicated leveraged loan market and the large end of the corporate direct lending market. As competition between these two markets persists, this could put additional pressure on documentation for certain private credit deals as lenders aim to compete for transactions. Regardless, it serves as a cautionary tale for how lenders can be impacted by transactions with loose covenants or documentation.

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