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Pensions See Opportunities in Distressed Debt as Businesses Struggle

By Bridget Hickey
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A number of pensions have been seeking distressed debt managers in recent months to take advantage of opportunities as companies struggle with fallout from the coronavirus pandemic.

The $2.3 billion Marin County Employees' Retirement Association (MCERA) has been advised by its general consultant Callan to add an opportunistic allocation of approximately 4% of total plan assets, or about $100 million, to distressed or dislocation funds, board documents from Aug. 12 show. Callan made the recommendation based on its assessment that the market was entering another distressed cycle, as defined by spreads in excess of 1,000 basis points, according to a presentation the consultant gave MCERA's board.

"Several industries – not just those directly impacted by COVID-19 – will likely experience higher defaults," Callan advised in the presentation.

MCERA's retirement administrator Jeff Wickman told FundFire in an email that the pension was waiting to interview three prospective managers at its investment committee meeting on Sept. 17 before deciding whether to move forward.

The $4.5 billion Vermont Pension Investment Committee (VPIC) is building out its private debt program, with the pension's consultant NEPC suggesting that the investment committee consider opportunities in distressed debt "given the current global economic environment," as first reported by FundFire's sister publication MandateWire. NEPC rated the outlook for distressed debt as "positive" and suggested that the pension consider “strategies that can allocate capital opportunistically between geographies and asset classes” and “favor distressed-for-control/influence strategies that can succeed in benign and highly distressed markets,” a private credit pacing plan prepared by NEPC and dated June 23 shows.

The $29 billion Texas County and District Employees Retirement System (TCDRS) increased its target allocation for distressed debt from 2% to 4% at a board meeting on June 25, as previously reported by MandateWire. The pension acted on advice by investment consultant Cliffwater.

The $12.7 billion New Mexico Educational Retirement Board (NMERB) also committed funds to distressed debt in April on the advice of NEPC, approving a $75 million commitment to Beach Point Tactical Opportunities Fund for an opportunistic credit strategy focused on distressed debt, special situations and private equity, MandateWire reported.

“There are countless opportunities to invest in distressed debt in the current environment, and this is an opportunity to take advantage of that without having to deal with new managers that the [NM]ERB is unfamiliar with,” NEPC partner Allan Martin told the board at an April 16 meeting, MandateWire’s reporting shows.

Several pensions have also committed capital to Oaktree Capital Management’s Oaktree Opportunities Fund XI, which is seeking $15 billion to become the largest distressed debt fund in history, Bloomberg reported.

The $83.8 billion Virginia Retirement System (VRS) committed $300 million to Oaktree’s Fund XI at a meeting on Aug. 12, board documents show. The $2.4 billion Oklahoma Police Pension and Retirement System (OPPRS) committed $30 million to Fund XI at a meeting on June 17, board minutes show. The pension also committed $30 million to another distressed debt fund, CarVal Credit Value Fund V, managed by CarVal Investors.

"It's a popular idea," says Michael Rosen, principal and CIO at Angeles Investment Advisors, a consultant and advisor. "That doesn't mean it's a bad idea. But it probably means that it's not as attractive as many people think it may be." Rosen cautions that there is no way of knowing if the distressed opportunity set is as large or as attractive as some have predicted it to be. "For the last decade or so, we've heard of the coming default cycle – the large wave of defaults that will present opportunities for high returns for investors willing to step into that opportunity set," Rosen says. "But it hasn't happened. There's no law of physics that says that a default cycle has to happen at a certain time in a certain magnitude."

Timing is key, says Benjamin Patzik, v.p. and head of portfolio strategy and solutions at Segal Marco Advisors. "If you invest too early, you could be sitting on capital that's not being deployed, but you're being charged on the commitment," Patzik says. "If you don't commit soon enough, then you can miss the opportunity altogether." These types of distressed investments also come with a great deal of credit risk and default risk, he adds. "It's very much incumbent upon a pension investor and/or their consultant to identify managers that have either a dedicated focus in this specific area and/or a proven expertise in underwriting these types of opportunities."

There are a record number of distressed debt funds in the market, June data from Preqin shows. The alts database tracked 60 new distressed funds in the market targeting raising $72 billion, more than double the amount of targeted fundraising at any point in 2019, Preqin noted in a report.