Alternative options spur European lending drive

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Regulatory change and deleveraging by European banks is creating a fast growing new market for alternative lenders, according to Alcentra head of European direct lending and mezzanine investments, Graeme Delaney-Smith.

Commenting on the current European lending landscape, Delaney-Smith said the aftermath of the global financial crisis saw a plethora of new regulations applied to European banking institutions. These include capital adequacy measures such as Basle III which have encouraged banks to improve their balance sheets, decrease leverage and, in some cases, withdraw from lending to mid-market companies.

"What happened on the back of the financial crisis was that the supply of capital coming from the banking sector dried up significantly. The banks are now working to improve their balance sheets post the financial crisis and we believe they still have some way to go," he said.

According to Delaney-Smith, changing banking attitudes to risk and a reduction in lending to medium-sized companies have increasingly created a shortage of capital in a European loans market heavily dependent on the banking sector.

"The problem for Europe, unlike the US, was that it had never really established any real lending alternative to the banks. The loans market was almost totally focused on banking sector supply," he added.

Increasingly alternative lenders such as Alcentra have moved to fill the void and Delaney-Smith believes this market can only grow over time.

"From 2012 onwards we have seen the economic backdrop start to improve and we are getting more and more demand and calls for capital. There has been a fair amount of capital raised in the European market already but it is still far outweighed by the opportunities available across the market and there is a long way to go. According to S&P figures[1] mid-market companies in Europe will need somewhere between €2.7-€3 trn over the next five years for refinancing and to fund growth," he said.

While the alternative lending market was once dogged by negative headlines about 'shadow banking,' Delaney-Smith said it has gained credibility in the European market over time. "The market has grown very quickly from a low base. In the first couple of years there was some concern about the credibility of lenders. But as more deals were undertaken alternative lenders have now very much established themselves and competition is growing," he added.

According to Delaney-Smith, one of the key drivers of growth in the market is private equity companies – which drive significant mergers and acquisition business in Europe. From a geographic perspective, he said that while the UK had been a 'front runner' in the alternative lending space, accounting for about 40% of deal count, other markets such as France and Germany were also showing significant growth.

1 S&P Banking Disintermediation in Europe 15 October 2015.

Delaney-Smith added that other European jurisdictions such as the Scandinavian markets and Benelux have also seen increasing deal flow and even peripheral markets such as Spain and Italy now offer significant potential for lenders and investors in the loans sector.

"Some of the more peripheral European economies are still important markets to us and countries such as Spain and Italy have taken steps to introduce legislation to improve their legal position on loans which helps in terms of general lending activity," he added.

Commenting on future prospects for the loans market, Delaney-Smith said Europe still had some way to go to catch up with the maturity of the US market, but that all indicators pointed to steady growth ahead.

"Lots of comparisons are made between the US and Europe loans market but I think that over the next 6 to 10 years we will see the development of a healthy institutional market for loans. This will most likely involve a degree of natural selection among the financial institutions that raise the money, but over time I believe Europe will move away from its dependence on the banking model to fully embrace alternative lenders," he said.

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