

ASSET BASED LENDING

EXPERTISE ON ASSET BASED LENDING - II



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How immune are asset based lending investments under present market conditions?

That depends on whether the investments are traded on a secondary market.

Liquidity is the issue.

Direct lending in the private sector with no secondary market will not be "affected" by the current market conditions. However, it doesn't mean that these investments are of any better quality. They are less liquid by definition – i.e. there is no "market" for them. Loan duration and collateralisation determine liquidity. Investments made in asset backed securities, packaged or pooled loans and/or corporate credit where there is a tradable market will always be subject to the supply and demand of that market. But again, it doesn't mean that the underlying loans are of better or lesser quality.

Which asset based loans are at a higher risk of defaulting or under performing under these market conditions? Why?

From a hedge fund point of view, investments made with funds that have exposures which are marked-to-market will be hurt. At present the market is pricing default rates very high. This doesn't mean that they actually will be so. US sub-prime mortgages issued in the last 18-24 months that are traded via RMBS are being priced the most aggressively.

Would you say collateral "valuation", in the asset based lending space, needs to be reviewed ... in what way and why?

Not really. The process is relatively simple and it is highly, if not totally, dependent on duration. With loans of very short term duration, say 3 to 6 months, no collateral valuation reviews should be necessary. Loans originated 2 years ago or more are different. Therefore, collateral valuation or "re-valuation" is dependent on duration.

Under normal market conditions asset based lending is meant to be a non-correlating strategy... has it/ could it begin to show signs of correlation to other assets/strategies... as, under abnormal market conditions – a portfolio's positions are being increasingly unwound to secure liquidity?

Again, it is an issue of the capital markets. If the strategy is removed from the capital markets then it can't be correlated to the capital markets. For example, a portfolio of 90 day trade receivables has nothing to do with any capital or derivative market. Strategies such as media library finance, inventory finance, factoring, etc. are the same. Strategies that have market exposure will be subject to the supply and demand of the relevant market. Even during the recent events in the market historical correlations to the performance of other strategies are extremely low.

If at all, when and what financial conditions could potentially cause asset based lending investment performance to "back track"?

Any situation that would reduce the demand for short-term funding will cause a slowdown in deal flow. This is a micro-economic issue and not a hedge fund strategy or performance related issue. A hedge fund would have to return money to investors in order to avoid a cash drag. On the macro side an extreme recession, or depression, would hurt asset-based lending.