Cheyne Capital Management: High-impact debt investor

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The growth of non-bank lending in Europe is often mentioned as a trend that could radically transform the European economy. This remains to be seen, but if banks gradually give some of their dominance in the lending market, then firms such as Cheyne Capital Management stand to benefit.

Cheyne was founded in 2000 by Jonathan Lourie and Stuart Fiertz, two fellow graduates of Dartmouth College, an Ivy League university in New Hampshire. Lourie took the role of CEO and CIO, while Fiertz is Cheyne's president and director of research. They had previously worked for Morgan Stanley in London, setting up and running the bank's convertible bonds business for a decade.

At the time there was probably nothing unusual about two colleagues leaving a large investment bank to set up a hedge fund. Having chosen London as their base, the pair got caught up in an important structural trend. In the nearly two decades since its foundation, Cheyne has become one of the largest providers of specialised credit in Europe.

The growth of non-bank lending is likely to face resistance by businesses themselves, which may be reluctant to partner with non-bank entities. However, regulators are exerting pressure in favour of this trend by reducing the capacity of banks to lend. Fiertz points out that the IFRS9 accounting rules implemented in 2018 force banks to put up reserves against an expected loss for any credit that has broken a covenant. This creates an opportunity for external investors to buy the 'stressed' credit asset. Fiertz estimates the volume of these credits amounts to about €250bn at the European level and argues that stressed credit is a different proposition to investing in non-performing loans (NPLs). "We would sit down with borrowers, discuss the debt terms and the new liquidity line, giving every incentive for them to work with us. It is effectively a consensual restructuring that avoids the court process," says Fiertz.

STUART FIERTZ (above right)

- 2000-to date: Co-founder, president and director of research at Cheyne Capital Management
- 1991-2000: Customised portfolio strategies and credit research in convertible bonds at Morgan Stanley
- 1988-90: High-yield credit analyst at Lehman Brothers
- 1986-88: High-yield credit analyst at Merrill Lynch
- 1984-86: Equity research analyst for the Value Line Investment Survey
- Council director of the Alternative Investment Management Association (AIMA)
- Chairman of the AIMA Alternative Credit Council
- Founder and trustee of the Standards Board for Alternative Investments

JONATHAN LOURIE (above left)

- 2000-to date: Co-founder, CEO and CIO of Cheyne Capital Management
- 1985-2000: Responsible for the creation and development of the convertible bond management practice at Morgan Stanley

CHEYNE CAPITAL

- AUM: $22.5bn (€20bn)
- Founded in 2000
- Strategies: real estate debt, social property equity, investment grade corporate credit, strategic value credit (stressed debt), equity-linked investing
- 150 staff
- Offices in London, New York, Zurich and Bermuda

Cheyne has hired experts focusing on regional markets, from Spain to Germany, and found suitable businesses in various sectors of Europe's medium-sized companies. The strategy, which Cheyne branded 'strategic value credit', was launched in May 2018. According to Fiertz, it is a seriously scalable strategy, where competition with large credit managers is less intense than in other sectors. It is also intended as a smart play for the later stages of the credit cycle.

The growth of the private debt market is intertwined with that of the private equity sector, as equity sponsors have started providing debt as well as equity. Fiertz argues that there are clear benefits from investing with a pure debt provider like Cheyne. Private equity sponsors tend to invest in the more liquid part of the market, where more leverage is needed to achieve attractive yields. Furthermore, he says: "We have seen many private debt operations being set up, with staff often coming from the leveraged finance teams of large investment banks."

Cheyne is also known for its real estate lending. The firm's real estate private debt strategy was launched in 2011, building on its expertise in real estate securities. Since then, the group has invested £2.5bn (€2.9bn) in 67 private real estate debt deals and has returned £1.7bn to investors to date. The portfolio consists of 40 deals, backed by assets mainly located in the UK.

The firm's real estate group consists of 28 professionals. Cheyne invests across the entire real estate capital structure, including senior, mezzanine and whole loans, listed real estate securities like commercial mortgage-backed securities (CMBS) and residential mortgage-backed securities (RMBS). There is also a focus on 'special situations' like workouts, loan-to-own, debt for control and recapitalisations.

The securitisation market has suffered owing to the Solvency II rules, which penalise insurers for owning asset-backed paper. But by lending across the capital structure, and for different purposes, Cheyne can take advantage of different opportunities.

The yields in this sector are attractive, according to Fiertz. In the UK, a typical real estate refurbishment loan can yield 9%. With leverage, that goes up to 15%, but Fiertz points out that putting leverage on investments is not essential for Cheyne. As a market veteran, he has seen the damage that overleveraged strategies can do.

Demand for property debt is high and banks do not have competitive advantage in this area, because the UK regulator forces them to lend to cashflow-generative assets. Fiertz says Brexit has had a limited impact, mainly reducing loan-to-value (LTV) ratios. At the same time, this sector has not seen the degradation of lending standards that is clear in other more liquid loan markets, where 'cov-lite' loans are the norm. "We have a full set of covenants to ensure works are being done on time and on budget," says Fiertz.

The real estate sector has seen fewer non-bank lenders being set up in recent years, compared with those focusing on corporate loans, according to Jonathan Lourie, Cheyne's CEO. "Typically our clients are real estate entrepreneurs or companies where property is a major factor, such as healthcare companies or student housing operators. It is harder to end up in a competitive situation."

Because Cheyne is known as a hedge fund it is perhaps surprising to learn that one of its flagship strategies involves impact investing. In late 2014, Cheyne launched a social property impact fund whose goal is to take advantage of huge shortage of affordable housing in the UK. "There are 1.15m households currently on the waiting list and just 47,000 new affordable homes were created in 2018, indicating a 24-year backlog," says Lourie. The social impact strategy builds residential property and enters into long-term leases with counterparties such as councils, housing associations and charities to help meet their housing needs.

Cheyne is proud of its multi-strategy approach but it remains committed to fundamental credit research and to exploiting opportunities where market dislocations appear. Lourie has a particular liking for investment-grade credit at present, in which the firm invests solely through single name credit default swaps.

The firm continues to run its event-driven and long/short equities strategies that leverage on its broad research capabilities. With the ability to allocate dynamically across different sectors of the credit and equity markets, Cheyne hopes to satisfy the needs of many investors as the hunt for yield continues.

See here for the online article.

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