THE FUEL

Middle-market companies demand debt capital. With traditional lenders departing the space, a few select groups have ramped up their involvement—including the recently combined forces of TIAA-CREF and Churchill Asset Management. To discuss market dynamics and company culture, *CIO* Editor-in-Chief **Kip McDaniel** recently sat with **Ken Kencel** (President & CEO, Churchill), **Randy Schwimmer** (Head of Origination & Capital Markets, Churchill), **Brian Roelke** (Head of Corporate Finance Originations, TIAA-CREF), and **Shai Vichness** (Head of Senior Leveraged Lending, TIAA-CREF).

***CIO*: There is a sense—and frankly, I'm slightly skeptical about its novelty—that we're in a unique environment for public markets right now. Is that mirrored in the private space?**

Roelke: Yes, we think so. Broadly speaking, in today's environment all markets are seeing more demand than they have historically. But, particularly given low interest rates, folks are looking to increase their yields through private debt markets.

TIAA-CREF is, historically, a very big investor in the private credit markets. We're attracted to three main things: diversification, because we can access issuers that you can't find in public markets; relative value; and finally—more often than in the public markets—good structures for your investments that provide downside protection, in the form of financial covenants and other collateral.

***CIO*: And beyond that?**

Kencel: One of the reasons that this is happening now is because the asset class performed very well through the cycle. It took a while for that to become evident, but once it did, investors said that private credit—especially the middle-market asset class—behaved as everyone said it was going to. Secondly, it became obvious that it was less correlated to public markets, which have been very volatile. The great thing about the middle market is that it's relatively insulated from those factors.

***CIO*: Let's talk about the risk diversification.**

Roelke: It is very important in terms of the overall return. This is because of the differences between a well-structured private debt investment—which will have a robust financial covenant package limiting a company's ability to take on incremental leverage, for example—and a comparable public debt investment in the same company without that covenant package.

***CIO*: So given the demand, and the diversification it brings, how have the players offering the supply changed? Like so much of the financial sector, have we seen a sea change here?**

Schwimmer: If you think about this global hunt for yield we've been in the midst of, there are definitely some clear themes. One is a move away from traditional lenders—the large banks—towards institutional and nontraditional lenders. There are various reasons for that, such as consolidation, but the fact is that banks, as it relates to corporate debt, have changed from being in the "storage" business, to the "moving" business.

***CIO*: Now to drill down to the middle-market space. Let's first define it.**

Schwimmer: There are lots of ways to define the middle market, but for us it's a matter of EBITDA. We generally consider the middle market to be companies with $10 million to $100 million, with the sweet spot being between $10 million and $50 million.

Vichness: And it's not a small market. If the middle market were a country on its own, it would be the fourth largest economy in the world. When you think about the middle market—that universe of 350,000 companies—you may think of it as a relatively small niche, but it's actually a very big market. They're companies that are really the growth engine for the US economy, and are, in many respects, underserved today by the traditional lenders.

***CIO*: So the middle market, excuse my pun, is not middling in size. What makes this a sweet spot in your eyes?**

Roelke: The combination of bank consolidation and capital requirements has made this middle market the province of nontraditional lenders. Today, more than 75% of lending to mid-market businesses is actually being done by nonbank lenders. It's increased from 25% of the market to over 75% of the market—and it's gone that way quickly. The vast, vast majority of lending to these companies is actually being done by nontraditional lenders.

Schwimmer: It's also about the way that the supply of deals comes to us. The middle market is where companies are growing; nearly all the employment growth in the US over the last three to five years has been in small- to medium-sized enterprises. Private equity sponsors, which always look to help grow companies, focus on these enterprises because they're the ones that need growth capital. And private debt is often needed to finance those deals, which is where we come in.

***CIO*: What are the real opportunities within that middle-market group?**

Vichness: First off, the subset that we're looking at here is companies that are backed by strong private-entity sponsors. Across the private credit business and the middle-market platform that we've developed—which includes private equity fund investing, mezzanine debt and equity co-investments, and now, in a much bigger way, senior secured loans—we're really focused on driving flow out of those private equity sponsors who need credit in that middle market where we play. We can leverage those relationships and rely on the good work that they're doing out there finding these companies.

Kencel: Today, there is over $500 billion of committed but uninvested private equity capital that is expected to be deployed over the next several years. In addition, we estimate another $500 billion of middle market loans that are already outstanding and are going to need to be refinanced over the next five years. This equates to expected loan demand of over $1 trillion—all at a time when the actual supply of senior debt capital to these companies has been decreasing due to the exit of many traditional lenders.

Schwimmer: And that's without adding one incremental dollar of equity raised or debt to be refinanced. Those are static figures—and this is anything but a static market!

Roelke: You've got this significant supply-demand dynamic that is actually in favor of the lenders. I think this is a very fundamental point. In the larger-cap markets, the supply-demand dynamic is actually in favor of the borrowers. Again, part of the fundamental attractiveness of our space is that we're in a secular period that puts us in a better position to be able to capitalize on the opportunity and drive returns to our investors.

***CIO*: What is the rationale behind combining the forces of TIAA-CREF and Churchill, which was just announced in early April?**

Kencel: At Churchill, we have a lot of experience financing companies owned by middle-market private equity firms. In those relationships, we aim to be a strong financing partner for our private equity clients. The fact that TIAA-CREF is a very active investor in middle-market private equity funds gives us excellent access to these firms and substantially enhances our deal flow with them. And our track record from a credit investment standpoint is very strong, which in the past has enabled us to raise a significant amount of capital from institutional and high-net-worth investors.

Roelke: … and the combination of that track record and those relationships—that's the one plus one equals three or four, in our eyes.

Vichness: One of the key things that attracted us to Churchill was the fact that they've got a wealth of experience, especially when it comes to interacting with the other active lenders in the middle market. We like to call them charter members of the club.

Roelke: The experience of the Churchill team is very important to us as well. The average experience in middle-market lending of the senior team is more than 25 years. So by that fact, they have a history of investing in middle-market loans through multiple cycles.

Kencel: In our business, we try to identify the top performing private equity sponsors. Not just in terms of driving equity returns but also from a lenders' standpoint. We look for sponsors who perform consistently over market cycles and invest in their companies, fixing problems where they arise, maximizing outcomes for their institutional investors, and are accountable to those investors. We've done that for many years, and the relationships we have, plus the resources that TIAA-CREF brings—we think that will provide a tremendous, ongoing source of deal flow.

Schwimmer: Institutional Investors today are very sensitive about capital and fee structures and that they align the investment team with the platform that invests in them. One of the most important elements of our strategy when we are speaking with like-minded institutional investors about partnership opportunities is that TIAA-CREF as an institution invests alongside us. Most institutional asset managers would not have the same type of capital base we do, and we think that's a very powerful part of our story.

FROM LEFT: **Randy Schwimmer** (Head of Origination & Capital Markets, Churchill), **Ken Kencel** (CEO, Churchill), **Shai Vichness** (Head of Senior Leveraged Lending, TIAA-CREF), and **Brian Roelke** (Head of Corporate Finance Originations, TIAA-CREF).