Q&A WITH GITESH GOYAL
THE PRIVATE DEBT OFFERING

We recently sat down with Gitesh Goyal, CFA (Vice-President, Global Fixed Income, Infrastructure and Power), to discuss the private debt space and the management of his portfolios. With his extensive expertise in public-private partnership (P3), as well as infrastructure and power markets, Gitesh has originated and structured transactions ranging from $100 million to more than $4 billion in the social infrastructure, transportation, renewable energy and power sectors.

WHAT IS PRIVATE DEBT?

[A] Private debt is an umbrella term that refers to a wide breadth of asset classes. Much like 'alternatives', a large selection of risk exposures is available to clients in this space. Private debt runs the whole gamut of products—from highly structured infrastructure deals with government counterparties to distressed debt situations offering equity-like returns. Other products in this segment that are accessible to clients include power debt, secured real estate, leveraged loans, and unitranche and mezzanine debt.

One of the advantages of private debt investing is the ability to directly negotiate the terms of each bond with the borrower. Public bond transactions are structured by investment banks and then rated by credit rating agencies; investors have limited ability to influence the structure and credit protection. With unrated private debt, we negotiate directly with the borrower, ensuring that the structure, credit protection and yield are appropriate for clients' portfolios.

WHERE WILL YOU FOCUS YOUR EFFORTS WITHIN THE PRIVATE DEBT SPACE?

[A] We will focus on the lower-risk investments in the private debt space. We believe clients will benefit from opportunities that arise in the P3 and power space, which is already showing a strong project pipeline in Canada. Our team has a long history of investing in these types of instruments. They provide access to investment-grade credits and contracted cash flows that align well with liabilities at a credit spread advantage to provincial and corporate bonds, without taking on incremental credit risk. These transactions are completed directly with the project company and involve only a handful of buyers. Even though these are unrated bonds, we can still accurately price the credit risk using our own due diligence and fundamental analysis that we apply to other fixed income investments, along with our understanding of the differences between private and public bond issues.

Due to the highly structured nature of these instruments, we can also ensure that our clients are getting exposures to the risks for which there is appropriate compensation—a unique feature of this asset class versus other fixed income instruments.

For example, in P3 transactions (which include projects such as courthouses, hospitals, roads, bridges and rail transportation), we participate in availability-based payment mechanisms. This means we are not taking on volume risk within these projects. Therefore, we are not concerned with the volume of cars using a toll road or ridership levels for a new LRT line. When investing in corporate bonds, factors such as management, technology and obsolescence are critical risk elements that investors need to assess. However, when investing in availability-based private debt, these risk factors are significantly lower and, at times, not present at all.

Within the power space, we see opportunities to participate in renewable energy bonds (solar, wind and hydro), which have long-term power purchase agreements and where we are lending against contracted power assets. The risk profile of these types of transactions varies greatly from the usual unsecured corporate bonds. We believe these types of risk profiles are attractive for institutional investors.

WHAT ARE SOME OF THE CRITICAL ELEMENTS REQUIRED TO MANAGE PRIVATE DEBT PORTFOLIOS?

[A] Several elements are critical to be a successful investor in the type of private debt transactions we plan to participate in. We believe that there are four key areas that impact success in the private debt space:

1 **Extensive Knowledge:** A deep knowledge of the marketplace, the transaction pipeline and key players in the market is essential. The size and experience of our fixed income team allow us to be “at the table” and to ensure that clients can participate in a wide range of transactions.

2 **Expert Experience:** Experience in analyzing and structuring the transaction, and assessing whether the credit spread appropriately compensates for the risk. P3 and power transactions are different from standard corporate bonds. Transactions are complex and, due to the stability of the cash flow and the strength of the structure, they often have very high leverage, sometimes as high as 90%. We utilize our expertise in structuring and analyzing the credit worthiness of the project and counterparties to ensure our clients are paid for taking on that risk, and we attempt to mitigate these risks in adverse situations.

3 **Due Diligence:** We undertake our own due diligence and structuring process, which includes the following:

- We ensure that we are comfortable with the cash flow generating ability of the asset.
- We require an equity dividend lock-up below certain minimum interest coverage levels.
- We require adequate cash reserves and other structural enhancements that benefit bondholders.

For P3s, we mitigate construction risk by ensuring that there are adequate security and covenant packages, and by assessing the relative complexity of construction projects. For example, we know that vertical builds carry less construction risk than horizontal projects.

4 **Disciplined Process:** A disciplined process is also key to success. We tap into the shared knowledge of the entire team when assessing a transaction. Our Credit Committee approves all transactions. This means we have the most senior fixed income personnel challenging our analysis and debating the merits of any bond in which we wish to participate. We also have structuring conversations with all the portfolio managers.

WHAT ABOUT THE LIQUIDITY OF THESE BONDS?

[A] Private bonds are illiquid, and investors are compensated for this with a premium to public bonds. Private bonds are generally buy-and-hold investments not meant to be a significant source of liquidity for an institutional investor. However, investors with allocations to private debt have several ways to redeem positions if necessary:

- On a best-efforts basis, we will attempt to arrange a buyer of a participant’s entire or partial position.
- Private bonds are generally amortizing, which provides cash accumulation that can be utilized for partial liquidity.

WHY WOULD CIBC ASSET MANAGEMENT CLIENTS ALLOCATE TO PRIVATE DEBT?

[A] We believe that our approach to private debt aims to best address the needs of institutional clients. Instead of focusing on rated, public deals in the infrastructure and power space, we focus on the unrated, private deals. Traditionally, these deals have been accessible only to life insurance companies that buy them for their balance sheets. Our goal is to bring our awareness of the project pipeline, structuring experience and credit analysis to participate in this space on behalf of clients. This is not new territory for us. We have a long history of participating in infrastructure and power bonds as we hold over $2 billion in assets across institutional portfolios.* We are simply leveraging this existing expertise to broaden our participation in this rapidly growing market of direct and unrated transactions.

Many managers have made the argument for why institutional investors should collect the illiquidity premium available through private debt in this low interest rate environment. While this premium is a critical compensation component for holding these instruments, this is not the only attractive feature. We believe the characteristics of the securities we are focusing on in the P3 and power space naturally align with the needs of institutional investors, including access to long-life infrastructure assets. These provide stable cash flow profiles that would otherwise not be available to small to mid-size plans. We also like the risk profile of P3 and power deals relative to the public bonds that our clients already hold in their portfolios. This includes minimal exposure to management, technology, obsolescence and revenue growth risks that are usually embedded in corporate bonds. There are also structural differences that benefit bondholders (such as amortization and lender step-in rights before contract termination).

HOW DOES PRIVATE DEBT FIT INTO THE LDI CONTEXT ?

[A] Plan sponsors hold a unique position in debt markets due to the long-term nature of their obligations. This characteristic allows them to be a liquidity provider to the marketplace versus those participants that are natural liquidity takers due to their shorter-term funding needs. Our area of focus within the private debt space aligns particularly well with longer-term institutional investors as we seek to harvest illiquidity premiums on behalf of our clients. A typical plan's liability profile aligns well with the contracted cash-flow profiles offered by infrastructure and power debt. In addition, the private nature of these assets means less mark-to-market volatility and balance sheet impact. The structuring of these deals also allows us to produce debt instruments that best meet the needs of our clients.

WHERE IS THE INFRASTRUCTURE DEBT MARKET NOW? WHERE DO YOU SEE IT GOING?

[A] Many investors would be surprised at how well established the infrastructure debt market is in Canada—specifically in the P3 and power space, which is our focus. We have seen 75 issues come to market since 2007, with an annual issuance averaging $2–5 billion.** In addition, 93% of the projects that have reached substantial completion are below or within 2% of the budgeted total project cost. This means that not only has there been significant volume in the space but projects are being completed on time and on budget.

Looking ahead, the project pipeline in Canada is extremely robust. We expect approximately $34 billion in P3 deals over the next five years, $14 billion of which could be financed in the debt markets. We also see approximately $1.5 billion in power deals and $1 billion in municipal deals on the horizon. This is against a backdrop of the 2016 Ontario budget that allocates $160 billion to infrastructure projects alone over the next 12 years. We also believe clients will benefit from selective opportunities in the U.S., including participation in highly rated university deals that offer attractive yields relative to their credit metrics.

> "Infrastructure investing is about seeking stable returns through contracted cash flows while minimizing management and operational risk."
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> GITESH GOYAL, CFA – VICE-PRESIDENT, GLOBAL FIXED INCOME, INFRASTRUCTURE AND POWER

DO YOU HAVE EXAMPLES OF UPCOMING PROJECTS THAT WILL REQUIRE DEBT FINANCING?

[A] Some of the larger deals coming to market include light rail transit projects in Ontario, British Columbia and Alberta. The George Massey tunnel replacement is a very large project in British Columbia at approximately $3.5 billion. Within the transportation space, the approximately $2 billion Detroit River Crossing project will be of interest to investors. Many larger projects provide an opportunity for us to participate in both the short-term (3–5 years) and the long-term (30–40 years) end of their financing needs.

WHAT DOES THE INVESTMENT PROCESS LOOK LIKE FOR CIBC ASSET MANAGEMENT'S PRIVATE DEBT OFFERING?

[A] Our approach is simply an extension of our existing credit research process, which is well established and has shown its resilience through market cycles. We remain connected to the deal pipeline in Canada, leveraging our long-term relationships with participants in the private debt market, including construction contractors, equity sponsors, non-dealer financial advisors and law firms.

Once we choose to participate in a transaction, we will then work to structure the deal, alongside our credit analysts and fellow portfolio managers, to ensure terms and conditions benefit clients. Our credit research team will also perform due diligence on the bonds to asses credit risk and assign internal ratings—based on our analysis relative to published rating methodologies. Utilizing the existing credit committee process, we present our findings to the Credit Committee. The committee will vote on whether or not to participate in the final deal after challenging our findings and assessment of the credit. The process has fit seamlessly within the existing CIBC Asset Management framework, and I am excited to continue to leverage the expertise of my colleagues on the fixed income team.

PROCESS STAGE	TEAM RESPONSIBILITY
Monitoring Transaction Pipeline	Entire Team
Transaction Structuring	Portfolio Managers
Credit Analysis/Due Diligence	Credit Research Team
Assigning Internal Ratings	Credit Committee
Credit Approval	Credit Committee (majority vote)
Monitoring	Portfolio Managers and Credit Research Team

For more information, visit: cibcam-institutional.com

*$2 billion is as of September 2016.

**The issuance data is from 2007 through 2015.