Media Release

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Investors need to diversify private credit allocations beyond property

With more than half of Australian total household wealth invested in property assets, investors need to think beyond real estate when it comes to private credit, according to Tanarra Credit Partners (TCP) managing director, Peter Szekely.

Szekely said this is especially the case when the significant exposure to real estate - both commercial and real estate - in Australia's retirement savings is considered.

"Of the $4.2 trillion in superannuation at end 2024, nearly one-third is held in SMSFs. Asset allocation data for the same time period shows property represents 17 per cent of SMSF portfolios on average, only second to Australian shares at 27 per cent," he said.

Just like any other asset class, investments in private credit also need to be sufficiently diversified.

"This is critical for successful portfolio construction. This involves spreading exposure across industries, borrower types, geographies, and assets in order to mitigate concentration risk and ensure a more stable return," Szekely said.

"A well-diversified portfolio is better positioned to preserve capital and deliver more resilient, consistent returns throughout the economic cycle," he added.

To counteract this bias to property in most Australian portfolios, TCP's portfolio positioning has a differentiated investment focus on corporate lending in defensive sectors. Its portfolio is invested in the information technology, health care, and childcare industries, as well as professional services, education and industrials, among other defensive sectors, each of which exhibits stability across economic cycles.

TCP believes it is important to carefully manage exposure to the property market cycle, valuation volatility and development risks by ensuring there is a balanced exposure to real estate transactions.

"For example, the construction industry is presently dealing with rising material costs and skilled labour shortages which, combined with fixed price contracts, puts pressure on cashflow," Szekely says.

In 2023-24 the Australian construction industry was responsible for the largest number of insolvencies (27 per cent) of any sector. In contrast, the health care and social assistance industry (which includes childcare services), accounted for just 3 per cent of total insolvencies.

“It might be a popular dinner table conversation topic, but Australians need to understand their exposure to real estate. An overweight position in property - in either debt or equity - can negatively impact the performance of a portfolio," Szekely said.

"This is even more important given current geopolitical and economic uncertainties and high market volatility. Investors need to make sure their portfolios are well diversified and positioned away from those industries most likely to come under pressure," he said.

Deal sourcing

When sourcing deals, it is important that an investment management team has diversified sources, including private equity sponsors, corporates, banks, accounting and legal firms, as well as other intermediaries such as debt advisors.

"These relationships are important because they help the fund manager access a wide range of syndicated transactions from which to select attractive deals for investors," Szekely said.

He adds that high-quality private equity sponsors are an important part of sourcing private credit portfolios.

"These private equity sponsors maintain significant equity ownership in the underlying businesses issuing the private credit, which provides several advantages.

“These advantages include access to additional financial support from the sponsor during periods of stress, and enhanced credit quality as the private equity sponsor also conducts their own rigorous due diligence,” Szekely said.

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