



## ***Opportunities in Private Sectors:***

*The Potential for Additional Yield, Diversification and Control  
Through Private Placements and Private Real Estate Debt*

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Strategic Asset Alliance

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## *Challenges Facing Institutional Investors*

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- **Low Yield Environment and Pressures to Increase Income – Investors taking on greater risk**
- **Greater Volatility**
- **Limited investor protections in public markets**
- **Uncertain regulatory environment**

## *Opportunities in Private Debt*

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### **Possible Benefits:**

- Investment Grade-like risk with additional yield potential
- Greater portfolio diversification
- Greater Investor protections than public markets
- More in-depth information on securities and properties

**Private Placements and Private Real Estate Debt may provide solutions to investors' current challenges.**



## *Private Placements*

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## *What are Private Placements?*

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### **Private Placements are securities that both private and public companies can issue to raise capital**

- The securities are issued to a select group of investors through a private offering and are not offered to the public market
- These Placements are subject to the Securities Act of 1933, however they do not have to be registered with the SEC. Their investment is generally limited to accredited investors\*

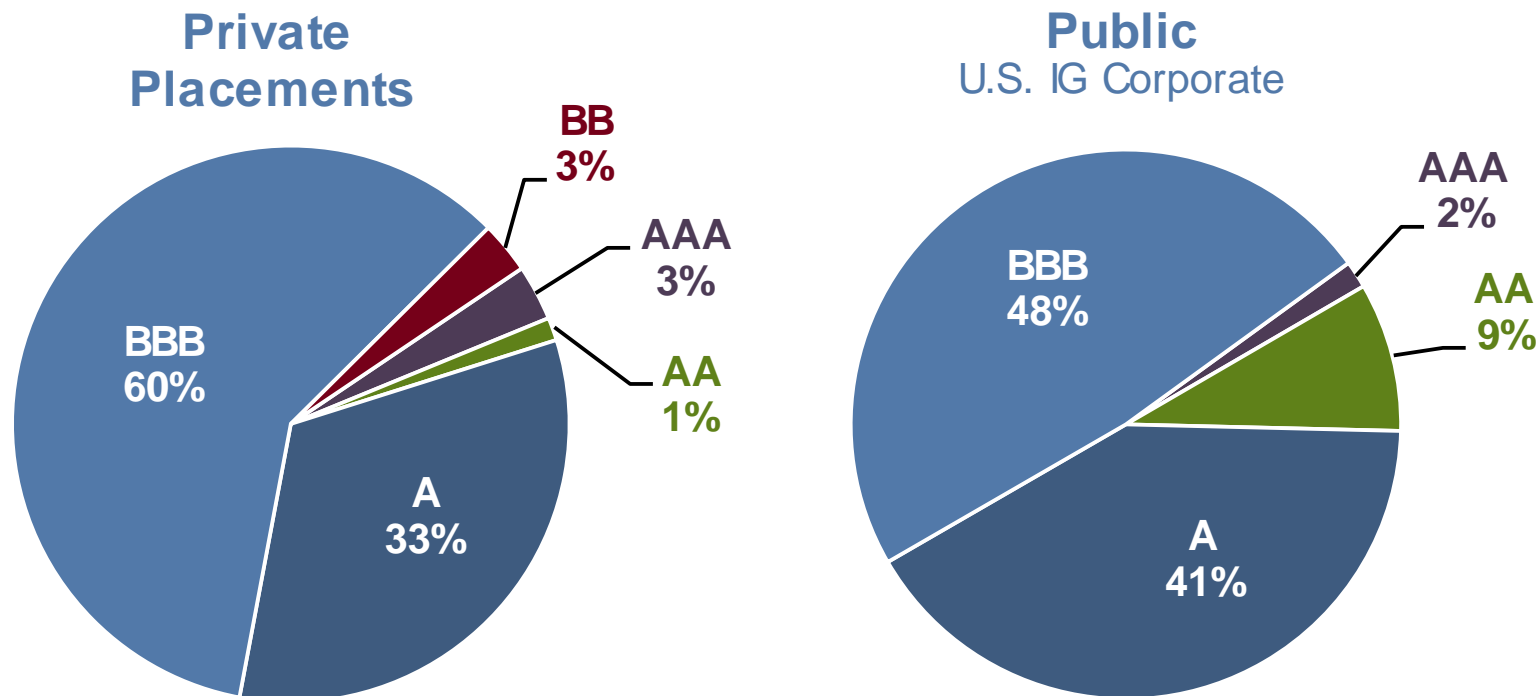
# What are Private Placements?

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## Market Overview

<b>Scale</b>	<b>\$400 billion total market outstanding</b> (estimated) <i>\$40 – \$50 billion annual new issuance</i>
<b>Purchasers</b>	<b>Life insurers</b> (primary)
<b>Quality</b>	<b>A3 to Baa3</b> (primary)
<b>Duration &amp; Maturities</b>	<ul style="list-style-type: none"><li>• Floating Rate and Fixed up to 30 years</li><li>• Greater variety than publics in Primary Market <i>(ideal for matching varied liabilities)</i></li><li>• Primary issuance: 5-12 years</li></ul>
<b>Issuers</b>	<ul style="list-style-type: none"><li>• Public and private companies</li><li>• Rated companies</li><li>• Domestic/foreign split (50/50) provides added geographic diversity</li></ul>

# Private Placements Credit Quality



Source: Barclays Indices, POINT (c)2015 Barclays Capital Inc. Used with permission. Barclays and POINT are registered trademarks of Barclays Capital Inc. or its affiliates (US IG Corporate), HIMCO Issuance Data (Private Placements), as of December 31, 2015

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## Issuers – Why Private Placements?

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**Issuers may elect to fund debt in the private placement market for a variety of reasons**

### **Confidentiality**

- Issuers want to maintain control over sensitive information to group of sophisticated institutional investors

### **Public Registration Issues**

- Less efficient for small issues
- Time consuming and cumbersome
- Increases market volatility risk
- Higher costs

### **Capital Market Flexibility**

- Non-Standard maturities
- Flexible funding dates
- Optimize tax efficiency

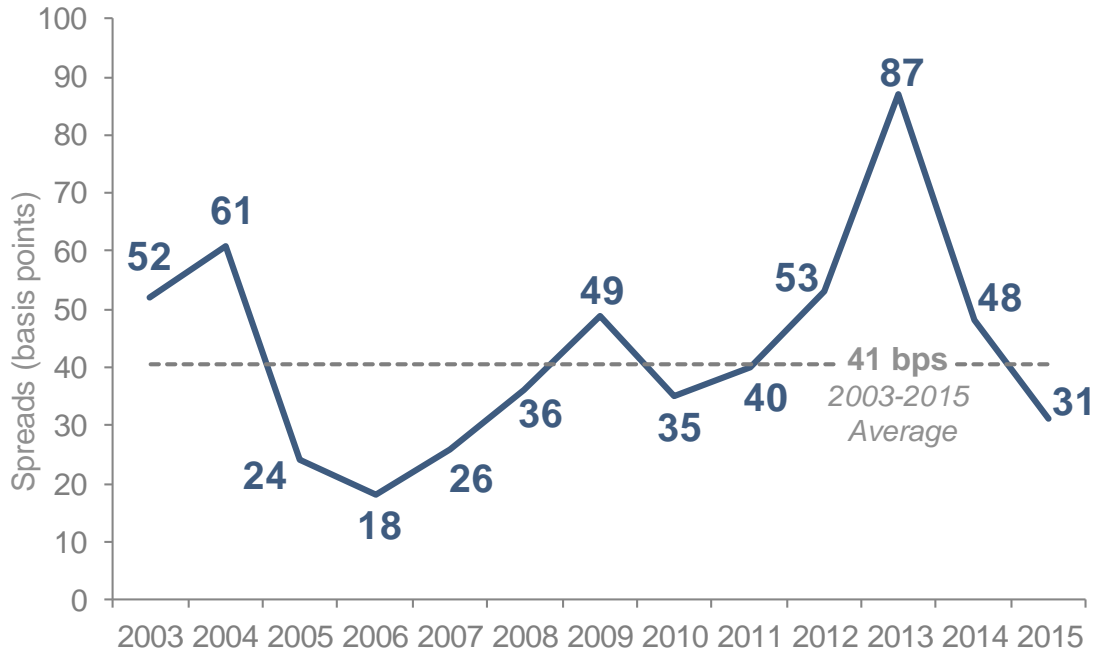
### **Access**

- Foreign issuers have access to US capital markets



# Historical Value Add From Spread\*

## Net Spread to Comparably Rated Public Corporate Bonds



Source: HIMCO, as of December 31, 2015. Net spread is distinct from performance and reflects the extra interest and dividends investors in private bonds receive for bearing additional risk. Depending on interest rates and other relevant factors, the net spread to public corporate bonds reflected above may not be replicated in the future.

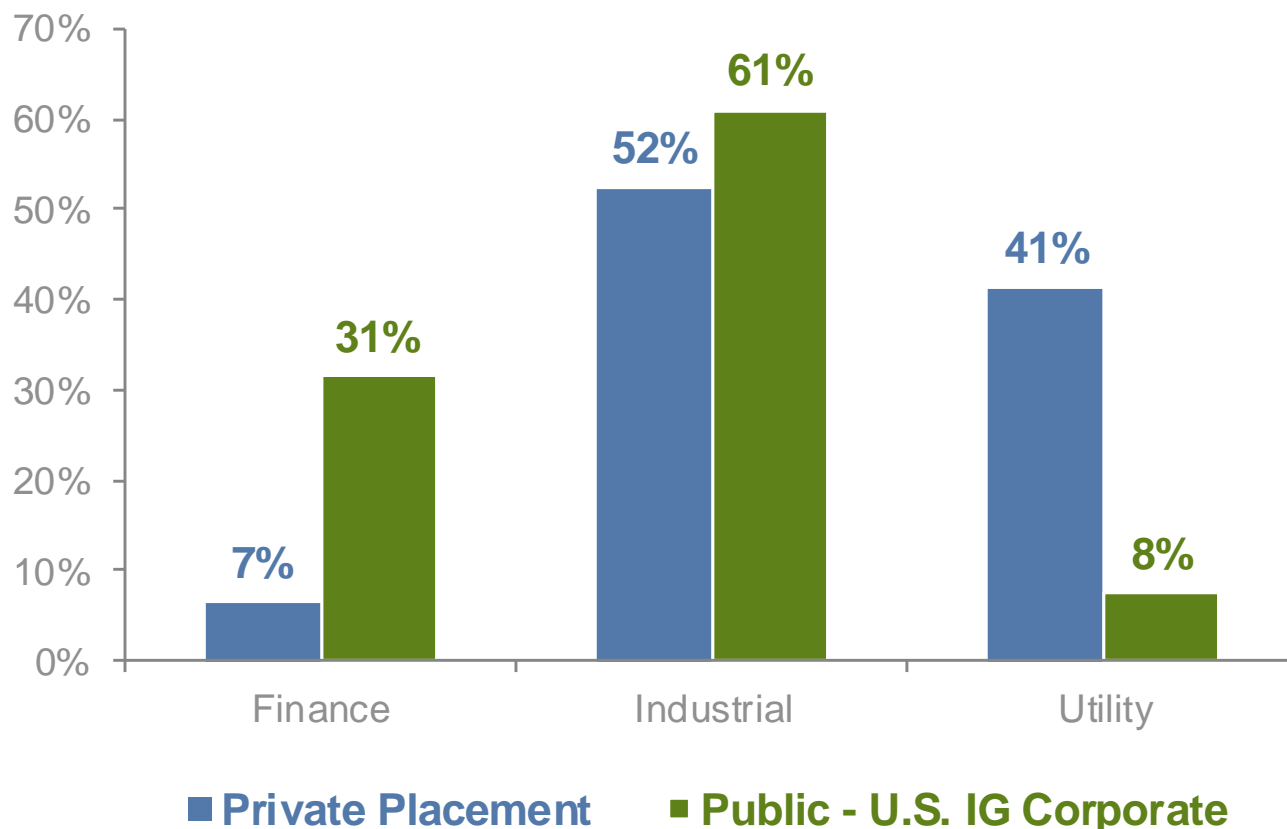
\*The portfolio is represented by the aggregate of all of HIMCO's private placement holdings across all its dedicated private placement or multi-sector portfolios, including General Insurance and discretionary client accounts.

\*\*Comparable public bonds are defined as the set of public corporate bonds of industry competitors identified by HIMCO, which are then adjusted for quality differences (using public bond comparisons) and maturity differences (using the U.S. Treasury yield curve), as well as the cost of amortization (rate of prepayment) and the cost of carry (time from commitment to investment).

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# Private Placements Diversification

## Sector Distribution



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Diversification cannot assure against market loss.

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## *Covenants — Negotiated Investor Protection*

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- Covenants are terms, financial or otherwise, in the legal documents of a Private Placement issue that restrict the actions of issuers in order to protect the investor
- Covenants are a key element of the Private Placement Market
- Private Placement Industry participants have established a Model Form of standard legal documentation
- Benefits of Covenants
  - Give investors an “Early Warning System” that notifies investors when a credit is deteriorating or under stress
  - Facilitate communication between lenders and Issuer Senior Management (CFOs & Treasurers)
  - Give lenders an initial seat at the table when problems arise
  - Helps to mitigate the severity of loss and event risk

# Financial Covenant Examples

Covenant	Definition	Mechanism/Tests	Private Placement	Public
Limitation on Indebtedness	Restricts an issuer from incremental borrowing beyond a prescribed level.	Debt/EBITDA, Debt/Capital	Yes	No
Interest Coverage	Ensures that the company maintains an adequate level of income to cover fixed charges.	EBITDA/Interest	Yes	No
Limitation on Liens/Negative Pledge	Restricts ability to incur future debt with the company's assets.	Priority Debt Basket	Yes	Yes
Limitation on Bank Security	Unique to private placement market an additional clause prohibits banks from being secured ahead of existing Lenders.		Yes	No
Tangible Net Worth	Requires an issuer to maintain adequate current tangible net worth.	Total Debt/Tangible Net Worth, Minimum Tangible Net Worth	Yes	No
Limitation on Subsidiary Debt	Limits or prohibits issuance of debt at subsidiaries to prohibit/limit structural subordination.		Yes	No
Liquidity	Requires an issuer maintain adequate liquidity.	Current Ratio	Yes	No



## *Commercial Mortgage Loans (CMLs)*

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# Commercial Mortgage Loans

## Institutional Quality Lending

Potential Returns/Risk

Typical Real Estate Capital Structure

Loss Position



For illustrative purposes only.



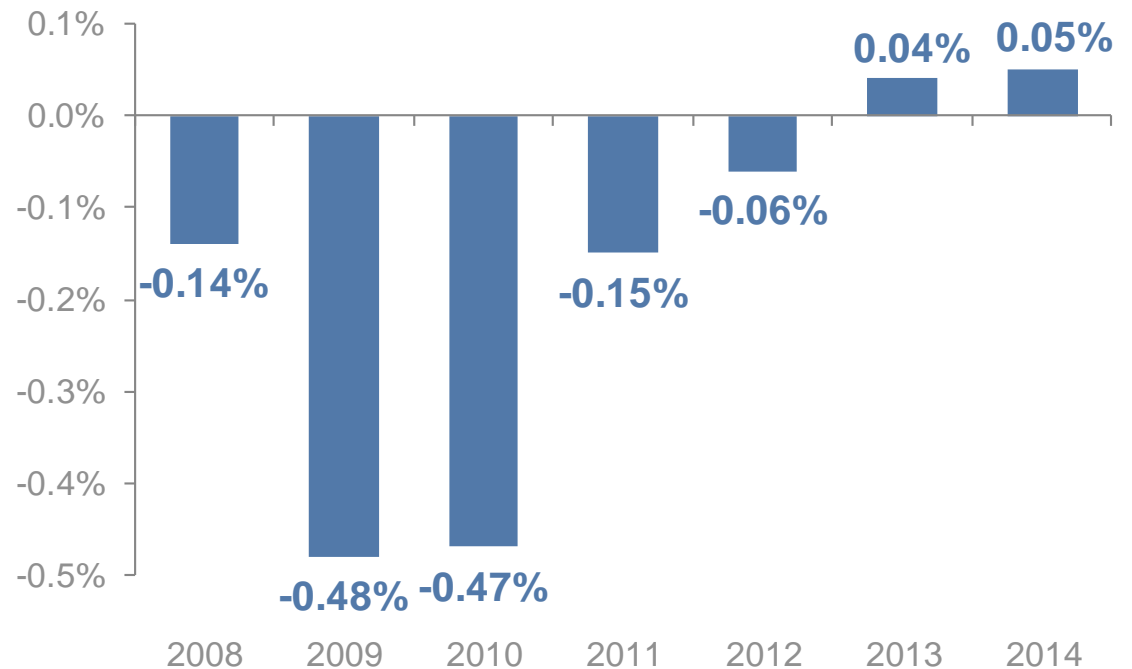
- Loan secured by first mortgage lien on collateral (commercial property) located in major metros.
- Capital Structure at loan origination: Institutional Loan typically 55-65% LTV, Borrower's Equity typically 35-45%.
- Borrower's equity in first-loss position; Borrower's equity would have to be eliminated before Lender sustains potential loss.
- Terms:
  - Maturities vary, 3-25 years; fixed or floating
  - Payment terms vary: Loan can amortize (typically 30 years); be interest-only (I/O), then amortize; or I/O for entire term
  - Primarily fixed rate financing (applicable U.S. Treasury plus spread)
  - Balloon payments at maturity; some fully amortize
- Diversify among property types and geography
- Loans are generally non-recourse except for certain recourse carve-outs for fraud and environmental issues

## Risk Profile Similar to A-Rated Bonds

### Typical risks of investing in CMLs:

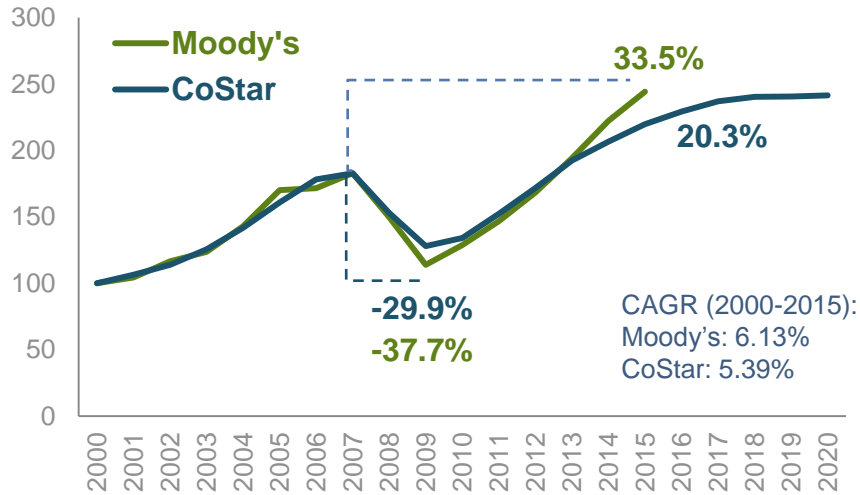
- Liquidity
- Credit
- Supply growth/  
new construction
- Concentration

### Life Industry Commercial Mortgage Losses During and Post Financial Crisis (2008-2014)

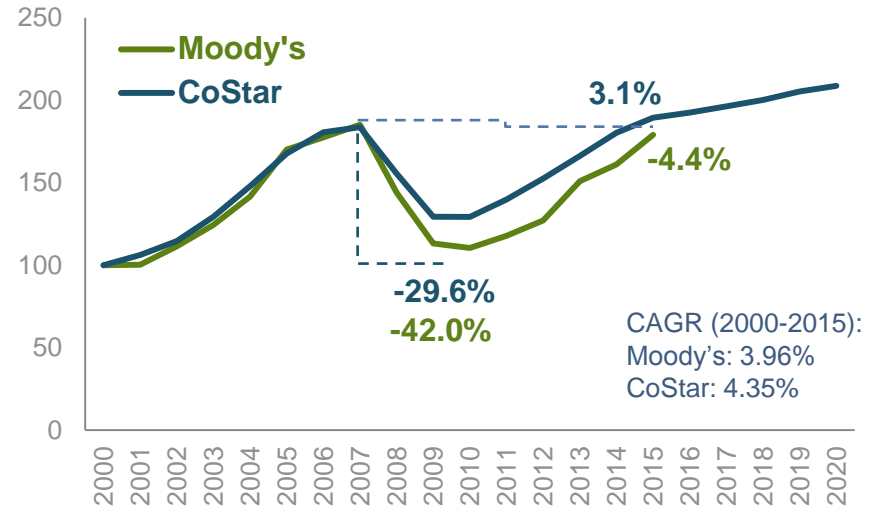


# CRE Value Indices: Apartment, Office, Retail, Industrial

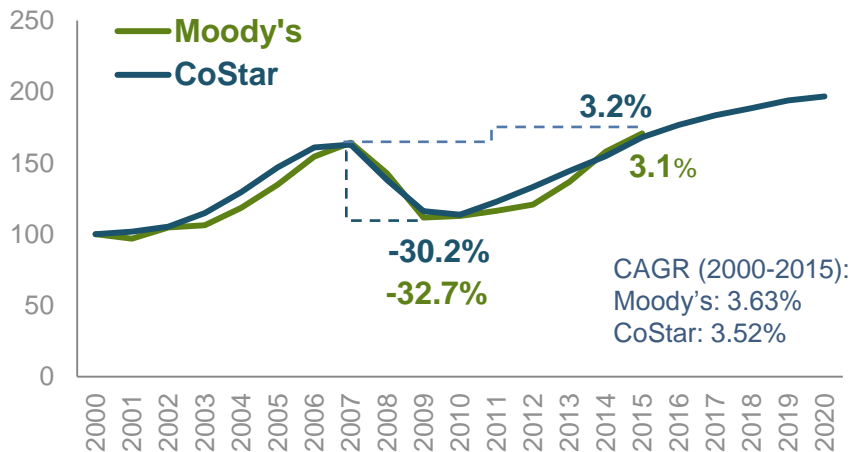
## Apartment



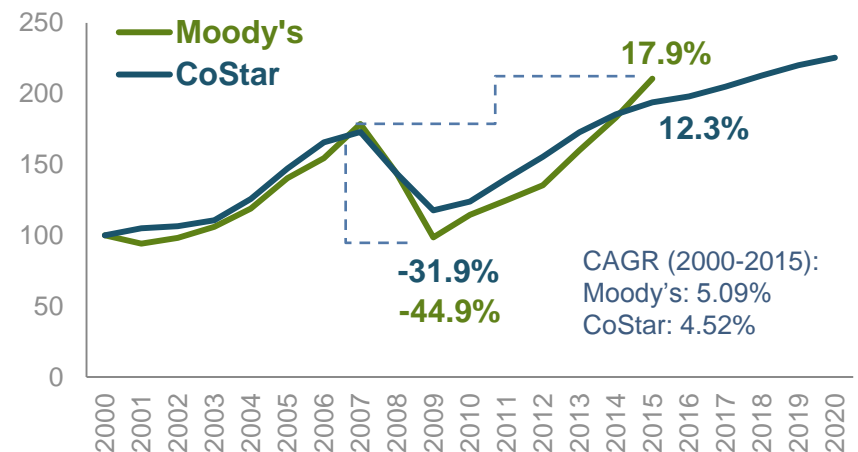
## Retail



## Industrial



## Office

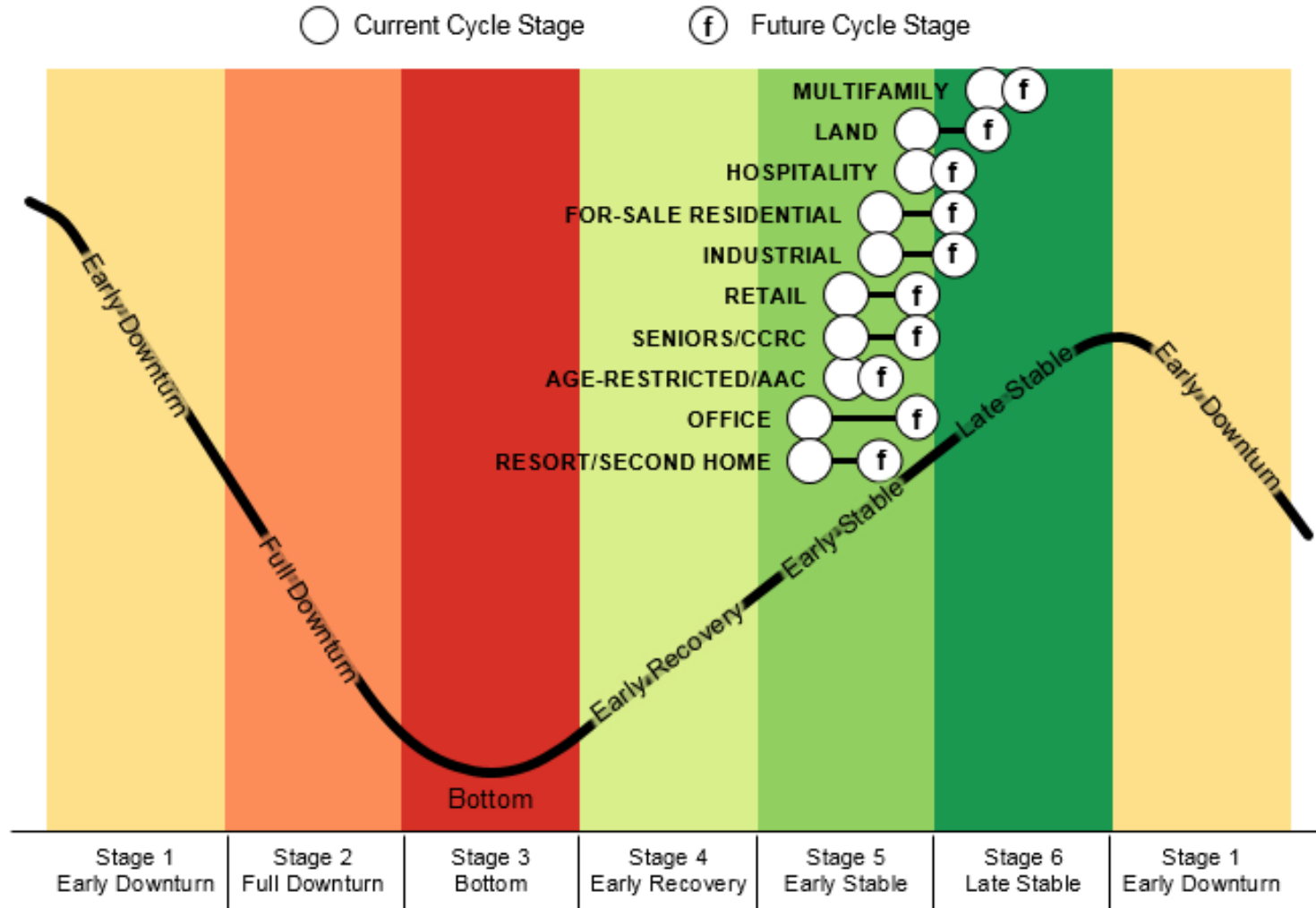


NOTE: Moody's, CoStar data as of September 30, 2015. CoStar Q4 2015 and future data are projections. All chart values are indexed at 100 starting in 2000.



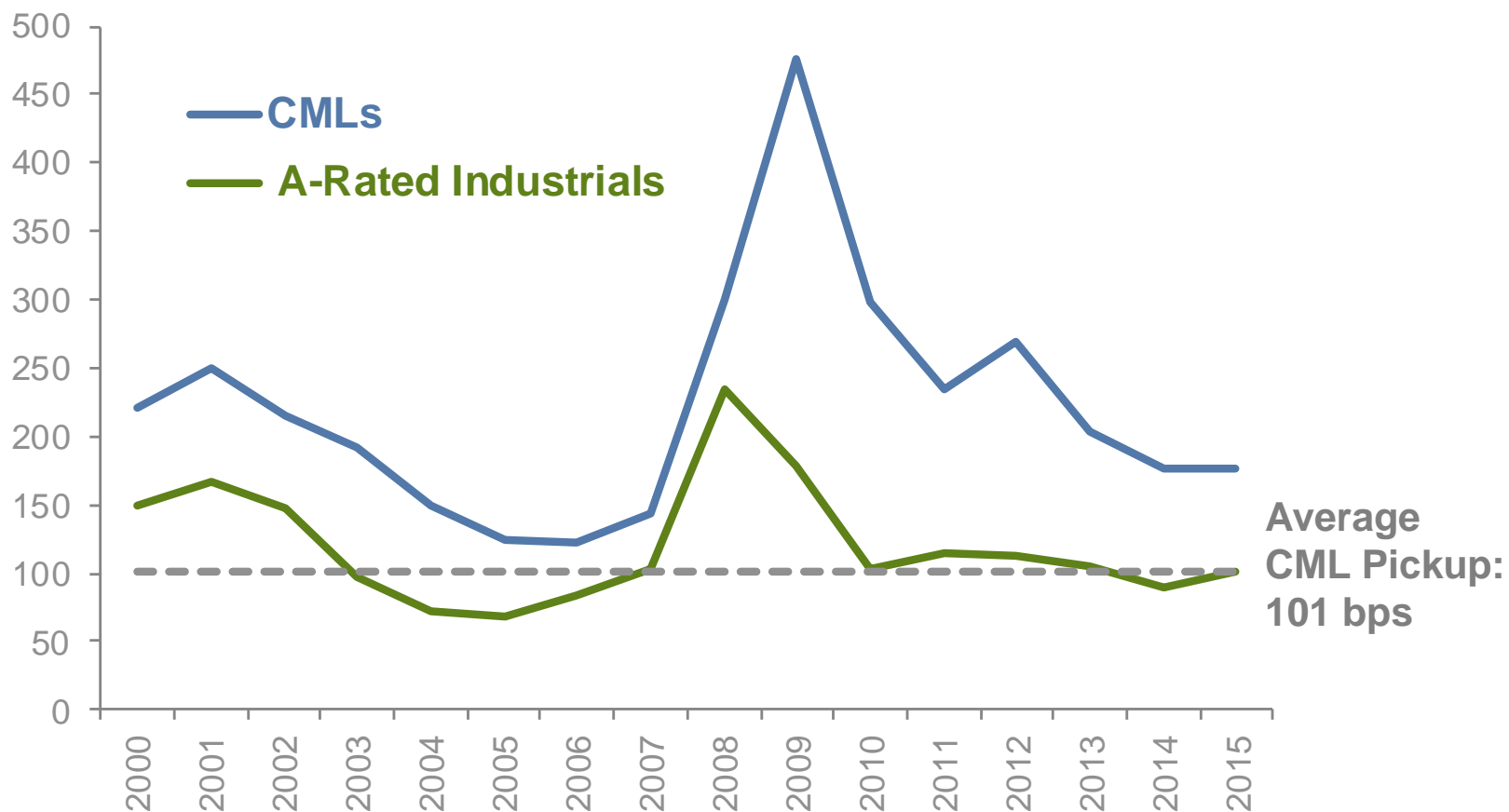
# RCLCO Sentiment

**RCLCO Sentiment Survey Results by Product Type, 1Q 2016**



# Commercial Mortgage Loans Income

## Spread over U.S. Treasuries Commercial Mortgage Loans vs. A-Rated Industrials

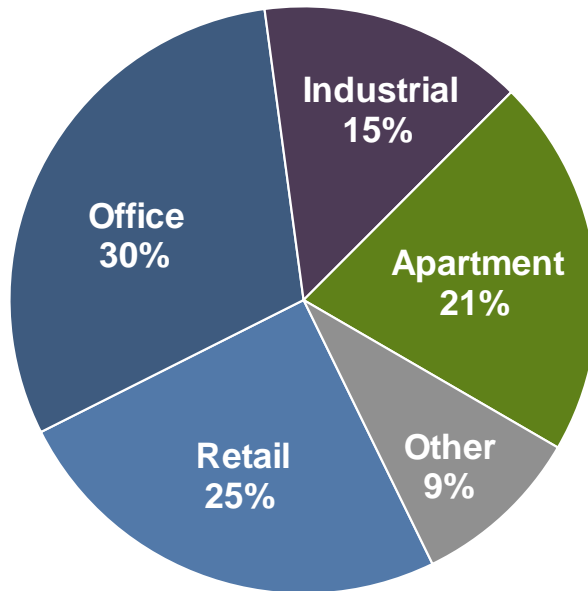


Source: ACLI and Barclays POINT, as of June 30, 2015. Past performance is no guarantee of future results.

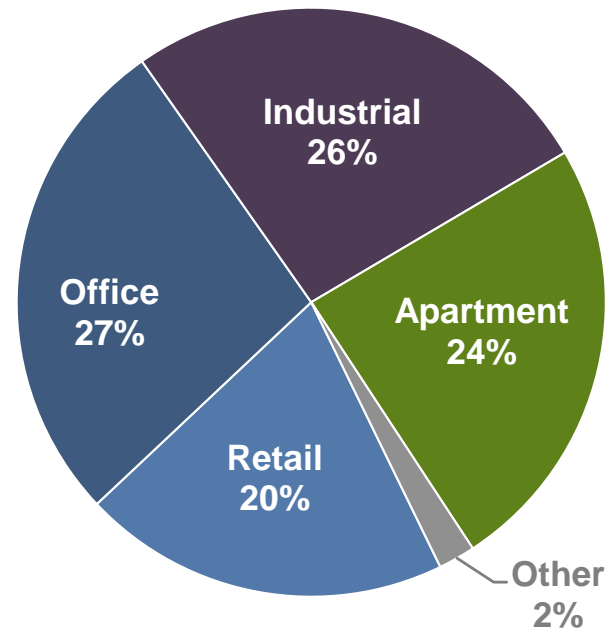
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## Commercial Mortgage Loans by Property Type

American Council of Life Insurers

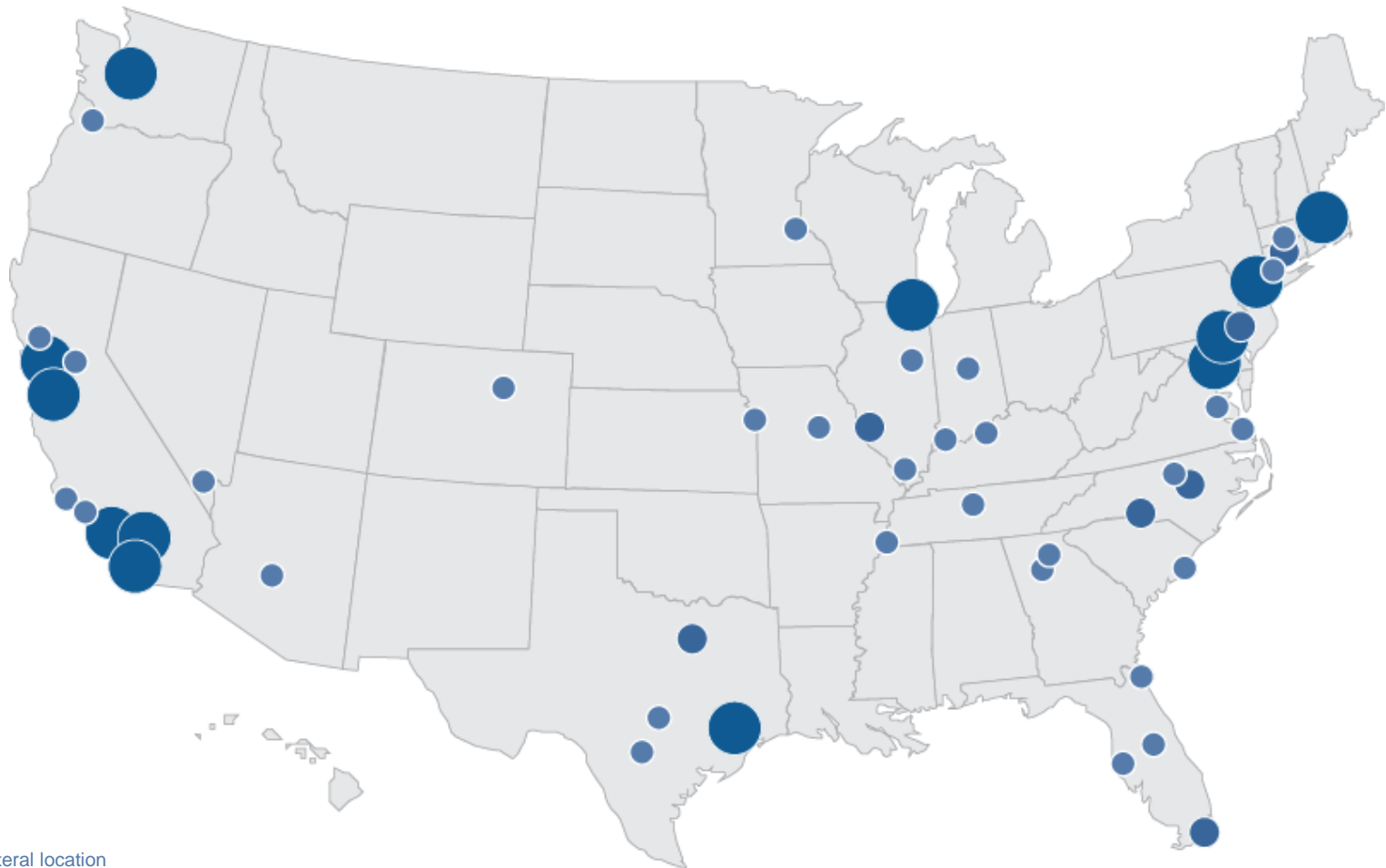


The Hartford General Account



# Diversified Investments by Geography

**U.S. market conditions vary by region, providing Real Estate investors with additional diversification potential**



● - HIMCO collateral location

As of December 31, 2015

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## *CML Lender Protections*

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- Prohibitions on additional financing without lender consent
- Single lender simplifies potential workout negotiations
- Amortization can help reduce exposure over term of loan
- Pre-payment provisions, including Treasury make-wholes and lock-out periods
- Monthly loan payments vs semi-annual for bonds
- Loan collateralized by real property vs unsecured asset in corporate market

# Summary

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## **Private Placements and CMLs offer:**

- Additional yield potential on Investment Grade-like credit
- Stronger lender controls and protections
- Better information flow
- Greater portfolio diversification
- Customized structures that meet liability requirements