Buyers Clamor for Distressed Debt Nobody Wanted: Credit Markets

By Alastair Marsh

Oct. 7 (Bloomberg) -- They were the bank assets nobody would touch during Europe's financial crisis. Late payments on credit cards, underwater mortgages and failed loans to small businesses. Now everybody wants them.

The number of funds in the region's distressed debt market doubled to 200 in the past two years as money managers seek to boost returns in a world of record-low interest rates, according to KPMG LLP. Amid the increasingly crowded playing field, prices jumped more than 10 percent since January, HSBC Holdings Plc data show.

"Investors are flocking to Europe because they see it as the best place for buying distressed portfolios," said Vishal Soni, who bought real estate loans at Deutsche Bank AG in London before helping start consulting firm Oxane Partners Ltd. "The new players have yet to test the market, while those who have been around longer realize there's less chance of winning a bid now."

Lenders are relinquishing a record 100 billion euros ($125.2 billion) of loans this year to meet tougher rules requiring them to increase the capital they hold to absorb losses. They're also being scrutinized by the European Central Bank, which will announce the results of stress tests and an asset quality review this month.

Prices Increase

Banks were getting from five cents to 40 cents on the euro for their bad loans at the beginning of the year, now the top of the range is an average 50 cents, according to PricewaterhouseCoopers LLP. As prices increased, so has banks' willingness to offload them, said Dermot Murphy, who trades distressed debt as co-head of HSBC's credit situations group in London.

"The market for non-core and distressed assets has become more competitive," Murphy said. "The trend towards selling non-performing loans has been gathering momentum."

New investors are shaking up a market that has been dominated by a handful of large U.S. firms including Lone Star Funds and Apollo Global Management LLC, said Graham Martin, global head of portfolio solutions at KPMG in London.

Newcomers will fare better in smaller deals in countries where banks have been less active in disposing of debt, he said.

"There's huge interest from funds looking to get involved or become more involved, but in established markets for asset disposals like the U.K. and Ireland they'll find it difficult," said Martin. "As activity shifts to southern Europe, other players could be more successful."

New Hire

London-based hedge fund CQS U.K. LLP., which oversees $14.2 billion, hired Simon Finn from Apollo to head a new unit that will buy distressed debt. Michael Rummel, a spokesman for CQS in London, declined to comment on the hiring.

Ellington Management Group LLC in Old Greenwich, Connecticut and New York-based MKP Capital Management LLC have also established European units in the past 18 months to compete for discounted assets.

While disposals accelerated this year, the flow of new assets into the market is less than has been forecast by Oaktree Capital Group LLC, the world's largest distressed-debt investor. Sales are more of a "trickle" than the flood the firm had prepared for, John Frank, the firm's managing principal, said in August.

Funds have started to look for new ways to get hold of bad debts, such as by investing in asset-backed securities, because competition on loan portfolios has become so intense, said Oxane's Soni, who is based in New Delhi.

Investors are being helped in their search by the ECB's asset quality review, which is forcing banks to assess the bad loans they are holding and prompting disposals, according to Alexandra Jung, a partner and co-head of European investments at Oak Hill Advisors LP, a New York-based debt investor with $24.4 billion under management.

"Lenders are focusing on areas of their balance sheets where regulators are worried they're under-provisioned," Jung said. "There's been a lot of activity as they prepare for the AQR."

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