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FINANCIAL NEWS



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Asset-based lending rises up the food chain

By Ellen Kelleher



The credit crunch arrived almost a year ago and continues to plague the markets. But there is one area where it has not bitten hard - asset-based lending (ABL).

The practice of issuing private loans that are secured using a pool of companies' physical assets - such as property, machinery or leasing agreements - as collateral is generating interest from borrowers looking for alternative funding because of the rising cost of debt and the scarcity of loans written by commercial banks.

Assets available for lending in the ABL industry have increased from \$2bn three years ago to \$13.2bn in the first quarter of this year, according to Hedgefund.net, a US research firm. And the average ABL hedge fund reported a return of 9.8 per cent in the 12 months to the end of May.

The advantage of investing in ABL funds is the chance to earn consistent risk-adjusted returns - which are not correlated to equities - of 9 to 12 per cent a year, analysts say.

"The asset-based lending sector is effectively moving up the food chain," said Niels Jensen, head of Absolute Return Partners, a London-based asset management group. "The reason we are getting excited about ABL lenders now is because they are facing, and will continue to face, much less competition from commercial banks which are pulling back from existing loan arrangements."

In the current environment, a flurry of new ABL funds - which average about \$170m in size - is being launched as hedge fund managers look for ways to earn higher returns not correlated to equities. Harcourt Investment Consulting has launched Belmont (Lux) Asset Based Lending, a fund of funds invested in pure asset-based lending strategies which caters to pension funds and other risk-averse institutional clients. The fund excludes the use of derivatives and shorting and leverage is held at 10 per cent. An annualised return of 2.5 per cent above Libor (5.8 per cent) net of fees is being targeted.

ABL loans are issued with quite conservative loan-to-value ratios, with the collateral tending to be worth 30 to 40 per cent more than the loan and any interest accrued. In most cases, the collateral is protected in a trust or a special purpose vehicle and personal guarantees also tend to be required. This technique lowers the risk of defaults.

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