Despite Strong Returns, BDC Equity Raise Remains Weak

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After 2015 put an end to their fundraising growth streak, non-traded business development companies posted another fundraising decline in the third quarter of 2016, according to Summit Investment Research's most recent Non-Listed BDC Market Snapshot.

After a record $5.9 billion capital raise in 2014, non-traded BDCs fundraising declined to $4.3 billion in 2015. In the third quarter of 2016, non-traded BDCs raised a mere $431 million, which is less than half of their 2015 fundraising pace.

Summit pointed to several factors responsible for the declining numbers including regulatory changes stemming from FINRA 15-02, as well as the abrupt exit of American Realty Capital from the non-traded investment space. In addition, disruptions in the high yield debt markets caused net asset values to decline, while rising credit risk is expected to further impact the space in 2017.

Open non-traded BDCs had their lowest quarterly capital raise in the last four years in the third quarter. FS Investments, formerly Franklin Square, continued to dominate the space it created with a 54 percent market share for its three open BDCs that held the top three fundraising spots.

FS Energy & Power Fund held onto the number one spot with a capital raise of $197 million, while FS Investment Corporation III took second with $51 million raised. FS Investment Corporation IV and CNL's Corporate Capital Trust came in third with both companies raising $39 million during the quarter. Carey Credit Income Fund 2016 T and Sierra Income Corporation shared the fourth spot with $35 million capital raises.

Non-traded BDCs maintained their secured debt ratios in the third quarter decreasing slightly from 76 percent in the second quarter to 75 percent in the third quarter of 2016, while first lien debt ratios remained unchanged at 50 percent. Summit noted that with the decline in private debt market prices and higher market yields, non-traded BDCs could obtain comparable secured debt and first lien debt at higher yields.

So far in 2016, first lien debt yields increased from 7.7 percent in 2015 to 7.9 percent. Second lien debt yields increased from 9.6 percent in 2015 to 9.8 percent so far in 2016. High yields combined with high fixed rates on unsecured debt, allowed non-traded BDCs to maintain average gross yields of 9.2 percent in 2016.

Net asset values increased 4.9 percent so far this year after sharp 12.5 percent declines in 2015. With the increase in NAVs and high distribution rates, total returns for non-traded BDCs were 12.1 percent third quarter year-to-date.

Summit Investment Research has been active since April 2016 and covers non-traded REITs, business development companies, interval funds, and listed REITs (that acquired non-traded REITs or were once non-traded). The company's research can be utilized by a variety of industry clients including financial advisors, registered investment advisors, broker-dealers, sponsors, service providers like law firms, due diligence firms, industry organizations, and news organizations, and institutions.

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