

The Sweet Spot Has Moved

Why higher rates, a record 2021 buyout vintage and a shrinking second lien market are pushing private credit returns to the two ends of the capital structure

EXECUTIVE SUMMARY

Private credit has grown from a US\$80 billion niche into a US\$1.3 trillion U.S. market.⁽¹⁾ The growth story is well known. What is less appreciated is how much the market has changed inside that growth.

Three forces have reshaped where value sits in a leveraged capital structure: the rise of unitranche lending, a 530 basis point shift in base rates, and a record 2021 buyout vintage underwritten for a rate environment that no longer exists. Together they have hollowed out the cash-pay second lien market and created large, underserved demand for Structured Capital.

Penfund believes the next several years favour lenders who can move across the capital structure. Unitranche loans and Structured Capital (PIK notes and preferred equity) are today's sweet spots. Prime Plus+ is Penfund's response to a market that has become more complex and more dynamic. It has been designed specifically to invest in both, and to shift between them as the market moves again.

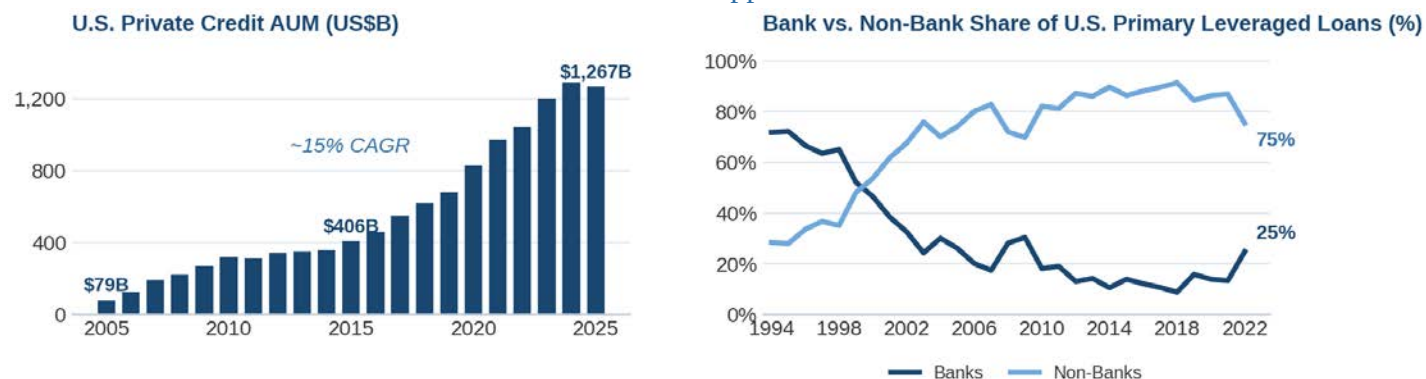
Fundamentally sound businesses, constrained by balance sheets sized for near-zero base rates.

A Bigger Market, and a Different One

Banks left, private lenders filled the gap. Post-2008 capital rules pushed U.S. banks out of leveraged lending; their share of U.S. leveraged loan volume fell from more than 70% in the mid-1990s to roughly 25% by 2022.⁽¹⁾ Smaller middle market borrowers now have few alternatives to private credit, and larger borrowers increasingly prefer it: no ratings, no syndication delay, no "flex", and known counterparties for the life of the loan.

But the product mix has shifted underneath the headline. Unitranche loans, a single facility blending senior and junior debt, grew from US\$47 billion in 2019 to more than US\$210 billion in 2024⁽¹⁾ and are now the dominant LBO financing structure. Every unitranche deal is a deal without a standalone second lien, and the addressable market for a narrowly focused subordinated debt fund has shrunk accordingly. Sponsors have also professionalized how they buy debt, and their capital markets teams favour partners with more than one answer.

Exhibit 1: A US\$1.3 Trillion Market Built as Banks Stepped Back



Source: PitchBook, May 2026 US Private Credit Monitor (AUM incl. dry powder and NAV, as of Sept. 30, 2025); PitchBook LCD (bank share; series ends 2022).⁽¹⁾

The 2021 Vintage Comes Due

Near-zero rates produced a record year: U.S. buyout volume reached US\$368 billion in 2021,⁽¹⁾ and those deals were generally struck at high leverage. The years that followed brought higher debt service costs, fading post-COVID demand and a closed IPO window. Exits stalled. By mid-2025 only an estimated 19% of 2021-vintage deals had been exited, against a historical norm of roughly 30%,⁽²⁾ and more than 16,000 buyout-backed companies globally had been held for four or more years: 52% of the inventory, the highest share ever recorded.⁽²⁾

The result is a maturity wall built from companies that have not deleveraged as planned and whose sponsors have not yet created enough equity value to sell. Conventional refinancings are ill-suited to this cohort: many cannot carry more cash-pay debt at today's rates.

Exhibit 2: Record U.S. LBO Volume in 2021



Source: PitchBook LCD, Q2 2026 US LBO Debt Quarterly Trend Lines; Bloomberg. Base rate reflects LIBOR prior to January 1, 2022 and SOFR thereafter.^(1,3)

Exhibit 3: A Looming Maturity Wall



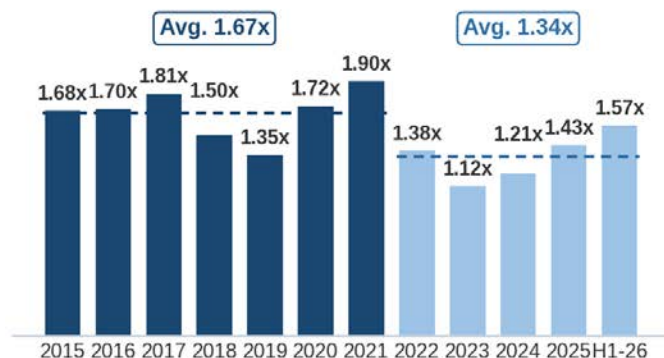
Source: PitchBook LCD, U.S. leveraged loan maturity wall breakdown as of August 7, 2026 (Morningstar LSTA US Leveraged Loan Index).⁽⁵⁾

Higher Rates Broke the Cash-Pay Junior Debt Model

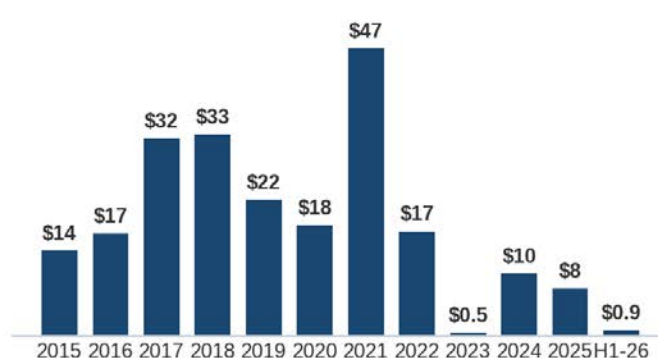
From 2009 to early 2022 the Federal Funds rate sat below 1% for most of the period. From March 2022 the Federal Reserve delivered more than 530 basis points of increases, taking SOFR to roughly 5.3% by mid-2023.⁽³⁾ For a borrower levered at 2021 multiples, that is a step-change in interest burden with no offsetting change in cash flow. Fixed charge coverage tells the story: average FCCR on new LBOs fell from 1.67x over 2015-2021 to 1.34x since 2022.⁽⁴⁾ Borrowers responded the only way they could: the share of BDC portfolios carrying PIK features has risen from 7% in 2013 to 18% as of Q1 2026,⁽⁴⁾ and U.S. second lien issuance collapsed from US\$47 billion in 2021 to under US\$1 billion in the first half of 2026.⁽¹⁾ Demand has migrated from cash-pay second lien and subordinated debt toward Structured Capital that does not require current cash servicing.

Exhibit 4: Less Coverage, Less Cash-Pay Junior Debt

Fixed Charge Coverage on New LBOs (>US\$50M EBITDA)



U.S. Second Lien Issuance (US\$B)



Source: PitchBook LCD. Fixed charge coverage is calculated based on market LBO leverage and institutional loan yields for targets with >US\$50 million of EBITDA. Second lien issuance includes syndicated and privately placed volume; PitchBook Q1 2026 US Second Lien Loan Statistics Report.^(1,4)

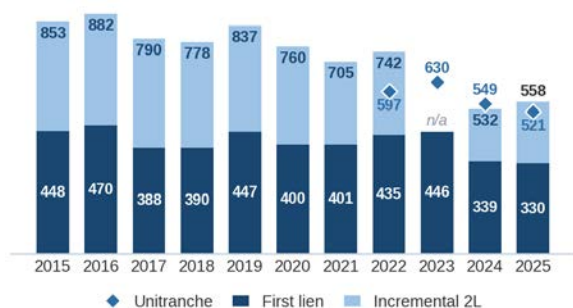
Returns Have Shifted to the Ends of the Capital Structure

For years second lien loans reliably earned 300-400 basis points over first lien. With base rates near zero that meant roughly 8.5-9.5% versus 5.5%, or 50-60% more return⁽⁶⁾ for one step down the structure. Second lien was, genuinely, the sweet spot; Structured Capital earned only a marginal premium because there was little demand for it.

That has reversed. Base rates are far higher and second lien spreads have compressed, so second lien today offers modest incremental return over first lien and a minimal (in some years negative) premium to unitranche. Meanwhile the Structured Capital premium has widened: preferred equity earns 13-15% against 9-10% on cash-pay second lien at similar attachment points, and because bespoke instruments cannot be syndicated, fewer providers compete for them.

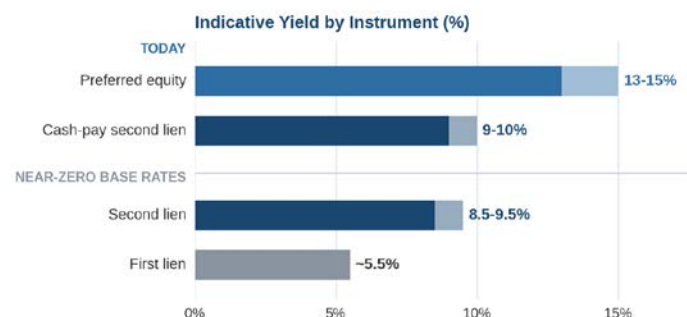
Exhibit 5: Credit Spreads by Tranche

First Lien, Incremental Second Lien and Unitranche Spreads (bps)



Source: PitchBook LCD (first lien and incremental second lien); KBRA DLD (unitranche, available from 2022). Second lien spread not available in 2023 due to insufficient observations.⁽⁹⁾

Exhibit 6: Indicative Yields, Then vs. Now



Source: Penfund observations of market pricing; PitchBook LCD. Lighter shading denotes the upper end of the range; second lien and preferred equity at comparable attachment points.

What Sponsors Need Now: Structured Capital

Many 2021-vintage businesses remain fundamentally sound; their capital structures are the problem. With sponsor equity contributions still at roughly 46-51% of purchase price,⁽¹⁾ a well-structured instrument attaches above a substantial common equity cushion. What these companies need is capital that does not add to cash interest, opens a refinancing path where conventional markets cannot, and lets the sponsor keep the upside.

Exhibit 7: Balance-Sheet Pain Points and the Structured Capital Response

	Sponsor Pain Point	Structured Capital Solution
1. Debt Service	Limited capacity for additional cash-pay debt at current base rates	Non-cash-pay structures (PIK, preferred) reduce debt service and free up cash flow for growth
2. Refinancing	Insufficient deleveraging to refinance in conventional debt markets	Bespoke structures provide a refinancing path where standardized capital cannot
3. Exit Timing	Sponsors unwilling to sell before additional equity value has been created	Non-dilutive capital extends hold periods without giving up equity upside

The Opportunity in Front of Us

The convergence is unusual: a record vintage coming due, coverage ratios that cannot support more cash-pay debt, a second lien market that has all but stopped issuing, and a Structured Capital premium that has widened while the pool of providers remains narrow.

Reach out for a deeper dive into any of these topics, or to discuss how Prime Plus+ is positioning within middle market private credit.

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Endnotes. (1) U.S. private credit AUM: PitchBook, May 2026 US Private Credit Monitor; bank vs. non-bank share, unitranche volume, U.S. LBO volume, leverage and equity contribution: PitchBook LCD. (2) Buyout inventory held four or more years: McKinsey Global Private Markets Report 2026, Clearer View, Tougher Terrain; share of 2021-vintage deals exited: PwC, as of mid-2025. (3) Base rate reflects LIBOR prior to January 1, 2022 and SOFR thereafter; Federal Funds rate from Federal Reserve Economic Data. (4) Market fixed charge coverage is calculated from market LBO leverage and institutional loan yields for targets with more than US\$50 million of EBITDA, per PitchBook LCD; PIK share represents the top 15 publicly traded BDCs by fair value of holdings as of Q1 2026. (5) Maturity wall: PitchBook LCD, as of August 7, 2026. (6) First lien and incremental second lien spreads: PitchBook LCD; unitranche spread: KBRA DLD.