2025-2026 IPA Rising Leaders Virtual Presentation:
Understanding Private Credit: Opportunities and Strategies
March 27, 2025

What Is Private Credit?

Private credit refers primarily to **corporate direct lending**—where asset managers provide customized loans directly to companies, bypassing traditional bank syndication.

- It is now a **$2 trillion market**, experiencing rapid growth due to a shifting regulatory environment and changes in capital markets.
- Historically, debt financing occurred in public markets: A private equity sponsor acquired a company, a bank underwrote the loan, and the loan was syndicated and traded on public markets. This still exists, but is shrinking in market share.
- Today, sponsors can engage directly with asset managers to structure **bespoke, bilateral loan agreements.** This private route offers speed, certainty of capital, and customized terms favorable to both sponsors and lenders.

Key Characteristics of Private Credit

- **Higher yields** than traditional fixed income.
- **Floating rate instruments**, typically tied to SOFR or another benchmark, reset quarterly—offering protection in a volatile rate environment.
- **Seniority in the capital structure**: These are usually senior secured loans, providing repayment priority.
- **Lower liquidity**: These are generally buy-and-hold investments, but a **secondary market** does exist for trading loans.
- Investment strategy aims to be **interest rate agnostic**, focusing on credit quality through rigorous, upfront due diligence and senior positioning to manage downside risk across market cycles.

Investment Strategies

<u>Buy-and-Hold:</u>

- Private credit is typically a **buy-and-hold strategy.** Loans are underwritten with a 5-year maturity and often 2–3 years of call protection.
- The private market offers **greater access to information** and **governance rights** (e.g., board seats, observation rights).
- Emphasis on **deep due diligence** and high conviction, since the investor is likely holding to maturity.
- Existing portfolios are leveraged for insights and diversification.

Liquidity Focus:

- On the **broadly syndicated loan side**, public information, ratings, and broader research make it accessible.
- There's greater **liquidity**, and investors can **exit loans** via the secondary market if necessary.
- While the mindset is still long-term, **investor liquidity needs** require flexibility. Loans can be purchased at a discount with potential for higher yield.
- Increasing interest in **CLO ETFs** to enhance liquidity and access.

Additional Concepts:

- **PIK (Payment-In-Kind)** interest allows borrowers to defer cash interest payments.
    - *"Good PIK"* is used for strategic reinvestment.
    - *"Bad PIK"* signals distress or liquidity problems.

Why Is Private Credit Attractive?

- **Floating rate and senior structure** provide protection and upside in the current environment.
- With **banks pulling back**, private lenders have stepped in, offering **8–11% yields**, and in some cases, equity-like returns (especially with fund-level leverage).
- The asset class has **outperformed over the past 15 years**, particularly for investors who understand and accept the **illiquidity premium**.
- Growing education around managing liquidity expectations: redemptions may be capped or suspended.

Private Credit Products

- Includes **mezzanine loans**, **asset-based lending (ABL)**, **asset-backed securities (ABS)**, **real estate debt**, and **infrastructure debt**.
- These are often **collateralized by assets other than corporate balance sheets**.
- Increasing innovation: Just as private credit addressed the M&A financing gap, similar solutions are emerging for securitized markets.
- **Structured credit** is a key growth area—pooling loans and slicing risk/yield for different investor profiles. These products can last 5–10 years and offer **customized exposure**.

Due Diligence Approach

- Resembles **private equity-style diligence**, involving deep dives into the borrower's structure, operations, cash flows, and liabilities.

Future of Private Credit

- **Geopolitical factors** have limited impact; focus remains on bottom-up credit selection.
- Avoiding credit events is key—focus toward **stable sectors**. With **82 Moody's industry sectors**, managers can tailor exposure.
- Strategy includes identifying **"good neighborhoods"** and tracking **mega-trends**.

Market Trends:

- **M&A deal volume** is currently down 30%, but a secular shift into private credit is underway.
- **Performance-based compensation** aligns managers with outcomes.
- Market growth is accelerating due to:
    - Institutional demand
    - The rise of private wealth platforms
    - Ample dry powder from private equity sponsors

Looking Ahead (2025–2026):

- Some analysts predict this could grow to be a **$30 trillion market** in the next decade.
- Private credit avoids the **maturity wall risk** seen in fixed-rate markets, due to floating rate structures.
- **Spread compression** has occurred, but **base rates remain elevated**, sustaining attractive yields.
- Companies are proving resilient despite higher borrowing costs.
- If the Fed cuts rates modestly, yields may drop slightly but the asset class will likely remain compelling.
- Increased **M&A activity** is anticipated, which will drive loan demand.

Final Thoughts

- While not a new asset class, **private credit is gaining prominence** in investor portfolios.
- As the market becomes more mainstream, **continued growth and innovation** are expected.
- The opportunity set is expanding, with private credit becoming a **core allocation** for both institutional and individual investors.