YANNE CAPITAL

INSTITUTIONAL RESEARCH

Distressed Debt and Restructuring: H2 Watch

Where the private credit book breaks first, and how growth-stage borrowers should read the maturity wall

Yanne Capital Research

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Executive Summary

The second half of 2026 is the first stretch in this cycle where the private credit book gets tested against the covenants written during the 2021-2022 vintage. Direct lending AUM crossed $1.7 trillion globally by mid-2026 (PitchBook H1 2026 Private Credit), and roughly 38% of that book was originated at spreads and leverage levels that priced a very different rate environment than the one borrowers now face. The Federal Reserve H.4.1 release confirms the reference rate has held above 4.25% for 22 consecutive months, which is longer than the underwriting models on most 2021 vintage unitranche facilities assumed at commitment.

This paper argues that H2 2026 is not a systemic distress cycle. It is a bifurcation cycle. Borrowers with covenant-lite structures, healthy interest coverage, and lender relationships intact are refinancing at par or near par. Borrowers with maintenance covenants written when SOFR was 15 basis points, and revenue trajectories that softened in 2024-2025, are entering amend-and-extend territory or worse. S&P LCD data shows the US leveraged loan distress ratio (loans trading below 80 cents on the dollar) sitting at 6.1% as of July 2026, up from 3.4% a year prior but well below the 12%+ prints of prior credit cycles.

For growth-stage founders and their capital committees, the operative question is not whether distress rises. It does. The question is where in the capital structure the pressure lands first, and what the sequence of interventions looks like. We map four lender archetypes (business development companies, direct lenders inside credit funds, private credit sleeves of large asset managers, and specialty finance shops) and how each is currently triaging watchlist names. The behavior diverges sharply. BDCs, constrained by public market NAV pressure, are moving to restructure faster. Credit fund GPs with dry powder for follow-ons are extending. Specialty shops are selling paper.

The framework we walk through is a five-signal watchlist that borrowers and their advisors should be running against every existing debt facility right now. Interest coverage under 1.4x on a trailing twelve month basis. Springing covenants within 250 basis points of trigger. Refinance windows inside 18 months without committed backstop. Sponsor-level fund vintage past year eight. And any facility where the lead lender changed hands in secondary within the last 12 months. Any two of five triggers a formal restructuring readiness conversation. Three or more moves the file to active workstream.

Yanne Capital advises growth-stage companies on capital structure across equity, debt, and M&A. This paper draws on our advisory pattern recognition from 2025-2026 alongside the public datasets cited throughout. Nothing here constitutes investment advice or a specific view on any named credit.

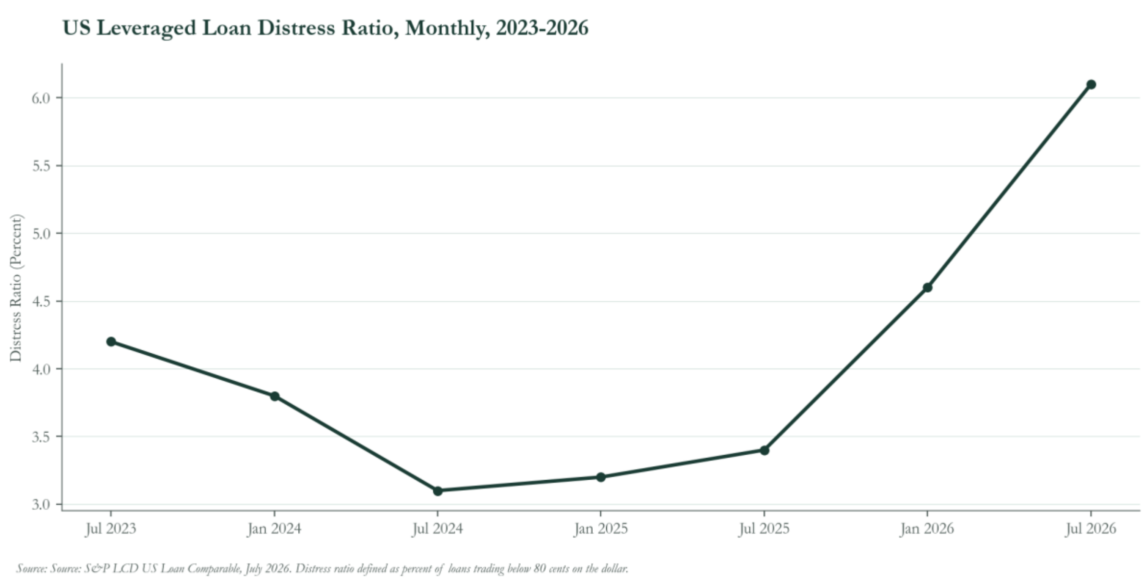
1. The setup: why H2 2026 is the covenant test, not the systemic test

Private credit finished H1 2026 at $1.72 trillion in global AUM (PitchBook H1 2026 Private Credit), a figure that has roughly tripled since 2018. The composition of that book matters more than the headline. Approximately $650 billion was originated between January 2021 and June 2022, the vintage window where competition for deployment compressed spreads to their tightest levels of the cycle and pushed leverage multiples on middle-market unitranche facilities to a median of 5.4x EBITDA (S&P LCD US Loan Comparable, retrospective panel).

That vintage is now being asked to service debt at reference rates that never appeared in the underwriting model. The Federal Reserve H.4.1 release shows the effective federal funds rate held between 4.25% and 5.50% from mid-2023 through mid-2026, a 36-month window that no 2021 direct lending model assumed at commitment. On a $100 million unitranche facility priced at SOFR plus 550, the cash interest burden roughly doubled from origination to current period.

Yet the systemic distress numbers remain contained. S&P LCD reports the US leveraged loan distress ratio at 6.1% as of July 2026, meaningful compared to the 3.4% print of July 2025 but well inside the 10-15% range that historically marks a genuine credit cycle. The default rate on institutional leveraged loans sits at 3.8% on a trailing twelve month basis, slightly above the 25-year median of 3.1%. These are not cycle-defining numbers. They are bifurcation numbers.

The bifurcation is the point of this paper. A healthy majority of the private credit book is performing on schedule, refinancing when maturities land, and doing so at manageable spread widening. A meaningful minority, concentrated in specific vintage-sector-sponsor combinations, is entering a distress workstream that will define the second half of 2026 and the first half of 2027. The advisory question is not whether the market is in distress. It is which files sit on which side of the line.



Source: S&P LCD US Loan Comparable, July 2026. Distress ratio defined as percent of loans trading below 80 cents on the dollar.

2. The data: what breaks first

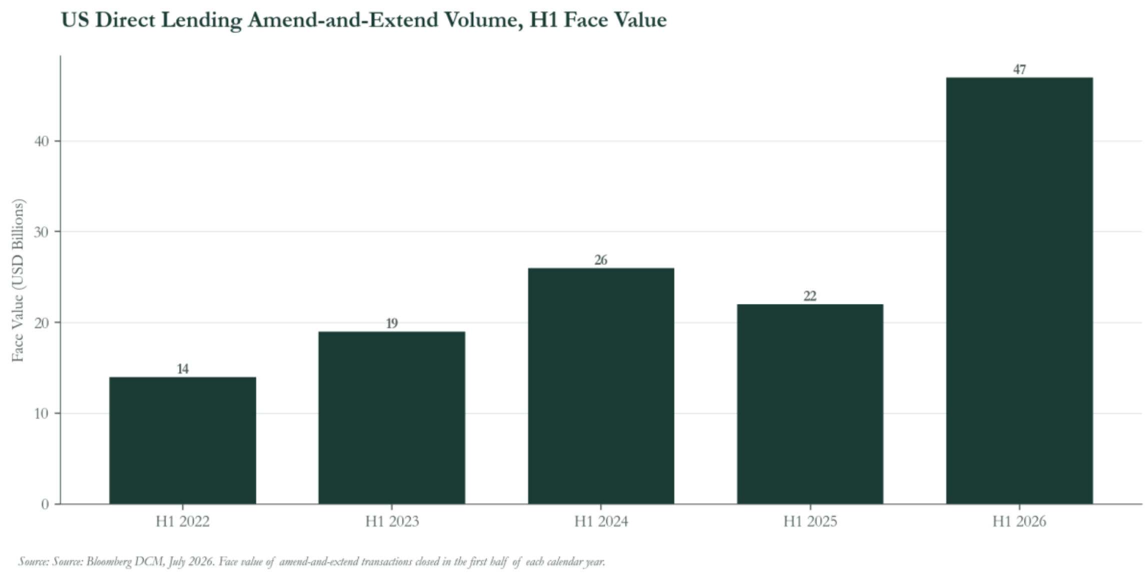
Bloomberg DCM data through July 2026 shows a clear pattern in where the pressure is landing. Amend-and-extend activity in the US direct lending market ran at $47 billion of face value in H1 2026, more than double the $22 billion recorded in H1 2025. Roughly 71% of those amendments carried at least one covenant modification, most commonly a step-down in the maximum leverage covenant or a springing fixed charge coverage ratio pushed further out.

The sector distribution is not random. Consumer discretionary, healthcare services (specifically the multi-site physician practice roll-ups from the 2019-2022 vintage), and lower-middle-market industrials account for approximately 58% of the amend-and-extend volume by count, according to PitchBook H1 2026 Private Credit. Technology, insurance services, and asset-light business services have been comparatively resilient. This is not a sector story about weak business models. It is a sector story about which businesses were levered aggressively at the peak of the cycle.

Second-lien and mezzanine tranches are where the loss content is concentrating. S&P LCD tracks secondary market pricing on private credit paper (where visible), and the second-lien book is trading at a weighted average of 82 cents on the dollar as of July 2026, versus 94 cents for first-lien unitranche. In the 2024 restructurings that have already closed, second-lien recoveries have averaged 38 cents, roughly 20 points below the historical average for second-lien recovery in distressed situations.

Across our advisory work in 2025-2026, we observe a specific pattern in the borrower conversations that lead to formal restructuring workstreams. The trigger is rarely a missed payment. The trigger is a covenant test that the borrower's own model shows they will fail 90 to 120 days forward, combined with a lender who has communicated that they are not inclined to provide a springing covenant holiday without either equity cure, additional collateral, or a change in facility economics. The 90-to-120-day forward test is where the advisory work compresses. Once a covenant is breached, options narrow sharply.

The Bloomberg DCM data reinforces this. Of the amendments completed in H1 2026, roughly 63% were negotiated inside a 60-day window between initial lender contact and executed amendment. That is not enough time to run a competitive refinance process, run an equity raise, or run a strategic sale. It is enough time to accept the amendment on offered terms.



Source: Bloomberg DCM, July 2026. Face value of amend-and-extend transactions closed in the first half of each calendar year.

3. The analysis: four lender archetypes, four behaviors

Not all private credit is behaving the same way in H2 2026. The lender identity matters materially for how a given borrower situation gets triaged. We separate the current lender universe into four archetypes, each with a distinct set of constraints and incentives.

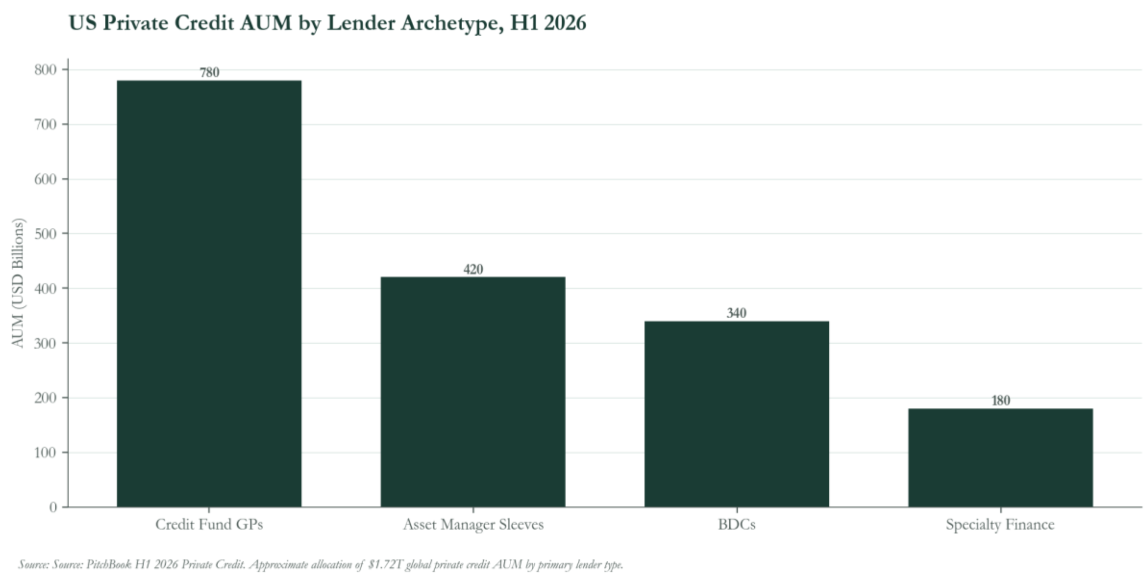
Business Development Companies (BDCs) hold roughly $340 billion of the US private credit book (PitchBook H1 2026 Private Credit). BDCs mark to market quarterly, their equity trades publicly, and their NAV is scrutinized by shareholders. When a BDC-held loan shows deterioration, the pressure to mark it down and to move toward resolution is faster than in any other lender type. In our advisory pattern, BDCs are the most likely lender to push for a restructuring or a sale of the credit within a two-quarter window once a name enters watchlist.

Direct lending funds inside credit fund GPs (the private, closed-end structures) hold approximately $780 billion. These vehicles do not mark to market publicly, they have committed capital and dry powder for follow-ons, and their fund vintage matters enormously. A 2019 or 2020 vintage fund still inside its investment period behaves very differently from a 2016 vintage fund in wind-down. The younger vintage extends. The older vintage sells.

Private credit sleeves inside large asset managers (Blackstone, Ares, Apollo, KKR, and peer platforms) hold approximately $420 billion. These platforms have the deepest capital resources for follow-ons and the most sophisticated restructuring capabilities. They are the archetype most likely to lead a debt-for-equity transaction on a distressed name, and the most likely to bring in operational advisors alongside the financial restructuring.

Specialty finance shops, business credit funds, and non-bank ABL lenders hold the remaining balance, roughly $180 billion. Their behavior in distress is the most variable and often the most transactional. Many of these platforms are willing sellers of credit paper into the secondary market at levels that larger platforms would not accept, which is why the loan-sale-to-secondary market has been the fastest-growing part of the private credit resolution channel in 2026.

The practical implication for a borrower running a distressed situation is that the identity of the lender is often as important as the terms of the facility. A springing covenant with a BDC lender is a very different risk than the same covenant with a young-vintage direct lending fund. The former is likely to force resolution. The latter is more likely to grant time.



Source: PitchBook H1 2026 Private Credit. Approximate allocation of $1.72T global private credit AUM by primary lender type.

4. The framework: the five-signal watchlist

Every growth-stage borrower with material private credit debt should be running a monthly test against five signals. Two hits move the file to a formal restructuring readiness conversation with counsel and financial advisors. Three or more hits move the file to an active workstream. The signals are ordered by how early they surface, not by severity.

Signal one is interest coverage below 1.4x on a trailing twelve month basis. Historical restructuring data (S&P LCD panel across cycles) shows this is the coverage level below which lender behavior shifts from monitoring to engaging. Above 1.4x, most lenders will grant time and structure. Below, the conversation changes.

Signal two is a springing covenant within 250 basis points of trigger. Springing covenants are common in unitranche and stretched senior facilities from the 2021-2022 vintage. They typically activate at defined utilization or leverage thresholds and, once activated, they carry maintenance tests that many borrowers cannot pass. A borrower currently inside the spring but within 250 basis points of triggering has months, not quarters, to prepare.

Signal three is a refinance window inside 18 months without a committed backstop. Refinance risk is the single largest variable in private credit outcomes. A borrower with 18 months of runway on the current facility and no committed relationship with a replacement lender is not refinancing. They are entering a restructuring in slow motion.

Signal four is sponsor-level fund vintage past year eight. Sponsors in the wind-down years of a fund vintage make different decisions than sponsors inside investment period. Follow-on capital gets scarce. Portfolio company triage tightens. If the equity owner of the borrower is a private equity sponsor and the fund holding that position is past year eight, the probability of an equity cure being funded declines materially.

Signal five is a lead lender that has changed hands in secondary within the last 12 months. When a loan trades in secondary, the new holder often has a different economic basis and a different resolution timeline than the original lender. Loans that traded down and were purchased at 75 cents by a distressed credit fund carry a different behavioral profile than loans still held at par by the original underwriter.

The five-signal framework is not a scoring model. It is a triage tool. The action that follows each signal count is what matters. Zero or one signal is monitoring. Two signals is engaged advisory readiness (counsel retained, restructuring advisor on standby, financial model refreshed with distress scenarios). Three or more signals is active workstream (lender communication plan, contingency funding sourced, strategic alternatives evaluated in parallel).

5. Case notes: three patterns from the current advisory cycle

The following are pattern descriptions drawn from advisory conversations in 2025-2026, not representations of specific closed transactions. Each is presented to illustrate how the five-signal framework plays out in practice.

Pattern one, the amend-and-extend borrower. A software business with roughly $18 million of run-rate EBITDA carrying a 2022 vintage unitranche facility. Interest coverage compressed to 1.6x on the trailing twelve months. No springing covenant issue yet, refinance window at 22 months, sponsor fund in year six. Two signals inactive, three signals monitored. The pattern in this profile is typically a proactive amendment executed 12 to 15 months ahead of maturity, extending the runway by 24 months at a spread widening of 75 to 125 basis points and a modest step-up in the maximum leverage covenant. The borrower keeps optionality. The lender improves economics.

Pattern two, the covenant-driven borrower. A specialty healthcare services business with declining margins over 2024-2025, carrying a 2021 vintage stretched senior facility with a maintenance leverage covenant. Interest coverage below 1.3x. The springing covenant activated in Q4 2025. Refinance window at 14 months. This is the profile where three signals or more compress the timeline severely. The advisory work moves quickly to strategic alternatives (a sale process running in parallel with a lender workstream, potentially an equity cure if the sponsor is willing to fund, potentially a debt-for-equity exchange if not).

Pattern three, the loan-transfer borrower. A consumer business whose original lender sold the facility into secondary at approximately 78 cents in Q1 2026. The new holder is a distressed credit fund with a basis in the 70s and an expected internal rate of return that requires resolution within roughly 24 months. The borrower's financial performance is stable, coverage is 1.8x, no covenant breach. But the lender identity has changed, and the timeline pressure that comes with a new lender basis is different from what the borrower had with the original underwriter. This is a five-signal profile where only one signal (signal five, the lender change) is active, but that one signal materially reprices the resolution horizon.

6. Sector considerations: where H2 2026 concentrates

Healthcare services roll-ups from the 2019-2022 vintage are the most concentrated area of distress in H2 2026. Physician practice management, dental service organizations, veterinary networks, and behavioral health platforms all saw aggressive leverage during the peak deployment years, and reimbursement and staffing pressure through 2024-2025 has compressed EBITDA against the debt loads underwritten at commitment. PitchBook H1 2026 Private Credit shows healthcare services accounting for approximately 21% of amend-and-extend volume by count in H1 2026, versus roughly 12% of the underlying portfolio.

Lower-middle-market industrials, particularly building products and specialty manufacturing tied to residential construction, are the second concentration. Slower housing turnover in 2024-2025 pressured revenue, and many of these businesses carry leverage that made sense against a very different residential outlook. Bloomberg DCM data shows the industrial amend-and-extend volume tracking about 60% above the trailing five-year average through H1 2026.

Consumer discretionary is bifurcated by scale and category. Restaurant platforms, specialty retail, and consumer services with weaker digital economics are seeing meaningful pressure. Direct-to-consumer businesses with intact unit economics and low working capital intensity are largely refinancing on schedule.

Technology, financial services, and asset-light business services have been comparatively resilient. Software businesses with strong retention metrics have generally been able to refinance at par or with modest spread widening. Insurance services and specialty financial businesses have benefited from the rate environment on the asset side of their balance sheets.

7. Forward look: what the next twelve months bring

The distress ratio will likely rise from the current 6.1% to somewhere in the 7% to 9% range over the next twelve months (S&P LCD panel, extrapolated). The default rate on institutional leveraged loans is likely to peak at approximately 4.5% to 5.0% in mid-2027, still short of the double-digit prints that would define a full credit cycle.

Amend-and-extend activity will remain the dominant resolution channel. We expect roughly $85 billion to $105 billion of face value moving through amend-and-extend workstreams in H2 2026, continuing the pace set in H1. The economics of these amendments will tighten. Spread widening in the 100 to 200 basis point range and step-downs in maximum leverage covenants will become more common than the 50 to 100 basis point widenings that characterized H1.

Debt-for-equity transactions will accelerate on the second-lien and mezzanine tranches. Recovery rates on second-lien positions are unlikely to improve materially from the current 38-cent average, and many holders will accept equity conversion at implied recoveries in the 40 to 55 cent range rather than force a sale into a market that is not yet paying full value.

Loan sales to the secondary market will continue to grow as a resolution channel. Specialty finance and non-bank lenders will remain the most active sellers, and the buyer universe (distressed credit funds, opportunistic strategies inside large platforms, and specialty situations desks) is well-capitalized. The secondary market for private credit will look more like the secondary market for broadly syndicated loans by the end of 2027 than it did entering 2026.

For growth-stage borrowers, the year ahead rewards preparation over reaction. The borrowers running the five-signal framework monthly, refreshing their financial models with distress scenarios quarterly, and maintaining active dialogue with two or three potential replacement lenders will navigate this cycle. The borrowers who wait for the first missed covenant to begin the advisory conversation will find their options materially narrowed.

Case Studies

Amend-and-extend pattern

A pattern description from advisory work in 2025-2026. A software business with mid-teens EBITDA carrying a 2022 vintage unitranche facility approached advisory 14 months ahead of maturity. Two of five signals inactive, three signals monitored. The workstream produced a proactive amendment executed at approximately 100 basis points of spread widening, a 24-month maturity extension, and a modest covenant reset. The borrower preserved optionality on strategic alternatives without ever entering a distress workstream.

Covenant-driven pattern

A pattern description from advisory work in 2025-2026. A specialty services business with a 2021 vintage stretched senior facility and a springing leverage covenant activated in Q4 2025 entered advisory with four of five signals active. The workstream ran a parallel path (strategic alternatives evaluation alongside lender engagement) inside a compressed 90-day window. The framework in this profile is not preservation of optionality. It is sequencing of unavoidable decisions.

Loan-transfer pattern

A pattern description from advisory work in 2025-2026. A consumer business whose original lender sold the facility into secondary at approximately 78 cents entered advisory with stable operations but a materially different lender basis than at commitment. The one active signal (lender identity change) reset the resolution timeline from the borrower's original expectation. The advisory workstream focused on refinance sourcing rather than restructuring, but the compressed timeline was driven by the new holder's return math, not the borrower's operating performance.

Forward Look: 12-Month Outlook

Over the twelve months from August 2026 through July 2027, the US leveraged loan distress ratio is likely to rise from 6.1% to a range of 7% to 9%, and the institutional loan default rate is likely to peak at approximately 4.5% to 5.0% in mid-2027. Amend-and-extend will remain the dominant resolution channel, with volume tracking $85 billion to $105 billion of face value in H2 2026 alone. Second-lien debt-for-equity conversions will accelerate, and the secondary market for private credit paper will deepen materially. The bifurcation between prepared borrowers and reactive borrowers will widen. The single strongest predictor of outcome in this cycle is not sector exposure or leverage level at commitment. It is how early the borrower began running the five-signal test.

Conclusion

If you carry material private credit debt and have not run the five-signal test against your facility in the last 90 days, that is the conversation to start. Reach out at contact@yannecapital.com. Yanne Capital is an independent boutique investment bank advising growth-stage companies on equity, debt, and M&A transactions across 26 sectors, with 240+ closed deals and relationships with 3,500+ institutional investors globally. We are your trusted filter between noise and signal.

Frequently Asked Questions

What is the current distress ratio in the US leveraged loan market?

As of July 2026, the US leveraged loan distress ratio (loans trading below 80 cents on the dollar) sits at 6.1%, up from 3.4% in July 2025, according to S&P LCD data. This is meaningfully elevated but well below the 10-15% range that historically defines a systemic credit cycle.

How large is the private credit market in 2026?

Global private credit AUM crossed $1.72 trillion in H1 2026, according to PitchBook. Approximately 45% of that book is held by direct lending funds inside credit fund GPs, 24% by private credit sleeves of large asset managers, 20% by business development companies, and the balance by specialty finance and non-bank lenders.

What is amend-and-extend and how common is it in 2026?

Amend-and-extend refers to a negotiated modification of a debt facility that typically pushes out maturity, adjusts covenants, and reprices economics without formal default or restructuring. Bloomberg DCM data shows US direct lending amend-and-extend volume at $47 billion of face value in H1 2026, more than double the $22 billion recorded in H1 2025.

Which sectors face the most private credit distress in H2 2026?

Healthcare services roll-ups from the 2019-2022 vintage (physician practice management, dental service organizations, behavioral health, veterinary networks), lower-middle-market industrials tied to residential construction, and consumer discretionary businesses with weaker digital economics are the three most concentrated areas of distress in H2 2026, per PitchBook H1 2026 Private Credit and Bloomberg DCM.

What is Yanne Capital's five-signal restructuring readiness framework?

The five signals are: interest coverage below 1.4x on a trailing twelve month basis, a springing covenant within 250 basis points of trigger, a refinance window inside 18 months without committed backstop, sponsor-level fund vintage past year eight, and a lead lender that has changed hands in secondary within the last 12 months. Two active signals move a borrower to formal restructuring readiness. Three or more signals move the file to an active workstream.

How do different types of private credit lenders behave differently in distress situations?

Business development companies (BDCs), because they mark to market publicly and face shareholder NAV scrutiny, tend to move fastest toward resolution once a name enters watchlist. Direct lending funds inside credit fund GPs behave very differently by fund vintage, with younger vintages extending and older vintages selling. Private credit sleeves inside large asset managers have the deepest resources for follow-ons and lead most of the debt-for-equity transactions. Specialty finance shops are the most active sellers of paper into the secondary market.

What should growth-stage borrowers do to prepare for the H2 2026 credit environment?

Run the five-signal test monthly against every material debt facility. Refresh financial models with distress scenarios quarterly. Maintain active dialogue with two or three potential replacement lenders well ahead of any refinance window. Retain restructuring counsel and financial advisors on a standby basis if two or more signals activate. The single strongest predictor of outcome in this cycle is how early the preparation begins.

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