June 5, 2025

Global Credit Weekly:

Taking stock of private credit fundamentals

BlackRock

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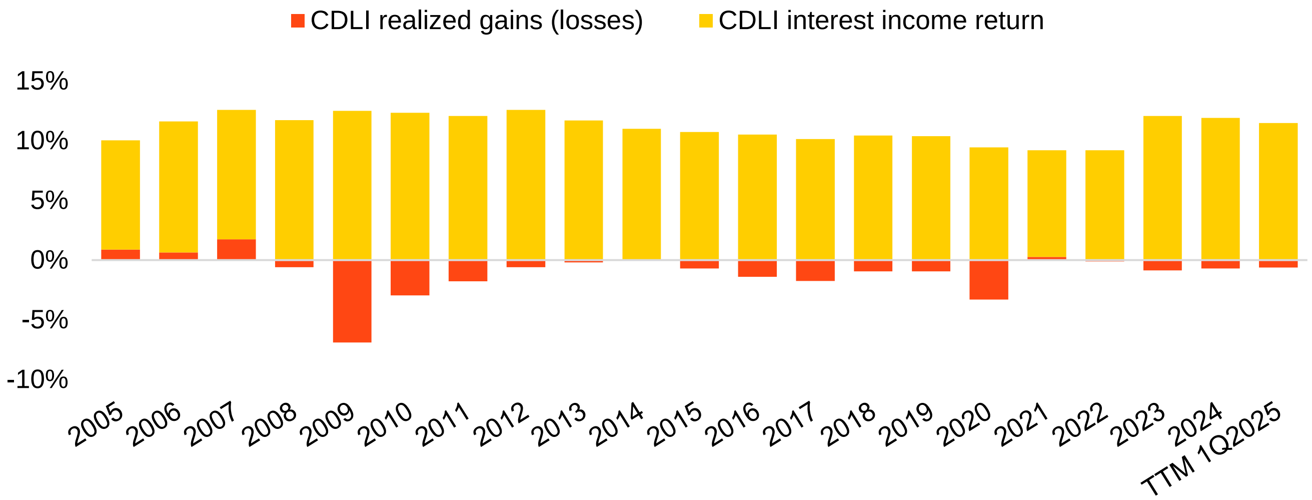
Key takeaways

- Despite the significant market volatility of the past few months, a few underlying views have remained somewhat consistent: U.S. growth is likely to moderate from the above-trend pace of the past few years, and prospects for preemptive Federal Reserve interest rate cuts in the near term are quite low. As a result, we expect corporate credit borrowers will likely need to navigate a structurally higher cost of capital environment, amid a less supportive growth backdrop.
- In this *Global Credit Weekly*, we take stock of the most recent fundamental and performance data from the private credit asset class, using a wide range of third-party data sources that we track. Our deep dive covers topics specific to private credit (i.e., covenant defaults, payment-in-kind, non-accruals, BDCs, fundraising) as well as the more 'traditional' metrics that we also track in the liquid credit market (i.e., all-in yields, realized losses, recovery rates, leverage, coverage).
- The growth backdrop is the most critical ingredient, in our view, as to whether this broad range of private credit fundamentals will remain resilient. This underscores the importance of monitoring real-time signals to track whether economic activity 'catches down' to the softer sentiment data.
- Additionally, private credit borrowers cannot be painted with a broad brush. Under the surface, there is a considerable amount of dispersion, similar to the trends we have observed across a range of other asset classes that we track such as liquid credit, commercial real estate, and the U.S. consumer. And across both the liquid and private credit markets, we are closely monitoring the 'tails', which were already under fundamental pressure prior to any slowdown in economic activity.

Exhibit 1: Realized losses for the Cliffwater Direct Lending Index were contained through 1Q

Trailing 12-month interest income return and realized gains (losses)



Source: Cliffwater Direct Lending Index, BlackRock. As of March 31, 2025 (most recent available as of June 4, 2025). Realized gains in the CDLI can be driven by equity stubs, warrants, and gains on exited investments. These were more common in 2005-2007, when second lien and mezzanine loans were a greater portion of the CDLI. We exclude unrealized gains and losses in this chart. Long-term unrealized gains (losses) are approximately zero, as they either convert to net realized losses upon a credit default or are reversed when principal is fully repaid. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs, or expenses. Indices are unmanaged, and one cannot invest directly in an index.

Private credit fundamentals: Taking stock

Despite the significant market volatility of the past few months, a few underlying views have remained somewhat consistent: U.S. growth is likely to moderate from the above-trend pace of the past few years, and prospects for preemptive Federal Reserve interest rate cuts in the near term are quite low. As a result, we expect corporate credit borrowers will likely need to navigate a structurally higher cost of capital environment, amid a less supportive growth backdrop.

In this *Global Credit Weekly*, we take stock of the most recent fundamental and performance data from the private credit sector, using a wide range of third-party data sources that we track. In short, the data, which extend through 1Q2025, show that a few private credit fundamental metrics have weakened somewhat, while most others have remained steady or even improved. That said, while fundamentals, in aggregate, are generally still solid, there is a notable degree of dispersion under the surface. These themes are consistent with what we have observed in other market segments, such as liquid credit, commercial real estate, and the U.S. consumer.

We believe private credit borrowers' ability to navigate the sharp increase in interest rates in 2022 and 2023 was due, in large part, to the above trend pace of growth which prevailed over the past several quarters. This underscores the importance of monitoring real-time signals to track whether economic activity 'catches down' to the soft sentiment data.

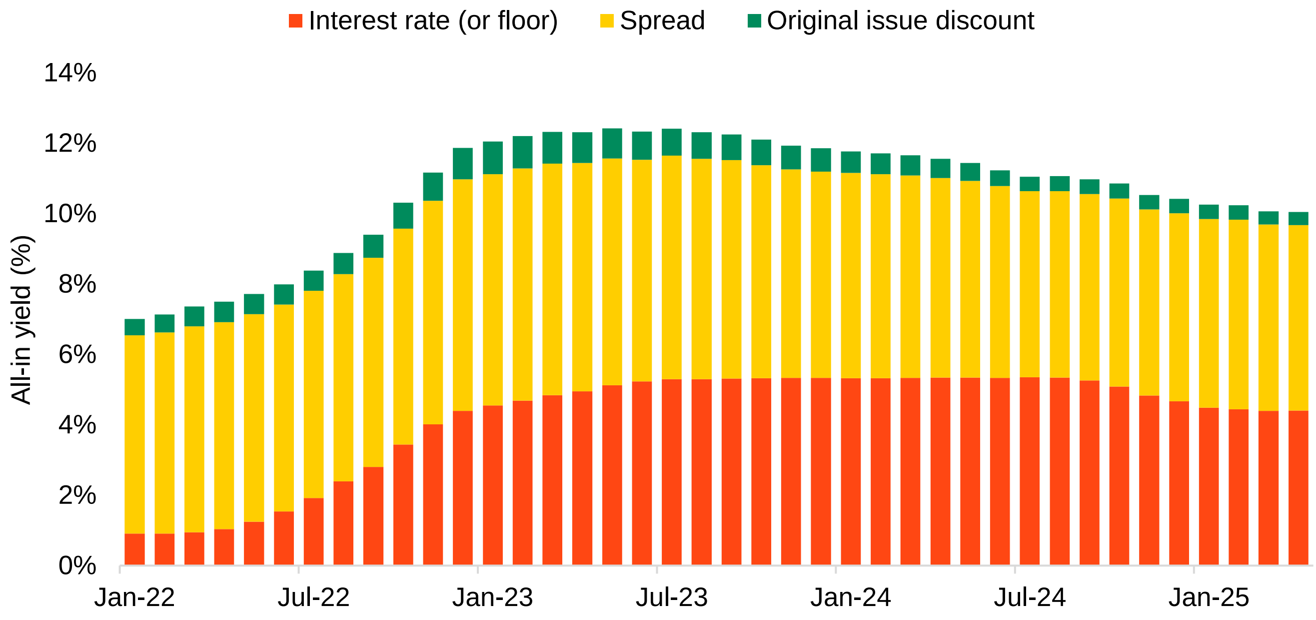
Income and realized losses

We first turn to the Cliffwater Direct Lending Index (CDLI), which is an asset-weighted index of approximately 19,000 directly originated U.S. middle market loans totaling $465 billion. In 1Q2025, the trailing twelve-month (TTM) interest income of the CDLI totaled 11.47%, compared to realized losses of 63bp (Exhibit 1). Notably, the trailing twelve-month loss rate remains below the longer-term average of roughly 100bp.

Exhibit 2 illustrates the historical breakdown of the all-in yield components for private credit loan ('unitranche') pricing, this time using data from KBRA DLD. While interest rates have declined modestly, in tandem with Federal Reserve rate cuts delivered in 2H2024, they remain elevated in absolute terms, relative to January 2022 (before the Federal Reserve began its rate-*hiking* cycle). Spreads as of April 2025 have compressed approximately 130bp vs. the February 2023 wides and are 40bp tighter vs. April 2024. That said, they have been relatively stable over the past few months.

Exhibit 2: All-in yields: modest spread compression and structurally high rates

All-in yield breakdown for U.S. new issue unitranche private credit loans (3-month rolling averages)



Source: KBRA DLD, BlackRock. As of April 30, 2025. 3-month rolling averages for 1L term loans. Original issue discount assumes a 3-year yield to maturity.

Defaults and recoveries

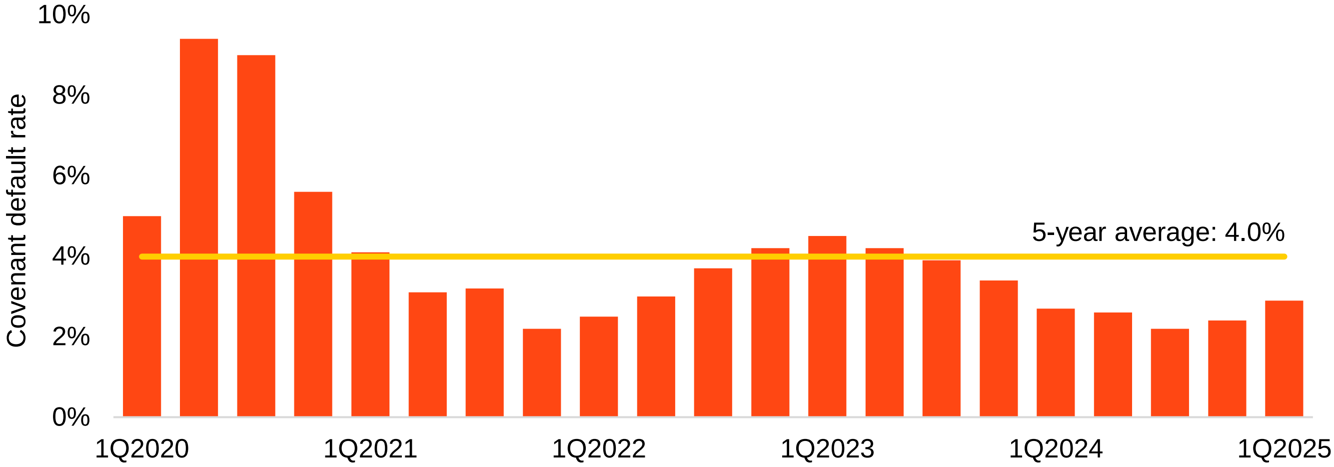
While still tracking below the 5-year average (4.0%; Exhibit 3), the recent uptick in the private credit covenant default rate warrants watching, in our view. Indeed, after six consecutive quarters of declines, the covenant default rate has increased for the past two quarters. The uptick is notable, as it may suggest a waning in lenders' willingness to amend challenged loans in the months ahead. This may be informed by an expectation of a combination of a more challenging growth backdrop, policy uncertainty, and structurally higher interest rates.

That said, for investors, we view ultimate *losses* as more informative than covenant defaults. Exhibit 4 demonstrates the implied recovery rates for private credit loans that defaulted. Most notable, in our view, is that the implied trailing 12-month recovery rates have remained steady over the last year, suggesting that loans which defaulted 1 year ago had a similar recovery as those which have defaulted more recently.

And so, amid some market participants' concerns of 'amend and extend' activity across various markets, data suggests that fair value marks and principal recovery have followed a somewhat consistent trend.

Exhibit 3: The covenant default rate remains below the 5-year historical average...

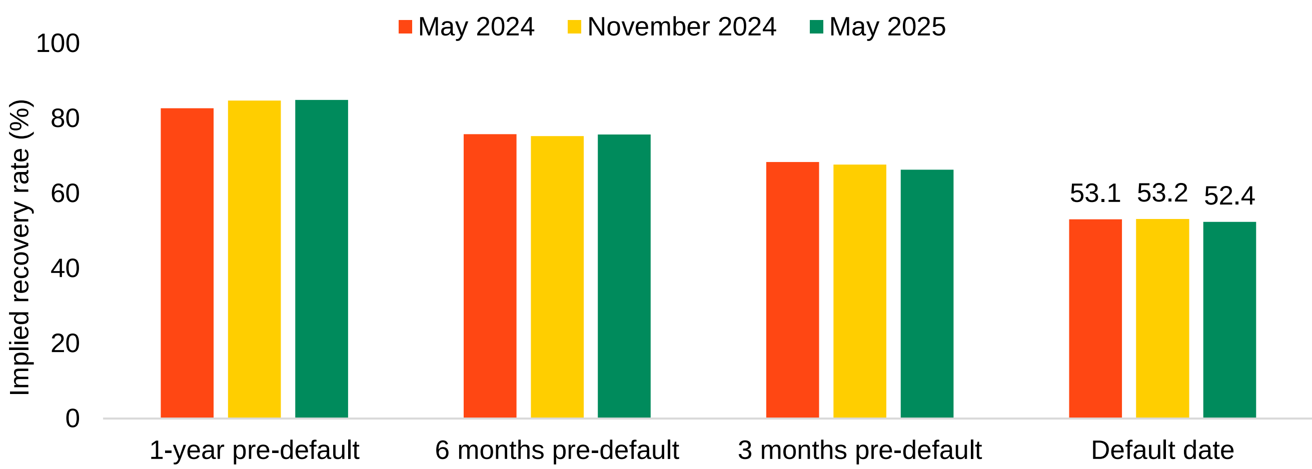
Aggregate size-weighted covenant default rate, and the 5-year historical average, for the U.S. portfolio companies included in the Lincoln International Proprietary Private Market Database



Source: Lincoln International Proprietary Private Market Database, BlackRock. As of 1Q2025. A default is defined by Lincoln as a covenant default (not necessarily a monetary default). The calculation is size-weighted and considers the total net debt balance for each of the portfolio companies that had a defaulting security in the respective quarter.

Exhibit 4: ...and implied recovery rates have held steady

Average trailing 12-month implied recoveries (equal weighted) for defaulted direct lending loans as of May 2024 (count = 23), November 2024 (count = 36), and May 2025 (count = 51)



Source: KBRA DLD, Solve, BlackRock. Captures data through May 22, 2025. Implied recovery rates are calculated as fair value / principal.

Non-accruals

Another fundamental indicator that we track closely is the non-accrual rate, which captures loans that are no longer current in paying interest income and would be considered in default. Data from the CDLI shows that non-accruals in private credit have been modest. As of 1Q2025, roughly 1.3% of the CDLI's loan value by cost was on non-accrual, suggesting $5.9 billion in aggregate value (Exhibit 5).

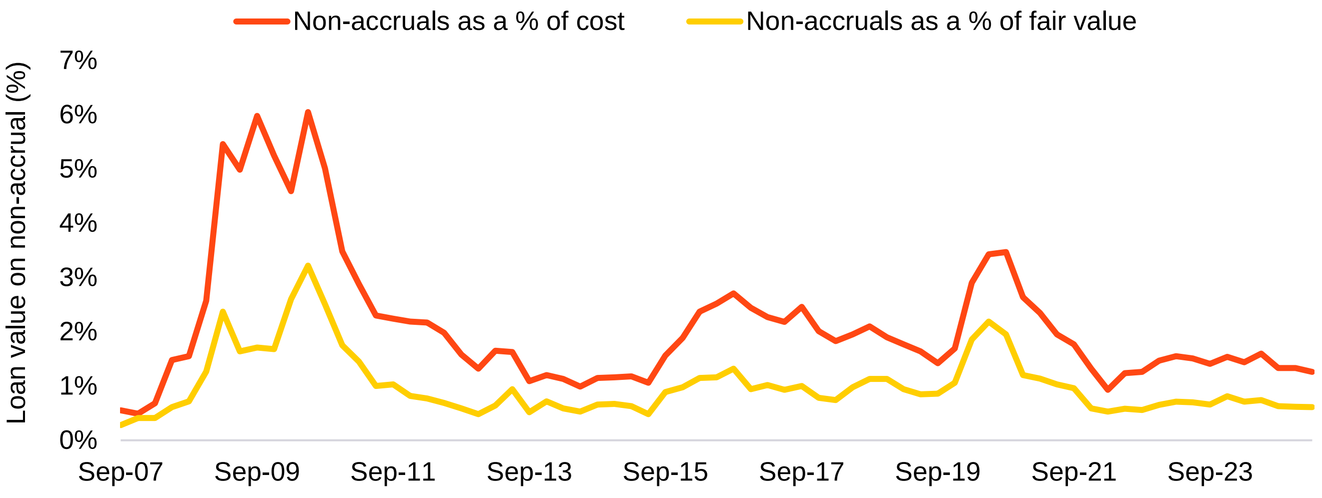
This represents a continuation of a low and range-bound level, with the share of loans on non-accrual hovering between 1% and 1.6% since 2022. This is also modest by historical standards, compared to a long-term average of 2.1%, and a peak of 6% in 2010.

That said, as is often the case in private credit, there is considerable dispersion under the surface. Indeed, as demonstrated by Exhibit 6, loans originated in 2021 represented roughly 30% of the total loan value at cost on non-accrual status in 2024.

2021 was characterized by ample deal activity, a favorable macro backdrop (owing to the 'reopening' of the economy following the pandemic), and a benign interest rate regime. As such, some underwriters may have underestimated the risk of a meaningfully higher interest rate backdrop (which ultimately came to pass). This, in our view, underscores the importance of vintage diversification in investing.

Exhibit 5: Non-accrual rates are below historical averages...

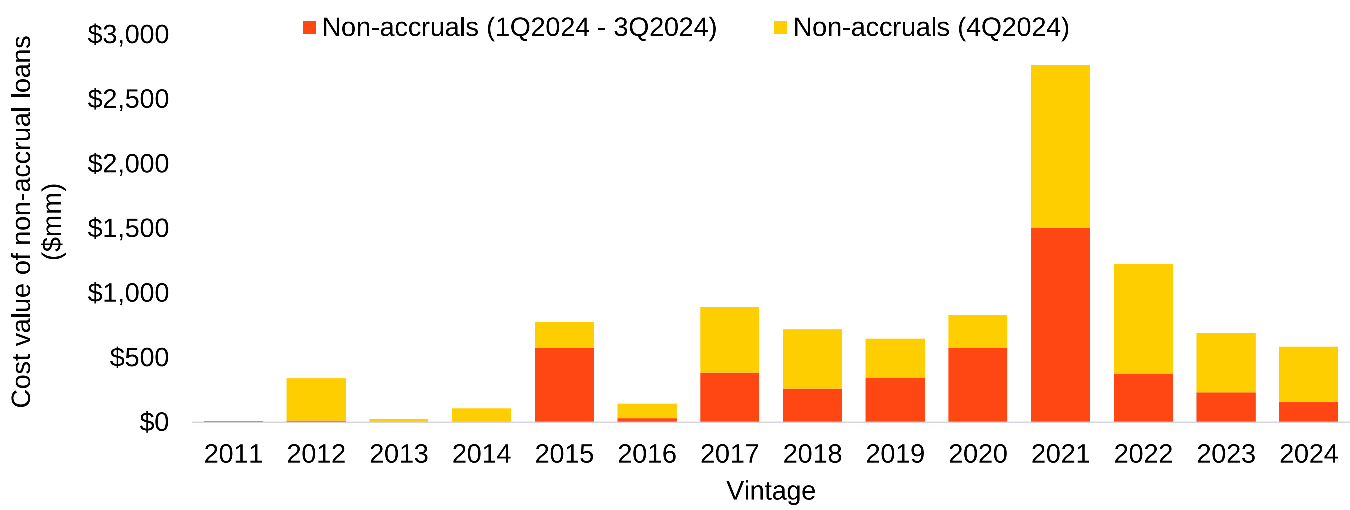
Non-accrual rates (as a percentage of cost and fair value) for the Cliffwater Direct Lending Index



Source: Cliffwater Direct Lending Index, BlackRock. As of 1Q2025.

Exhibit 6: ...though a look under the surface reveals dispersion

Cost value of non-accrual loans during 1Q2024 - 3Q2024 and 4Q2024, by origination vintage, in $ millions



Source: Cliffwater Direct Lending Index, BlackRock. **Performance data represents past performance, which does not guarantee future results.** There is no assurance that similar investments will be made or that similar results will be achieved.

Leverage and interest coverage

Of course, similar to our approach in analyzing the liquid corporate credit market, we also track the more 'traditional' fundamental metrics, such as leverage and interest coverage. In general, these fundamental indicators are also holding in well – at least through 1Q2025.

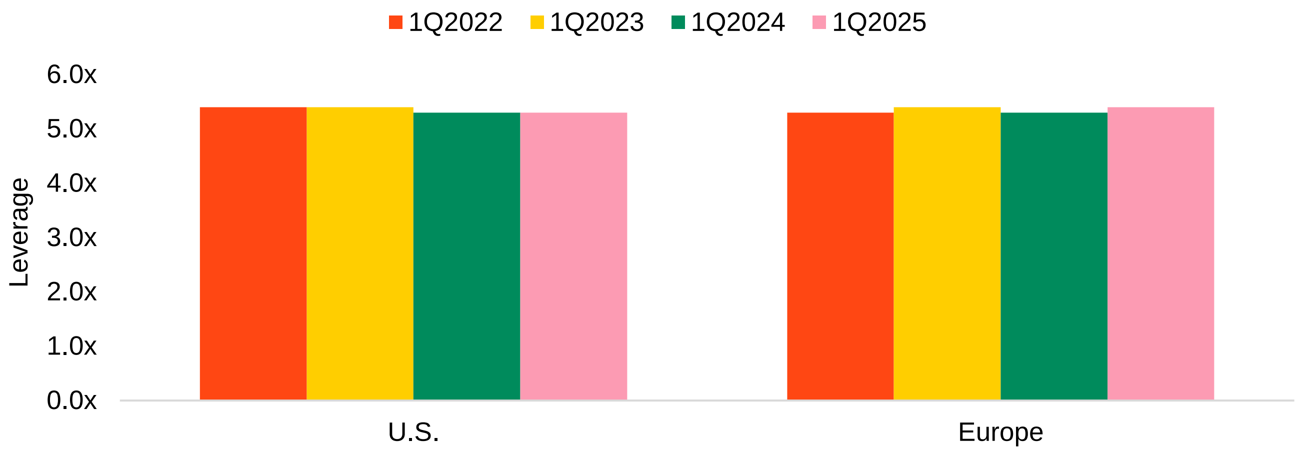
To assess these specific trends, we now turn to the Lincoln International Proprietary Private Markets Database, which captures over 6,000 portfolio companies across more than 200 sponsors. For context, the database captures roughly 30% of all U.S. private equity-backed companies.

Exhibit 7 shows that leverage levels have held steady for companies in the Lincoln International database over the last four years. This suggests that, in aggregate, debt has grown proportionately – at least relative to EBITDA (i.e., the denominator of the leverage multiple) – for borrowers in the database.

Fixed charge coverage ratios modestly *improved* across the Lincoln International universe of U.S. and European companies (Exhibit 8). This likely comes as a result of central bank rate cuts in both regions. We view improving fixed charge coverage as a positive signal for private credit borrowers. This metric will be important to watch, especially should the growth backdrop show signs of slowing.

Exhibit 7: Leverage levels have held steady over time…

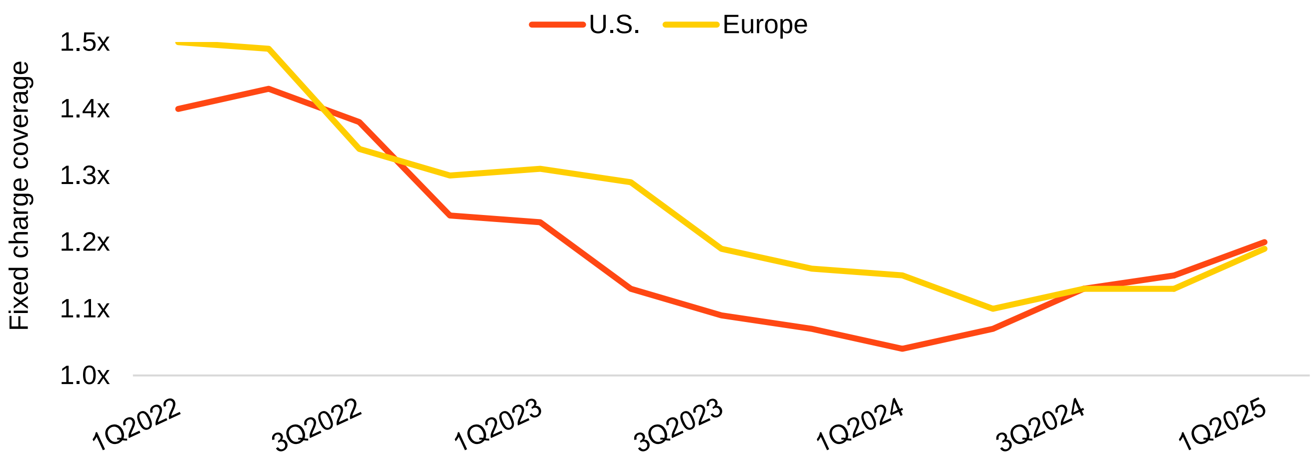
Average total leverage multiples (debt / EBITDA), over time, for the universe of U.S. and European firms captured by Lincoln International



Source: Lincoln International Proprietary Private Market Database, BlackRock. As of 1Q2025.

Exhibit 8: …and interest coverage has improved

Size-weighted fixed charge coverage ratios for the universe of U.S. and European firms captured by Lincoln International



Source: Lincoln International Proprietary Private Market Database, BlackRock. Captures data as of 1Q2025. Calculation: (EBITDA – Taxes – Capex) / (Interest Expense + 1% Debt Balance). For U.S., respective SOFR rates represent a trailing 4 quarter average. For Europe, interest is calculated regardless of whether the company is making cash payments, using Payment-in-Kind (PIK) interest if cash interest is not being paid.

PIK utilization

Payment-in-Kind (PIK) utilization represents another fundamental indicator of private credit borrower health. PIK reflects interest that is 'paid' in the form of additional non-cash principal, as opposed to cash interest income. As we've detailed previously, there are two ways to track PIK: (1) the share of deals that include PIK as an option and (2) PIK as a percentage of interest income. We view the second metric as more informative for credit deterioration, as it reflects a company's liquidity management choices in times of stress.

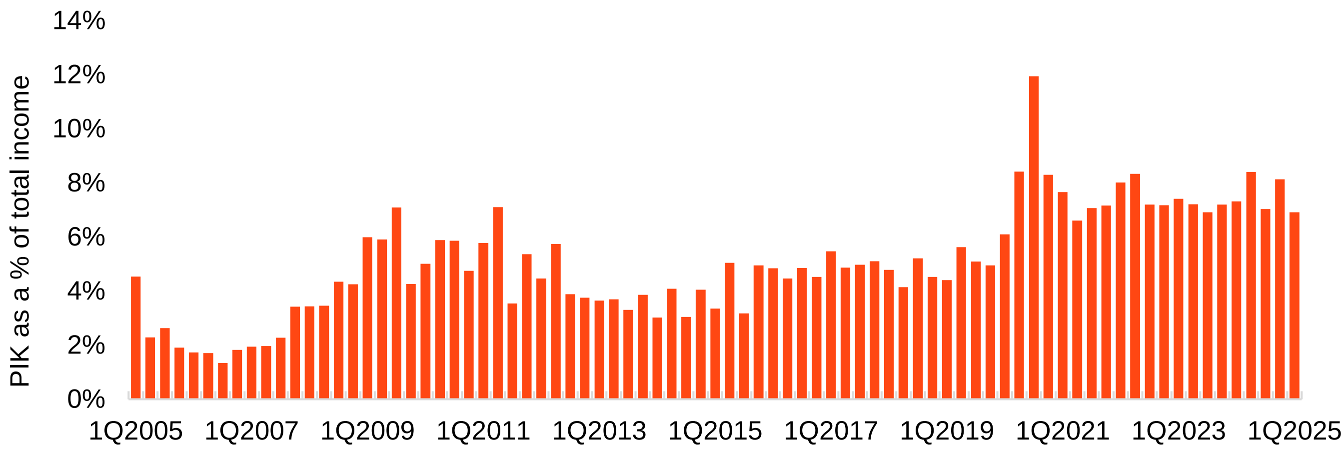
As demonstrated in Exhibit 9, PIK as a share of total interest income fell to 6.9% in 1Q2025, the lowest level seen since 3Q2023, but broadly in line with range-bound levels since late 2021.

An analysis from Lincoln International draws an important distinction between so-called 'good PIK' and 'bad PIK.' For example, 'good PIK' is defined as PIK included as an option for a borrower in the *original* credit documents. In this case, a PIK option may be included to 'win' a deal, generally signaling that the borrower is high-quality. By contrast, 'bad PIK' is PIK that is amended into a credit agreement *after* origination, likely because the borrower is experiencing (unanticipated) stress.

Exhibit 10 demonstrates how 'bad PIK' has grown as a share of total PIK in recent years. Though the share has grown, levels of 'bad PIK' have remained considerably steady since 2023, suggesting that while this trend warrants watching, it does not necessarily indicate excess stress vs. 2023 and 2024.

Exhibit 9: PIK as a share of total interest income fell in 1Q2025

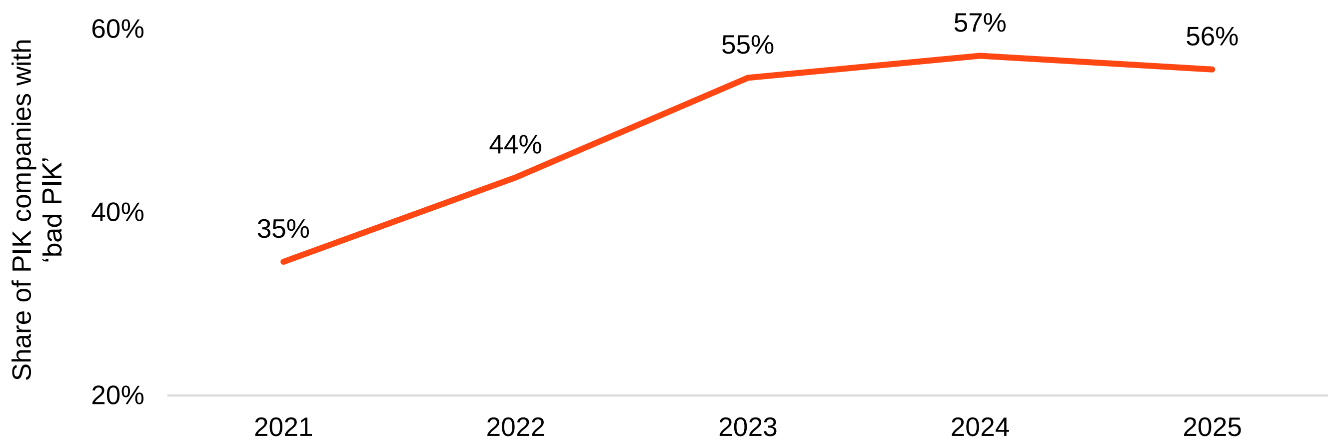
Payment-in-Kind (PIK) as a percentage of total interest income for the Cliffwater Direct Lending Index



Source: Cliffwater Direct Lending Index, BlackRock. As of March 31, 2025 (most recent available for CDLI).

Exhibit 10: Of the borrowers with a PIK option, the share of PIK added *after* deal close has been steady in recent years

Share of companies with Payment-in-Kind (PIK) interest currently, but did not have PIK at close (i.e., so called 'bad PIK') in the Lincoln International Proprietary Private Market Database



Source: Lincoln Proprietary Private Market Database, BlackRock. As of 1Q2025. 'Bad PIK' is defined as investments without PIK at close that have PIK now.

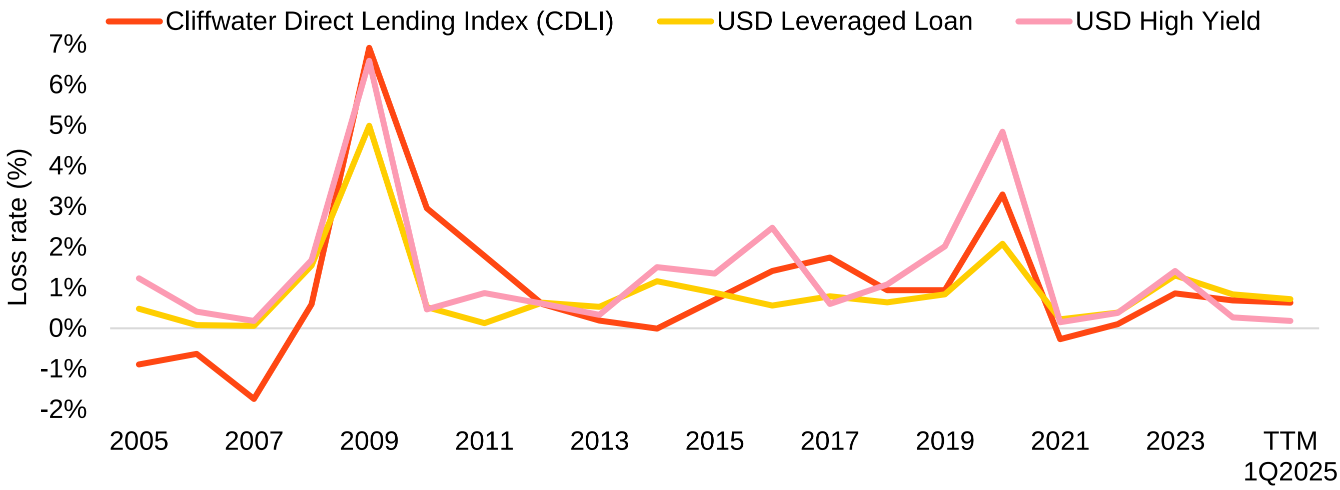
Loss rates, yield differentials

Exhibit 11 demonstrates how loss rates have compared between the CDLI and syndicated corporate credit markets, including USD leveraged loans and high yield bonds, over time. Using trailing 12-month data, as of 1Q2025, USD HY bonds have the lowest loss rates, followed by the CDLI and loan markets which have comparable metrics. That said, loss rates across all three segments remain notably contained and below long-term averages (2005 – 2024). We continue to view the collaborative relationship between private credit lenders and borrowers as a feature of the asset class that can help maximize recoveries in the event of borrower stress.

Similarly, Exhibit 12 shows how the private credit yield differential has compared to HY bonds and leveraged loans. We view loans as the most direct comparison to direct lending, as both are floating rate (as opposed to HY, which is fixed rate).

Exhibit 11: Loss rates remain contained across credit markets

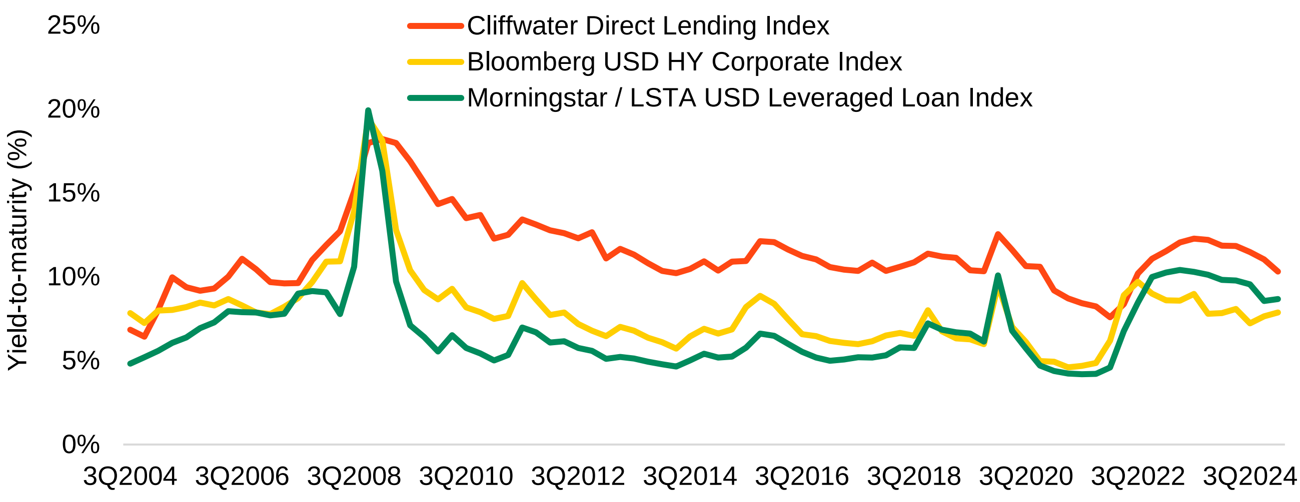
Realized annual and trailing 12-month 1Q2025 loss rates for the Cliffwater Direct Lending Index (CDLI) and for the universe of USD leveraged loans and HY bonds tracked by JP Morgan (calculated as actual issuer-weighted trailing 12-month default rate, multiplied by one minus the issuer-weighted recovery rate, based on prices 30 days after default)



Source: Cliffwater, JP Morgan, BlackRock. For the CDLI, we show annual and trailing 12-month realized loss rate data for 1Q2025 (most recent available). Realized gains in the CDLI can be driven by equity stubs, warrants, and gains on exited investments. These were more common in 2005-2007, when second lien and mezzanine loans were a greater portion of the CDLI. For USD Leveraged Loans and High Yield, we show implied loss rates based on JPM's actual issuer-weighted, trailing 12-month default and recovery rates.

Exhibit 12: The CDLI offers a modest yield 'pick up' vs. broadly syndicated leveraged loans

Average index yield-to-maturity levels



Source: Cliffwater LLC, Bloomberg, Morningstar / LSTA, Pitchbook LCD, BlackRock. As of 1Q2025 (most recent for CDLI).

For both charts: **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.

Continued dispersion warrants watching...

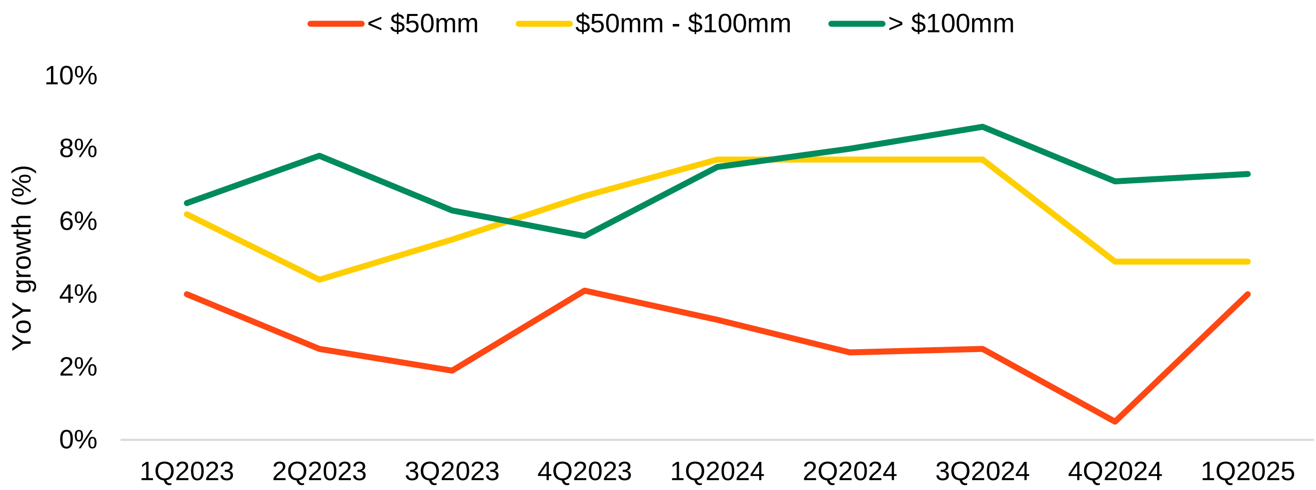
Even with a wide range of fundamental metrics at hand, the private credit asset class cannot be painted with a broad brush. Under the surface, there is a considerable amount of dispersion, similar to the trends we have observed across a range of other asset classes that we track. This underscores the importance of active credit selection, structural protections, and granular underwriting, in our view.

For example, Exhibit 13 demonstrates how year-over-year (YoY) LTM adjusted EBITDA growth has varied across company size cohorts. Those with EBITDA of $100mm or more demonstrated the highest growth rate throughout the data set, though this has varied over time. Generally, larger companies in the Lincoln International database have exhibited faster growth than smaller ones, supported by scale, operational efficiencies, diversification in their revenues, and flexibility in their capital structure, among other drivers.

Exhibit 14 shows how EBITDA growth has varied across (and *within*) different sectors, as well. Looking ahead, we believe sectors with exposure to certain key factors, such as international supply chains and discretionary consumer spending, will be important to monitor, given the lingering downside risks to global growth.

Exhibit 13: EBITDA growth has varied across buyer sizes, but typically favors larger borrowers

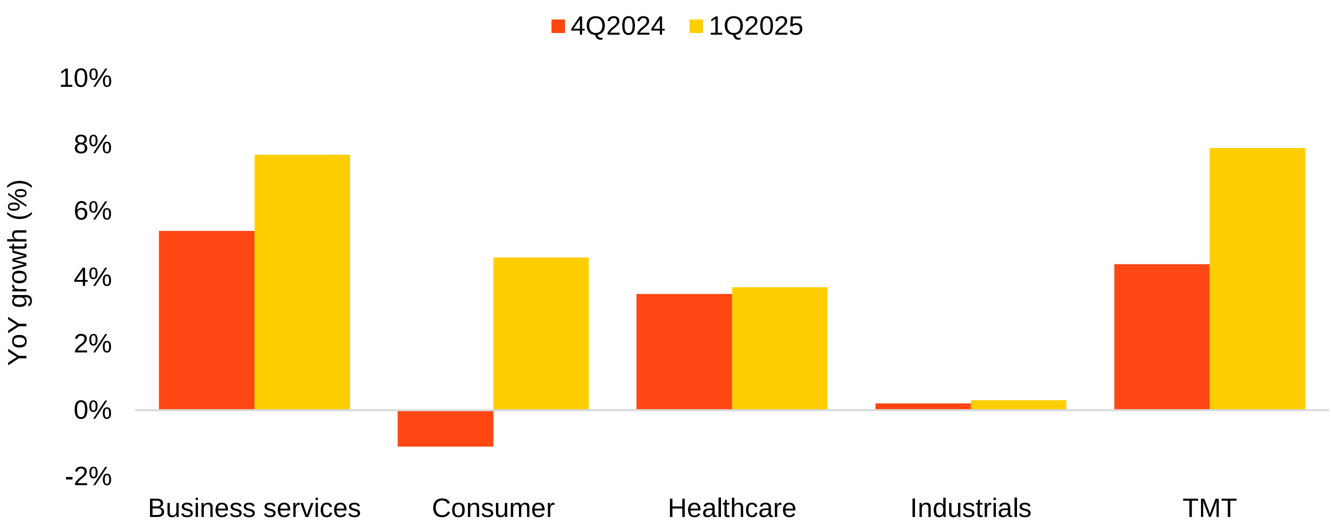
Year-over-year last-twelve-months' adjusted EBITDA growth, by company size (annual EBITDA)



Source: Lincoln International Proprietary Private Market Database, BlackRock. As of 1Q2025. © 2023 Lincoln Partners Advisors LLC. All rights reserved. Used with permission. Third-party use is at user's own risk.

Exhibit 14: There is meaningful dispersion between borrower sectors

Year-over-year last-twelve-months' adjusted EBITDA growth, by industry



Source: Lincoln International Proprietary Private Market Database, BlackRock. As of 1Q2025. © 2023 Lincoln Partners Advisors LLC. All rights reserved. Used with permission. Third-party use is at user's own risk.

…and has implications for performance

Similar to the liquid credit market, we are closely monitoring the 'tails' of the private credit universe, which were already under fundamental pressure prior to any slowdown in economic activity. Here, too, this highlights the potential for heightened performance dispersion, in our view, across strategies, sectors, and even managers.

Exhibit 15 demonstrates the variation in net realized gains (or losses) between the top and bottom quartiles of private credit business development companies (BDCs), in comparison to the CDLI. The quartiles were built using annualized net realized gain (or loss) rates since inception, per Cliffwater, to prevent outlier calendar years from skewing segmentation.

The net realized gain/loss differentials between the top and bottom quartiles are sizable, averaging 317bp per year over the last 10 years. As the private credit market shifts to be more senior, the ability to achieve net realized gains (typically through prepayment fees, equity kickers, etc.) becomes more challenging, as these are typically included in more junior instruments. This underscores the importance of capital preservation or loss mitigation.

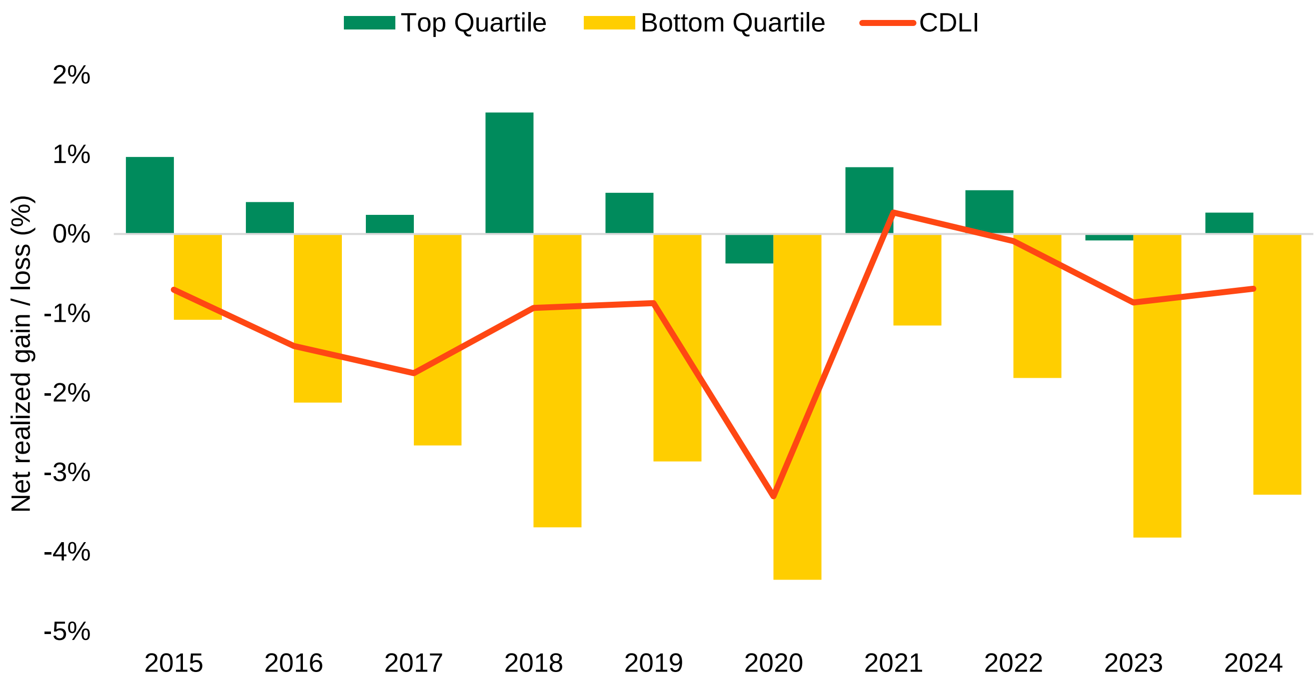
Relatedly, an analysis from Lincoln International examines sponsor-backed companies that were 'taken over' by a lender over the past six months (or were imminently expecting to change to lender ownership) – a cohort of $17 billion. Within this cohort, 70% were 2021 or 2022 vintage loans, and 75% had less than $50 million of EBITDA – echoing themes we've discussed earlier around vintage and borrower dispersion.

There were signs of notable stress in this cohort, with the average CAGR since close at -17%, and the median loan-to-value at takeover at 150%. That said, 50% of the companies had sponsor infusions in 2024.

These learnings, in our view, underscore the importance of manager section and diversification in a holistic portfolio allocation. A manager with a robust operating and workout team is likely better equipped to extract value from an already defaulted borrower. Further, given the considerable uncertainty in the macro backdrop, diversification across different factors, including vintage, strategy, and among portfolio company profiles, should support more resilient portfolio performance, in our view.

Exhibit 15: Dispersion is evident across BDC quartiles

Trailing 12-month net realized gains (losses) for the top and bottom quartile BDCs, and the entire Cliffwater Direct Lending Index



Source: Cliffwater Direct Lending Index, BlackRock. Data as of YE2024. Performance data represents past performance, which does not guarantee future results. There is no assurance that similar investments will be made or that similar results will be achieved.

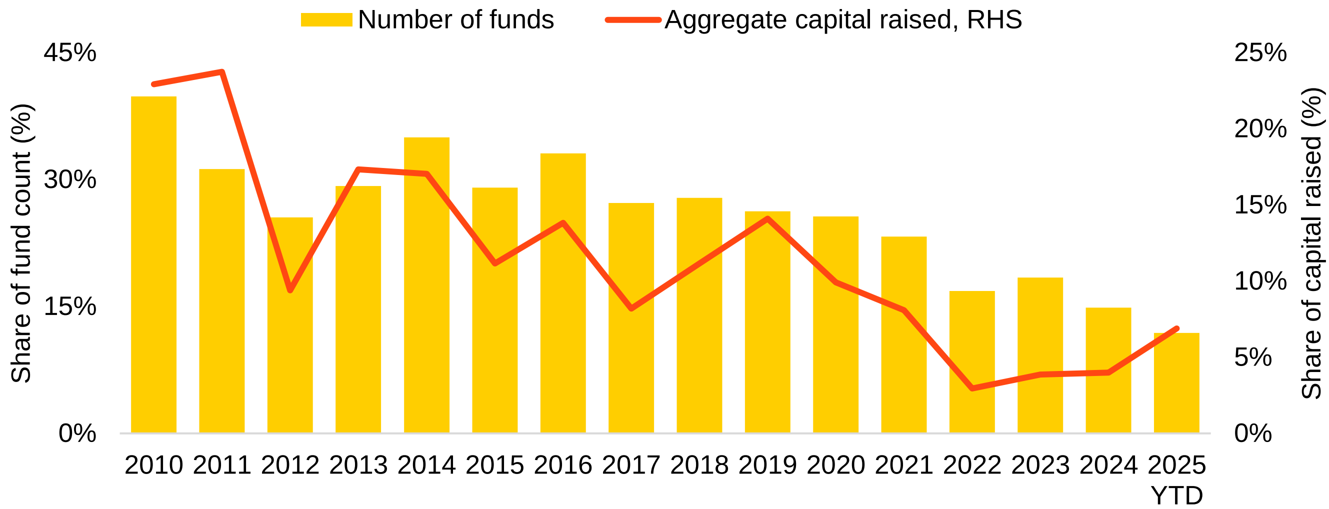
Fundraising favors manager experience

And as we've noted previously, fundraising data from Preqin highlights a trend of allocators favoring experienced managers.

Exhibit 16 demonstrates how the number of funds, and the share of capital raised, by first-time private credit fund managers have both fallen over time. That said, there has been a modest uptick this year in the share of aggregate capital raised by first-time fund managers. This uptick is likely driven by a large fund closing from an experienced team, that recently spun off into a new firm.

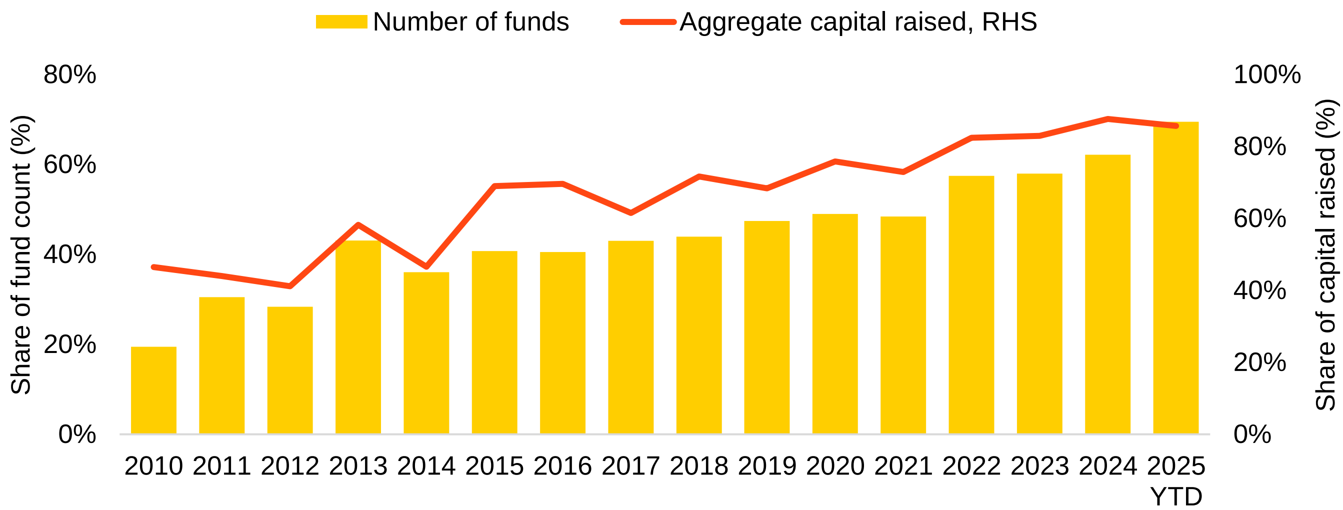
At the same time, experienced managers, or those with four or more private credit funds, have been growing their share of total fundraising (Exhibit 17). This trend of favoring experienced managers is evident across other private capital asset classes as well. Preqin attributes some of this 'consolidation' to allocators increasingly viewing private credit as complementary to a fixed income allocation (which can be flexed up or down depending on the market backdrop) – rather than a pure 'alternatives' allocation. As such, the ability for managers to deploy capital at scale is an important consideration in investment decisions.

Exhibit 16: First-time fund managers are raising a smaller share of aggregate capital
First-time manager fundraising as a proportion of total private credit funds and aggregate capital raised, RHS



Source: Preqin, BlackRock. Captures data as of June 3, 2025. Captures closed-ended private credit funds.

Exhibit 17: Experienced managers continue to raise the majority of aggregate capital
Fourth fund or later private credit fundraising as a proportion of total funds and aggregate capital raised, RHS



Source: Preqin, BlackRock. Captures data as of June 3, 2025. Captures closed-ended private credit funds.

Mix of funds in market reflects evolving allocation preferences

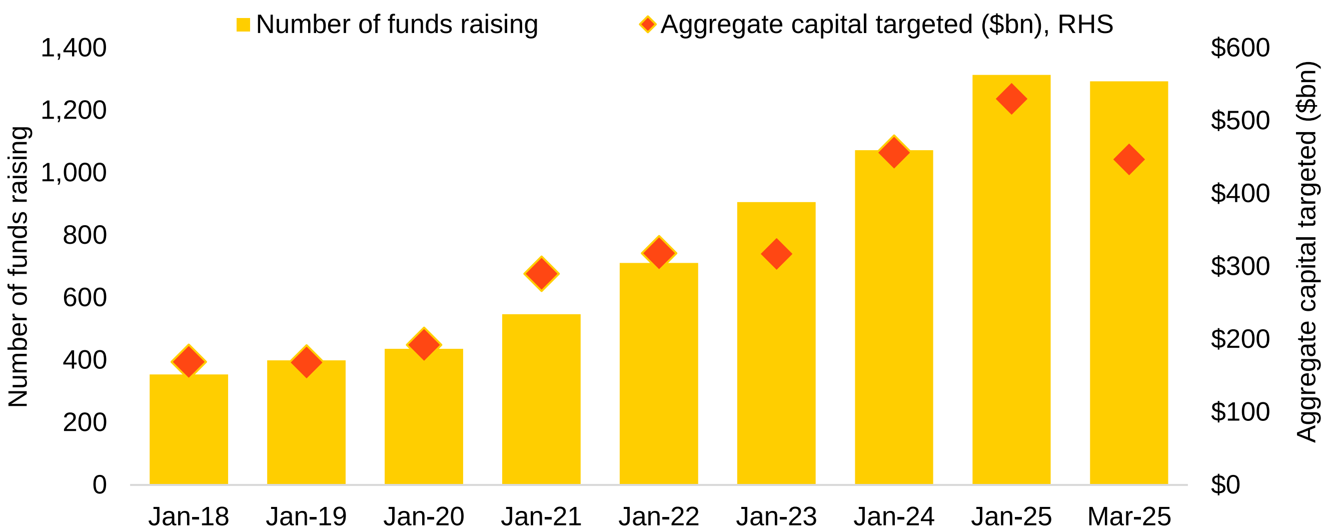
The shift in asset allocation toward experienced managers has likely also impacted the current fundraising landscape, including what funds are coming to market and what their fundraising targets will be.

The number of private credit funds currently fundraising fell for the first time on record in March, per Preqin (Exhibit 18), suggesting that fewer managers may be initiating fundraises.

In tandem, fund capital targets skew meaningfully toward the largest fund cohort. Exhibit 19 demonstrates that the number of private credit funds in the market across each size cohort is relatively even. That said, funds targeting more than $1 billion represent nearly 70% of the total capital targeted, indicating that the funds with the largest target fund sizes are seeking to raise a disproportionate amount of capital (versus their smaller peers).

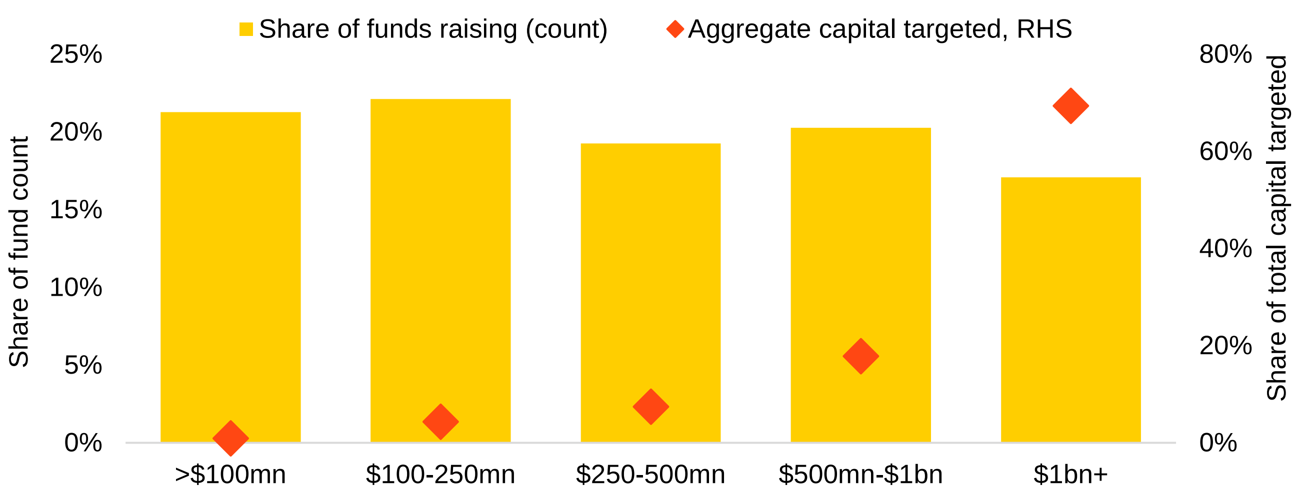
This shift in the fundraising landscape highlights the benefits of experience and scale. Indeed, structurally higher interest rates have encouraged allocators to be more selective in where they allocate capital. Scaled managers, who are often also experienced managers (i.e., those with four or more private credit funds), tend to benefit from some combination of: an enduring performance track record, more robust origination capabilities, operational expertise and efficiencies, incumbent portfolios, and/or in-house workout expertise. These benefits can also create barriers to entry for newer managers.

Exhibit 18: The number of private credit funds in market has fallen
Count of private credit funds in market and aggregate capital targeted, in $ billions, RHS



Source: Preqin, BlackRock. As of 1Q2025.

Exhibit 19: Funds targeting $1 billion or more represent 70% of total capital targeted
Share of private credit funds in the market by target size, and by aggregate capital targeted, RHS



Source: Preqin, BlackRock. As of 1Q2025.

Unless otherwise stated, all reference to $ are in USD.

Risk Warnings:

Capital at risk. The value of investments and the income from them can fall as well as rise and are not guaranteed. You may not get back the amount originally invested.

Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

Changes in the rates of exchange between currencies may cause the value of investments to diminish or increase. Fluctuation may be particularly marked in the case of a higher volatility fund and the value of an investment may fall suddenly and substantially. Levels and basis of taxation may change from time to time.

Cliffwater Direct Lending Index (CDLI) is an index that assists investors to better understand private credit as an asset class. The CDLI seeks to measure the unlevered, gross of fees performance of U.S. middle market corporate loans, as represented by the underlying assets of Business Development Companies ("BDCs"), including both exchange-traded and unlisted BDCs, subject to certain eligibility criteria. The CDLI is an asset-weighted index that is calculated on a quarterly basis using financial statements and other information contained in the U.S. Securities and Exchange Commission ("SEC") filings of all eligible BDCs. Eligibility is set as all assets held by BDCs that (1) are regulated by the SEC as a BDC under the Investment Company Act of 1940; (2) have a substantial majority (approximately 75%) of reported total assets represented by direct loans made to corporate borrowers, as categorized by each BDC and subject to Cliffwater's discretion, and (3) file SEC form 10-Q (or 10-K, as applicable) within 75 (or 90) calendar days following the current Valuation Date. If a BDC meets the eligibility criteria, but has not filed its report on Form 10-K or 10-Q with the SEC at the time the index is reconstituted, asset information from its report will be included in the index at the time of the next reconstitution. This information is derived from sources that are considered reliable, but BlackRock does not guarantee the veracity, currency, completeness or accuracy of this information.

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