

# Recent Trends in Private Credit

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What began as an outlet for companies with riskier credit to raise debt, the private credit asset class has morphed into a viable alternative lending source for middle-market and, increasingly, large-cap companies. Private credit has grown from managing around \$250 billion in assets in 2008 to nearly \$1.7 trillion in assets as of June 2023.

In addition to the growing market share, private credit has begun adopting the borrower-friendly terms typically characteristic of the broadly syndicated loan (BSL) market for well-positioned borrowers while still offering the flexibility in deal structure, speed, and certainty that borrowers and private equity sponsors prefer. Acknowledging the growth and success of private credit, banks have started engaging in private credit lending, blending the two sources and starting a healthy competition that is benefiting both borrowers and lenders. Here are the trends we are seeing in 2024:

### Larger Deal Sizes and Club Deals

At its outset and until recently, private credit primarily served middle-market companies. Deal sizes rarely surpassed \$500 million. Now, this number is more common with an increasing number of private credit-funded deals exceeding \$1 billion. Current estimates show that private credit is funding 85% of leveraged buyouts. As private credit has grown, it has also expanded its lending to companies with higher capitalization, moving into BSL deal territory in terms of size. Some private credit funds have increased their loan sizes by consolidating capital into larger funds, while other direct lending facilities are composed of typically one to six other lender participants in a club-style deal to meet the need.

### Covenant Loose Loans and Flexibility

In the competitive market, private credit is also adopting other syndicated loan features, namely, less stringent covenant structures, especially in large-cap deals. In the BSL market, many loan facilities are “covenant lite,” with the main feature being incurrence-style covenants and the removal of financial maintenance tests. To stay competitive, many private credit funds are now swapping higher protections for higher portfolio values and are providing “covenant loose” terms. While covenant loose loans typically have at least one maintenance financial covenant, such as a quarterly tested leverage ratio, the cushions set are so generous that it would be unlikely to ever be triggered. Direct lending also offers borrowers and private equity sponsors more flexibility and bespoke deal structures than a traditional bank, such as deferred cash pay interest, PIK interest offers, and unitranche structures. Direct lenders can also guarantee deal terms, size, and pricing upfront while also having the ability to work with a borrower when obstacles arise, often working together to avoid default scenarios.

### Bank Participation

Recognizing the growing success of private credit lending and in an effort to recapture the market, banks have entered the private credit space. Some banks are starting their own private credit funds, buying private credit firms, and advising clients on private credit deals. Banks are also working with private credit investors to engage in hybrid lending where loans are comprised partially from private credit funds and partially from a bank. The increased activity from banks in the private credit space has driven competition, which is pushing pricing down for well-positioned borrowers. The partnership could benefit both bank lenders and private credit funds as a way to open up deal sourcing for private credit and allow bank lenders to maintain customer relationships and cash management accounts.

## Impact

In a market on target to reach between \$2.8 and \$3.5 trillion in assets by 2028, private credit offers a wealth of opportunities to fund deals. Particularly with the forecasted rebound of M&A deals in the second half of 2024 and heading into 2025, private credit provides an additional source of capital to fund acquisitions. For companies, direct lending offers a tailored loan structure suitable to their business needs and faster deal execution. Though private credit funds are increasingly interested in investing in companies with higher earnings and stronger balance sheets, direct lending remains a strong option for lower-middle market companies.

Both companies and private equity firms stand to gain from some of the cost savings associated with private credit. Private credit deals do not require public reporting or ratings issued from credit rating agencies — transaction costs which companies can save and put toward other deals. The time saved without these extra steps, coupled with a smaller set of lender participants, produces the speed with which private credit can execute financing transactions — a critical element for quick access to capital which will remain important as the potential for lower interest rates in the second half of 2024 could result in an uptick in M&A deals.

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