

# How private credit is evolving in a changing market

*Markets are cyclical, so understanding the origins of private credit helps to orientate our understanding of where the asset class is today, writes [Andrew Tully](#)*

The private credit market is a war baby, primarily the result of market dislocation during the global financial crisis of 2008. Prior to this, banks dominated the European leveraged finance market, but they were negatively impacted by regulatory and balance sheet constraints, as well as a lower risk tolerance precipitated by the crisis. The originate-to-distribute model of providing loans was essentially broken and mid-market deals, which would previously have had a sole mandated lead arranger, instead relied on a consortium of banks to achieve the same result. For example, a private equity firm seeking £100 million of term loans in 2010 would likely have needed five banks to deliver this result, and took considerable execution risk if any one lender didn't fulfil their mandate. Alternatively, the sponsor fully funded the deal and took market risk to refinance their bridging loan. This resulted in terms that were significantly more lender-friendly, increasing the time it took to execute.

## The golden age of private credit

This is the fertile ground which enabled the private credit market to get established and [grow rapidly](#). The burgeoning asset class's ability to provide a fully funded solution, on competitive terms and to a quick timeline proved a winning combination for the private equity market which has embraced this funding source, with higher interest margins offset by typically higher leverage and more flexible terms. Most notably the way funds operate has featured a reduction from four maintenance covenants to 'cov-lite' (no maintenance covenant), and partially amortising to interest-only term loans.

The success of private credit is reflected in its market penetration, which has turned on its head. In 2016 there was a 70/30 deal volume split in favor of banks, which by the end of 2024 had switched 70/30 in favor of funds, fuelled by seemingly bottomless investor appetite. Banks, meanwhile, pivoted to providing

super senior or FOLO (first out and last out) working capital facilities in support of fund-led structures. This provides banks with lower risk exposure, as well as profitable and non-capital-intensive ancillary banking opportunities.

One of the key challenges the private credit market has successfully overcome is proving to private equity sponsors that they remain borrower-friendly after deal completion. This particularly applies in relation to how assets are managed that underperform, or those that require follow-on funding to support growth. In practice, borrowers' suspicion of loan-to-own tactics underpinning lender strategy has proven unfounded and funds, in the main, have been patient investors who seek to work through problems whilst PE shareholders continue to actively support their assets.

This is relevant in the [current climate](#) where borrowers are encountering headwinds from a series of economic curve balls including geopolitical instability, tariff shocks and a slowdown in the expected timeframe for the lowering of interest rates. However, private credit has proved to be resilient, as it was during COVID-19 and the experience gained from the market during that time showed how successfully funds supported their portfolio assets, while instances of funds taking control in non-consensual processes were few. Amend and extend continues to be the preferred strategy, and covenant amendments and term extensions are routinely provided as part of wider negotiations regarding equity injections or tightening terms.

The sudden and unexpected increase in base rates in 2022 caused a short-term market slowdown while managers (and sponsors) weighed the impact of a higher interest cost both on prospective and portfolio deals, however the income impact on floating rate instruments was positive and the addressable market was able to exploit a pause in collateralized loan obligation (CLO) formation to take deals, which would ordinarily fall to the broadly syndicated market. Notably, the private credit market capitalized on investment banks and CLOs' lack of liquidity and entered what became known as "the golden age of credit" where margins widened and fees increased considerably.

Private credit then has been an incredibly successful asset class, which has drawn in massive capital from institutional investors attracted by the prospect of higher yields in a low interest rate environment, coupled with a low risk to invested capital.

## Where the market is today

The current environment has created challenges as reduced M&A activity and a focus on a narrower range of defensive sectors for lending has created intense competition for deals. Despite this, given the various threats to economic growth, margins on some deals in the market are currently sub 5% and terms are very borrower- friendly as lenders compete aggressively to win mandates for safe assets such as subscription-based software businesses, mission critical business services, financial services or pharmaceutical companies.

At the same time, fundraising has become much more challenging. Capital invested in older vintages is not being cycled as quickly as expected and the dispersion in fund managers' performance has become increasingly apparent to investors. This is a factor influencing the direction in which new capital flows, and there's a noticeable bias for capital to flow to the larger, more experienced GPs.

All this points towards a period of adjustment, however the market has shown it can adapt, demonstrated by the recent growth of secondary funds, which provide LPs with options for liquidity, and the burgeoning trend of semi-liquid funds which potentially create access to a significant new [retail capital base](#).

Unlike public markets, private credit asset valuations are not materially impacted by sentiment, so are not systemically volatile. Indications are that quarterly valuations for Q1 and Q2 2025 show little impact, however those portfolios with a higher exposure to consumer-related sectors or smaller businesses sizes (<£10m EBITDA) show the greatest movement in their valuations. Of course, it will take some time for last twelve months earnings before interest, taxes, depreciation, and amortization (LTM EBITDA) to reflect the full impact of current macro conditions.

## Bigger, better, faster

Based on our experience in private credit, our key predictions for the near-term for this agile asset class is a flight to quality and a focus on scalability. This will be coupled with an increased use of outsourcing to enable managers to focus on deal origination and the delivery of quality and timely reporting demanded by institutional investors. This need for experienced third-party providers will also be informed by the more frequent reporting requirements for semi-liquid and other

types of retail funds.

Aztec Group is well positioned to advise and assist fund managers on traditional funds and new fund structures requiring greater oversight and more frequent [valuation and monitoring](#), as European private markets continue to adapt to accommodate retail investors. If you'd like to discuss any of the points raised in this article, please contact us.



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