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SFA Research Corner

Private Credit Loans Trending Larger, Contributing $22bn to CLO New Issuance

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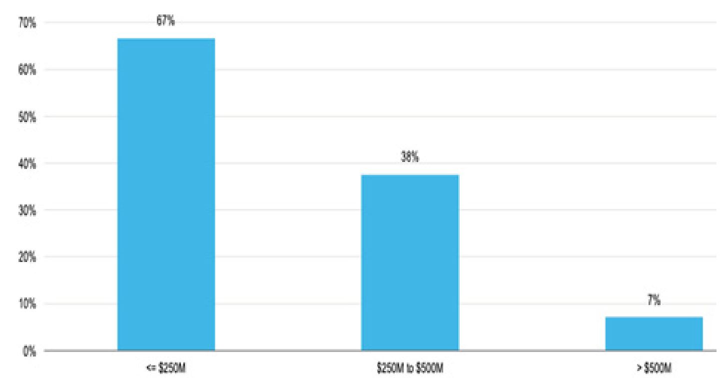
Private Credit Loans Trending Larger, Contributing $22bn to CLO New Issuance in 2023

In a recent analysis of 28 private credit loans and 15 broadly syndicated loans, Moody's identified a noticeable correlation between the expanding size of private credit loans and the diminishing presence of financial maintenance covenants. These covenants, which are used by lenders to monitor an obligor's financial health and may serve as early indicators of potential default, have historically characterized private credit loans extended to middle-market companies. Such loans traditionally featured robust covenant packages and maintenance requirements, distinct from the covenant-lite structures commonly associated with syndicated loans made to large companies (see diagram below for key differences in loan characteristics).

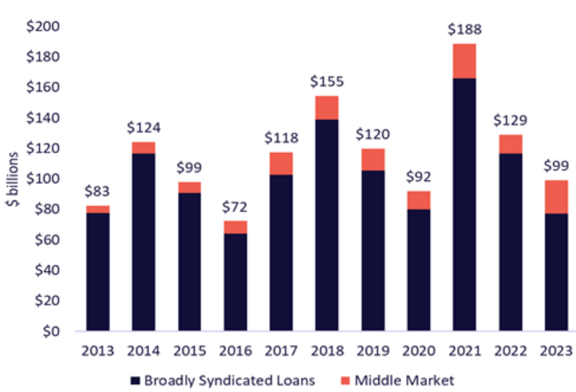
However, this critical distinction may be blurring as loan sizes grow in response to heightened demand from larger companies and increased competition between non-bank and bank lenders to borrowers of this size. According to a recent Moody's report, 67% of private credit loans below $250 million incorporate maintenance covenants, while a mere 7% of private credit loans exceeding $500 million offer similar protections. This evolution of loan protections on Collateralized Loan Obligations (CLOs) backed by private credit loans remains to be seen and should be monitored.

Moody's: Maintenance Covenants Go away as Private Credit Deals Get Larger Percentage of Private Credit loans with Always-on (Not Springing) Term Loan Maintenance Covenant



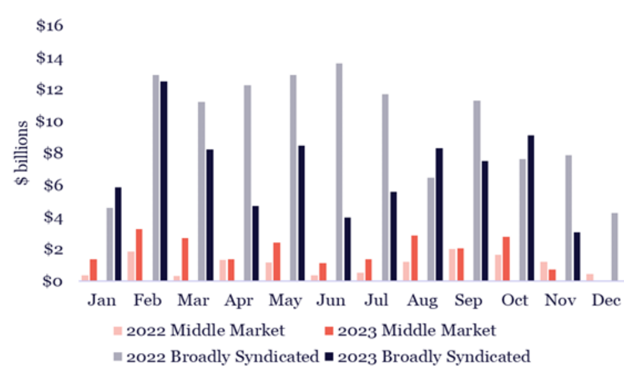
Source:Moody's Investors Service, "Private credit, syndicated loan protections will converge as competition grows," October 26, 2023

Deutsche Bank CLO Research: US CLO Primary Market – Historical Issuance



Source: PitchBook LCD, Bloomberg Finance LP, Deutsche Bank

Deutsche Bank CLO Research: US CLO Primary Market – Monthly Issuance 2022 vs. 2023



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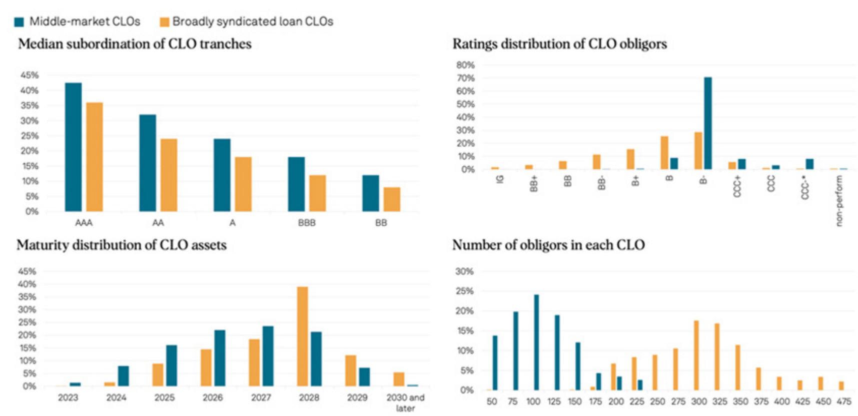
In 2023, CLOs backed by private credit loans have contributed $22 billion to the $99 billion CLO new issue market. This marks an 85% increase compared to the previous year and stands in stark contrast to CLOs backed by broadly syndicated loans, which experienced a 31% decline during the same period. Of the nearly $1 trillion U.S. CLOs currently outstanding approximately $100 billion are CLOs backed by private credit loans to middle-market companies, according to Bank of America Global Research.

The metrics below, compiled by S&P for S&P-rated CLOs, offer a comparison between Middle-Market (MM) CLOs and Broadly Syndicated Loan (BSL) CLOs. In terms of pool composition, a notable distinction is that MM CLOs are backed by lower-quality corporate obligors, the majority of which (>60%) are not rated. MM CLOs also have fewer obligors (50-200 compared to 200-475 for BSL CLOs) and are diversified across fewer industries (15-20 versus 24 sectors in BSL CLOs). In terms of structure, the typical credit support for the triple-A tranche in an MM CLO is in the mid-40%, whereas it is in the mid-30% range for BSL CLOs.

Despite a traditional middle market loan borrower's EBITDA being well under $100 million, company size varies significantly, with MM CLO managers often specializing by size and industry. The chart below illustrates S&P-rated MM CLOs by CLO manager based on EBITDA, categorized into three buckets by S&P: Lower (EBTDA <$20 million), Core ($20 to $50 million), and Upper ($50 to $100 million)

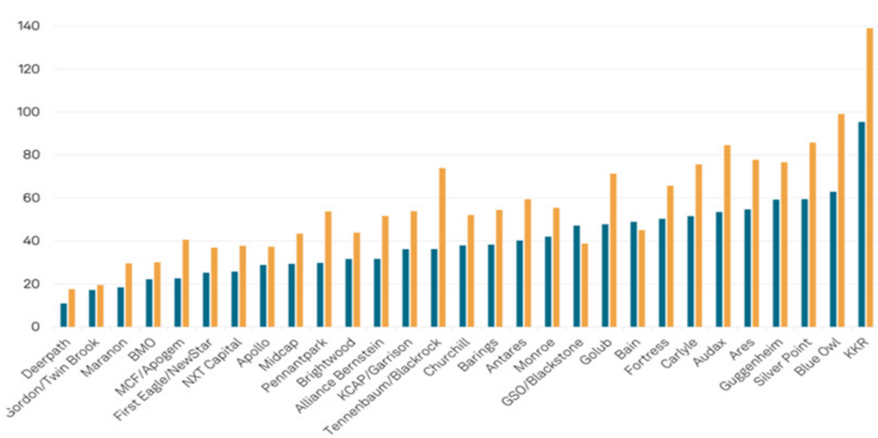
MM CLO ratings have shown resilience, with S&P reporting 4.5 upgrades for every downgrade since 2020. In contrast, BSL CLOs have experienced only 0.75 upgrades for every downgrade.

S&P: Middle-Market CLOs - Comparison of Metrics Against BSL CLOs



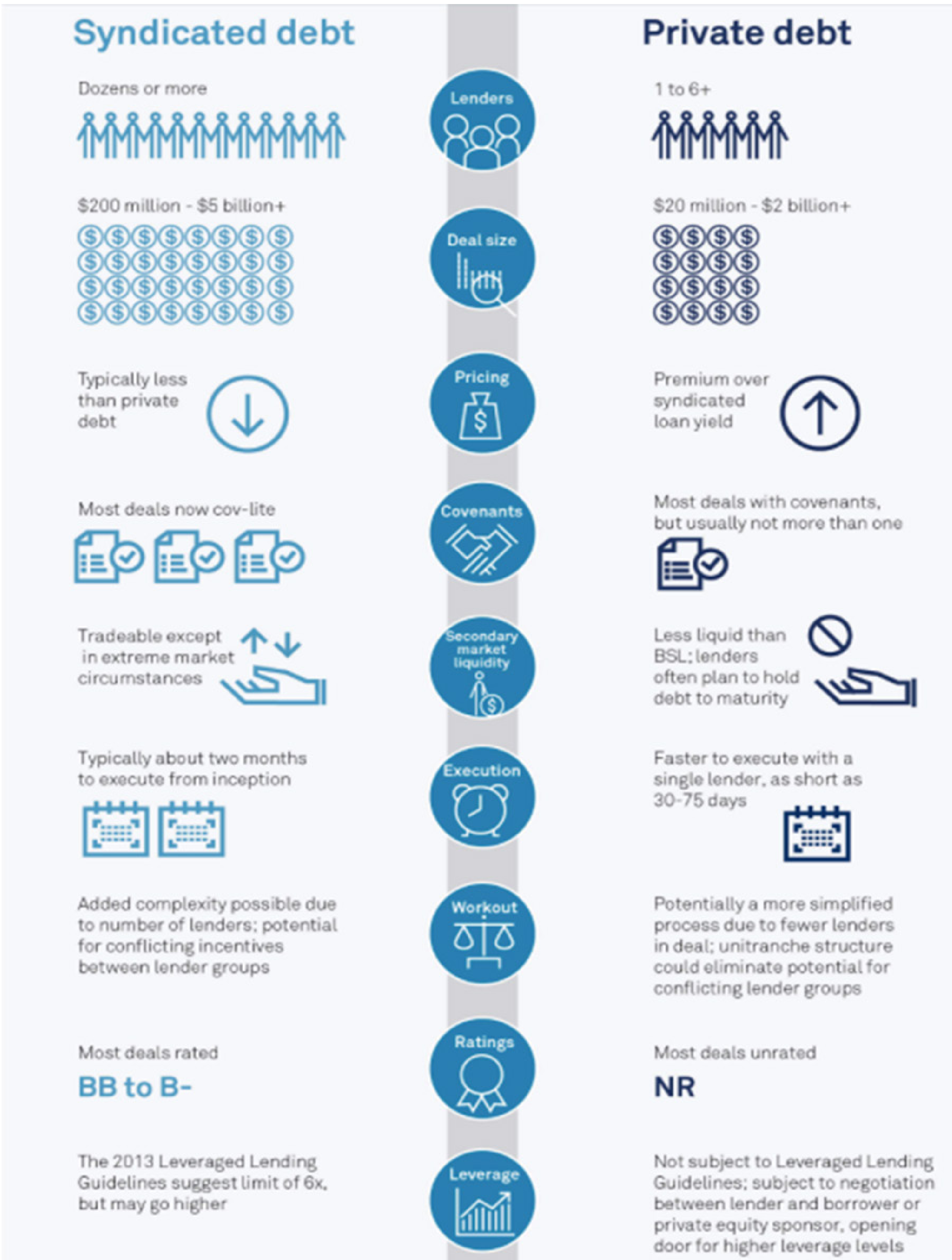
Source: S&P Global Ratings, Middle-Market CLO And Private Credit Quarterly: Strong CLO Growth, But Weakening Underlying Credit, October 20, 2023

Company Size Varies by Middle-Market CLO Manager



Source: S&P Global Ratings, Middle-Market CLO And Private Credit Quarterly: Strong CLO Growth, But Weakening Underlying Credit, October 20, 2023

S&P: Key Differences Between Broadly Syndicated Loans and Private Debt



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