

Fund Finance Friday



The Rise of Private Credit in Leveraged Lending: A Preview for Fund Finance?

August 19, 2022 | Issue No. 189



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Private credit funds are making their presence felt in the leveraged loan market. Recent transactions illustrate the scale direct lenders have achieved, enabling these managers to compete head-to-head with banks. Earlier in the month, a private lender group provided a \$2.5 billion unitranche facility that facilitated Vista Equity Partners' acquisition of Avalara Inc., the latest in a string of large-cap loan transactions that have been done away from banks.

Private credit lending groups bypass the broad loan syndication process used by banks and are therefore able to execute faster with greater pricing certainty. The concentration of financial firepower among a smaller group of institutions affords them greater leverage to negotiate improved terms of the credit documentation than would be the case in a typical bank-arranged syndication. Transaction size also clearly no longer poses the barrier to entry it once did.

Banks are countering by allocating balance sheet to hold loans and by raising in-house direct-lending funds. These moves are intended to provide more streamlined closings and remove syndication price flex. A large inventory of committed unsold loans and significant anticipated writedowns, however, are holding banks back from being more competitive. A Reuters [article](#) this week cites estimates that U.S. and European banks may post losses of \$5-10 billion on leveraged loans in coming quarters.

Private credit AUM totaled \$1.21 trillion in late 2021, according to Preqin data, and may more than double to reach \$2.69 trillion by 2026. A loss of market share in the leveraged loan market may cost banks a significant amount of fee income, but also means the loss of an important connection point for advisory, trading, and other revenues from financial sponsors.

From a fund finance perspective, the unfolding story in the broader loan market illustrates the growing significance of non-bank lenders. We see a few implications for the fund finance market:

- Private credit funds will become a more significant source of capital to the fund finance market in coming years. In the U.S., the advance has been slow but is likely to accelerate.
- Growth in AUM, significant underwriting resources, larger fund sizes, a running clock on deployment windows, and a branching out in strategies are all in-place trends likely to support more private credit lending in fund finance.
- This growth is likely to show up mostly in NAV lending where loan margins align better with private credit cost of capital.
- Banks will continue to play an important role in the market for subscription lines where their ability to bridge liquidity needs cannot be matched by funds primarily due to differences in cost of capital.
- Bank regulation, which often proves to be **pro-cyclical**, also seems on course to continue driving capital formation towards less regulated institutions.
- In fund finance, the relationship with these funds is more likely to be collaborative. Leveraged loan market speed-to-execution and pricing dynamics don't carry over into fund finance and should allow for mixed lending groups.

- Finally, banks may become more sensitive to extending subscription financing to funds that then directly compete with them for lending business and could instead become strategic in selecting funds with which to partner.