

Lenders Tighten Standards In Private Credit

Under pressure from investors, firms are increasing costs and curbing sweeteners

BY ANNAMARIA ANDRIOTIS

The era of anything goes in private-credit underwriting is coming to an end.

Private-credit firms are tightening their lending standards, increasing interest rates and other fees they charge on new loans, restraining how much debt they give borrowers and closing loopholes that allow financing to be taken out against borrowers' assets.

Executives and lawyers said standards began shifting around March and have intensified since then. Fund managers said they are seeing more risk of loan losses in the market. They are also dealing with the repercussions of increased scrutiny from their investors, which has reduced the amount of money private-credit firms have to put to work.

For months, individual investors have worried about potential risks in the underlying loans made by private credit and responded by pulling billions of dollars out of private-credit funds. Executives in the industry have said that is an overreaction, and they are moving to share more information and calm the jitters. But a Blackstone fund, the biggest of the group, reported on Thursday that investors were continuing to ask for their money back.

The tighter standards are a sharp reversal from recent

years, when a rapid growth of private credit fueled competition, leading lenders to offer sweeteners and generous terms to win deals.

"One of the benefits of the noise in the market and some of the outflows in wealth is you're seeing less competitive pressure in the market," said Michael Arougheti, chief executive of Ares Management, at an investor conference last week. "So it has gone from maybe a borrower-friendly market to a lender-friendly market. And that's a good place to be."

On new loan originations, lenders are tacking a bigger margin on to the base interest rates, especially for larger companies. For companies with more than \$100 million in earnings before interest, taxes, depreciation and amortization, the median margin on a common structure of new debt issued in the direct-lending market was 5.13% in May, compared with 5% in April and 4.88% in March, according to investment-banking adviser Lincoln International. That is the highest it has been in nearly two years.

Loans that aren't top credit quality are also seeing margin increases.

Beyond interest rates, loans are getting more expensive in other ways. Private-credit lenders are increasing the fee they charge when they issue a loan—what the industry calls "original issue discount"—which lowers the amount the borrower actually receives. For instance, at the end of last year borrowers of \$100 million loans were, on average, only getting \$99.15 million after this fee, though they have to repay the full \$100 million—plus interest. As of the end of April, the average is down to \$98.96 million, according to Lincoln International, equivalent to a \$1.04 million charge right off the bat.

In some cases, it is much larger. Charlesbank Capital Partners recently offered a private-equity firm's target a roughly \$100 million loan with a discount of about 5%, equivalent to a \$5 million fee, people familiar with the matter say. After reviewing the company's financials, Charlesbank felt the discount was appropriate for the risk of the loan, the people said.

Others have cut back on offering adjustments that help make their loans more enticing to borrowers, executives said, including allowing borrowers to defer interest payments.

Some lenders are applying more conservative underwriting criteria to entire industries because of the threat AI poses.

Guggenheim Investments is scrutinizing accounting firms and other white-collar service companies out of concern that artificial intelligence could potentially take out whole businesses. It is lowering the leverage borrowers can build, tightening loan-to-value ratios and seeking stricter documentation in cases where it isn't sure which firms would be winners or losers in the AI future.

"When we have to debate who is going to win and who is going to lose, we want to be conservative," said Joe McCurdy, head of origination in Guggenheim Investments' corporate credit group. "Solving it with lower leverage rather than price makes sense to us because if you start out conservative, it gives you more cushion if you're wrong."

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