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Markets

Private Credit Is So Big That It's Changing Part of a $1.3 Trillion Market

- Some firms are using CLOs to finance their direct lending
- HPS and Blue Owl bundle their billion-dollar loans into CLOs

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Private credit firms, having shaken up financing markets by snatching buyout debt deals from Wall Street, are now changing the landscape in a part of the $1.3 trillion collateralized loan obligation business.

HPS Investment Partners and Blue Owl Capital Corp. have issued private credit CLOs in recent months, a new name for an old product that reflects how the size of the loans going into these CLOs is getting bigger over time.

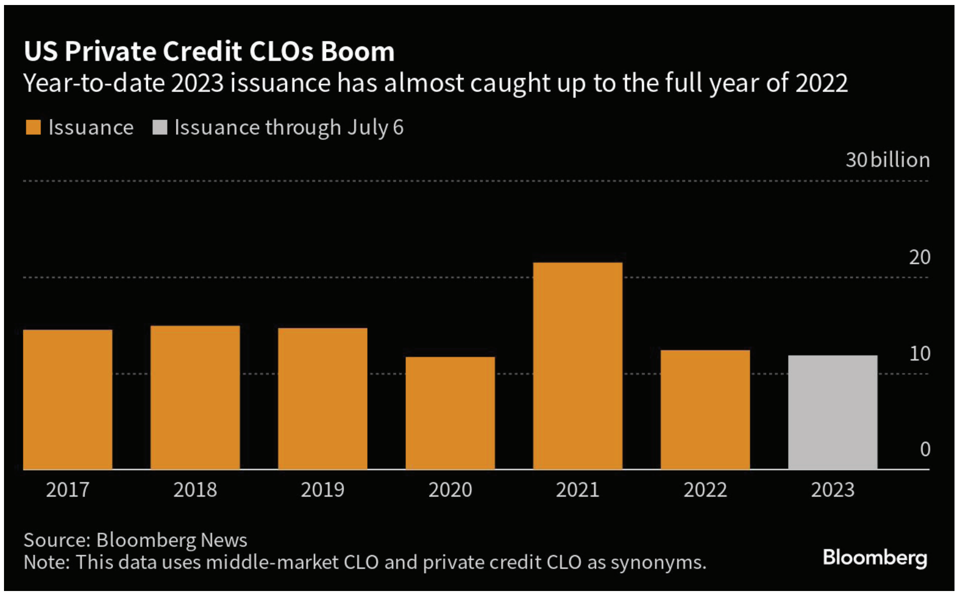
CLOs repackage corporate loans into securities of varying risk and size that are then sold to other investors. Historically about 90% of new CLOs each year buy debt from larger companies in the form of leveraged loans, and about 10% were in the so-called middle-market space - or loans to highly levered small- and medium-sized companies.

While typical CLO managers buy debt from the liquid leveraged loan market, where the loans can be underwritten by Wall Street banks and then sold to a large group of institutional investors, middle-market lenders typically use CLOs to finance their own lending businesses.

In recent years, the middle-market space grew into what's now more frequently called private credit, where some firms compete with Wall Street banks for multi-billion dollar financings that traditionally would have been done in the leveraged loan or high yield bond markets. Now there's a growing push to rename the CLOs that buy slices of these massive loans.

"There's tranches of billion-dollar buyouts in those CLOs," said Mike Patterson, an HPS governing partner, pointing to a nearly $2 billion financing for the buyout of Baxter International Inc.'s contract medical manufacturing unit that his firm helped provide. "That's not middle market anymore."

The structure of middle-market and private credit CLOs is essentially the same - it's more about changing the name to expand the definition and better reflect the types of loans that go into the vehicles, according to market participants. JPMorgan Chase & Co., an arranger of such deals, has been helping to spearhead the rebrand, and "private credit CLO" has shown up in research by JPMorgan and also from Citigroup Inc.



Issuance of private credit or middle-market CLOs in the US has ballooned to more than $11.8 billion so far this year, almost matching the total for all of 2022, according to data compiled by Bloomberg News. They comprise 20% of total CLO issuance in the US in 2023, up from slightly above 10% historically.

The increase comes as the largest subset of CLOs, those that bundle leveraged loans, is down in sales volume by almost 34% this year compared to last, according to data compiled by Bloomberg.

The middle-market loan space has been growing for years, and the definition has continued to expand in size, said Alan George, head of structured products at Golub Capital. The key attributes today are that the loans are less liquid, closely held, and not publicly rated at issuance, which doesn't necessarily mean the companies borrowing the money are small or more risky.

"We can call it middle-market CLOs, we can call it private credit CLOs. All we're saying is it's not broadly-syndicated loan market collateral," he said.

To be sure, not all direct lenders are seeking to do the larger loans. For instance, while Golub Capital BDC Inc. and Antares Holding LP are pursuing larger middle-market loans in their private credit CLOs, Apogem Capital LLC, formerly known as Madison Capital, is prioritizing smaller middle-market debt, according to a report by Citigroup.

"Middle-market CLOs still exist, but now there's a new category as well," Patterson said. "There's a distinction between the two."

Even in Europe, some direct lenders are considering tapping this smaller subset of the CLO market for the first time. And the CLO rebrand is gaining investor acceptance in the US.

The size of private credit deals is likely to keep increasing. For example, several private credit firms are now working with Vista Equity Partners on an almost $6 billion financing for its portfolio company Finastra Group Holdings Ltd., which would be the biggest private credit deal ever if completed.

"We expect to see buyers of broadly syndicated CLOs, who have traditionally stayed out of the middle-market space, coming into private credit CLOs because that's where the loans they'd normally have exposure to are starting to end up," said Charles Arduini, partner and portfolio manager in alternative credit strategy at Ares Management Corp.