What is Private Credit?

Private credit funds are designed to generate enhanced risk-adjusted returns and current income by investing in the debt of strategically identified companies, either by making loans to these companies or acquiring loans in the secondary market.

TAILORED FINANCING SOURCE

Private credit fund managers negotiate directly with small and medium-sized companies seeking a tailored financing solution that is not accessible to them in the public credit markets or through bank lenders, who are subject to strict regulations. Increasingly, large companies are borrowing from private credit managers due to their ability to offer speed, flexibility, and certainty of execution that traditional banks often cannot, particularly in challenging market conditions. The company pays interest, typically at a spread above a floating reference rate, until returning the principal amount at the end of the loan term. In addition, private debt agreements typically include covenants that offer greater protection to the lender, i.e., the fund manager.

FUND INVESTMENT PROCESS – DIRECT LENDING

The fund investment process varies depending on the type of private credit investment strategy. The graphic below provides an overview of the typical fund investment process for a direct lending strategy, one of the most common private credit strategies in the market today.

PRE-LOAN

IDENTIFY COMPANY SEEKING FINANCING

Fund managers may leverage their networks or be approached by companies requiring financing

DILIGENCE AND STRUCTURE FINANCING

Fund managers conduct diligence to evaluate risks and determine key terms, including interest rates, tenor, collateral, covenants, and price

LOAN FUNDED

MANAGE THE PORTFOLIO

The portfolio management approach depends on the type of strategy – typically passive for direct lending

EXIT

REFINANCE OR SELF-LIQUIDATE

Private credit assets typically have a fixed term, allowing for scheduled exits

PRIVATE CREDIT CATEGORIES

There are a range of private credit strategies, each with unique risk profiles. These strategies include, but are not limited to:

Investment Strategy	Description	Typical Fund Term	Typical Target Fund Returns	Repayment Priority
Direct Lending	Fund acts as a non-bank lender and extends senior secured loans or credit to companies seeking financing.	5–8 years[1]	7-12%	Priority, first lien
Asset-Backed	Fund extends senior secured loans against specialized assets, such as aircraft or shipping vessels, or financial assets, such as contractual revenue streams or leases.	5–8 years	7-14%	Typically, priority, first lien
Subordinated Debt	Fund acts as a non-bank lender and extends mezzanine or subordinated loans or credit to companies seeking financing.	8–10 years	12-15%	Junior to first lien, above equity interests
Distressed/Special Situations	Fund invests in the debt of a financially distressed company that has filed for bankruptcy or has a significant chance of filing for bankruptcy in the near future, with the goal of providing a more appropriate capital structure for the restructured company.	5–10 years	> 15%	Could be structured as first lien or second lien

BENEFITS

- Private credit has generated higher yields than most other fixed income strategies, including public high yield and broadly syndicated loans.[2]
- Private credit managers can impose protective covenants for investors in their lending agreements, providing downside protection not typically available in the public credit markets.
- Private financing is typically offered with interest payments at a spread above a floating reference rate and a floor on minimum rate, reducing interest-rate risk for investors and providing protection in an inflationary environment.
- Private credit lenders typically are first lien, and have seniority on company assets in the event of default.
- A private credit allocation can provide enhanced income potential, diversification benefits, and access to an array of investment not available in the public markets.

1. Direct lending strategies may also be offered through business development companies ("BDCs") and interval fund structures.
2. Source: Goldman Sachs Asset Management, October 20, 2022. This is not intended to be an offer or solicitation to employ a specific investment strategy. Past performance is not indicative of future results. Future results are not guaranteed.

KEY RISK CONSIDERATIONS

Key risk considerations may include, but are not limited to, the following:

- **Credit Risk:** Private credit funds may hold debt in non-investment grade borrowers, and therefore there may be a greater risk of nonpayment of scheduled payments or default, which may affect the return to investors.
- **Manager Selection:** Not all private credit managers are the same. It is critical to have a thorough diligence process in place to evaluate private credit fund managers.
- **Liquidity:** Private credit funds are considered longer-term investments with terms of five to 10 years, depending on the fund strategy.
- **Transparency:** Private credit funds may not offer the same level of transparency as traditional investments, which are required to provide frequent and full disclosures.
- **Fees:** Private credit fund managers charge an annual management fee, typically 1% of assets under management. Fund managers also collect performance fees, known as carried interest, which traditionally represent 10–20% of any value appreciation or aggregated profits generated by the fund.
- **Leverage:** Private credit funds may use some form of leverage, which offers the potential for higher returns, but also increases the downside risk.

Please contact your financial professional or a fund manager to learn more.

IMPORTANT INFORMATION

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