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Private Credit

An Overview of America's Hottest Capital Market and Private Credit Financing Structures

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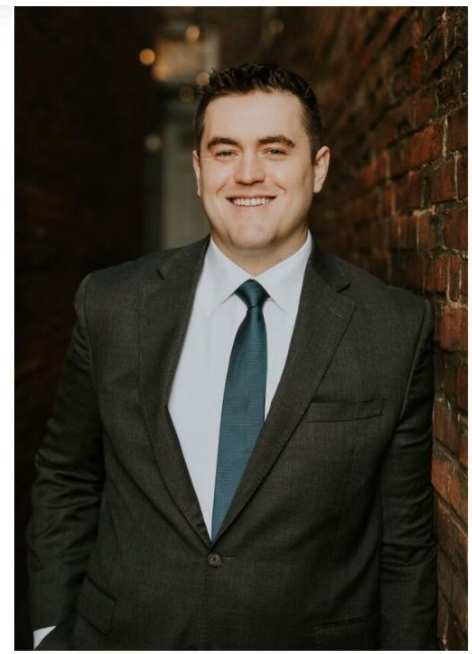

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Agenda

- What is Private Credit?
- Types of Private Credit Transactions, Structures, and Spotting the Legal Issues.
- Advantages and Risks of Private Credit.

What is Private Credit?

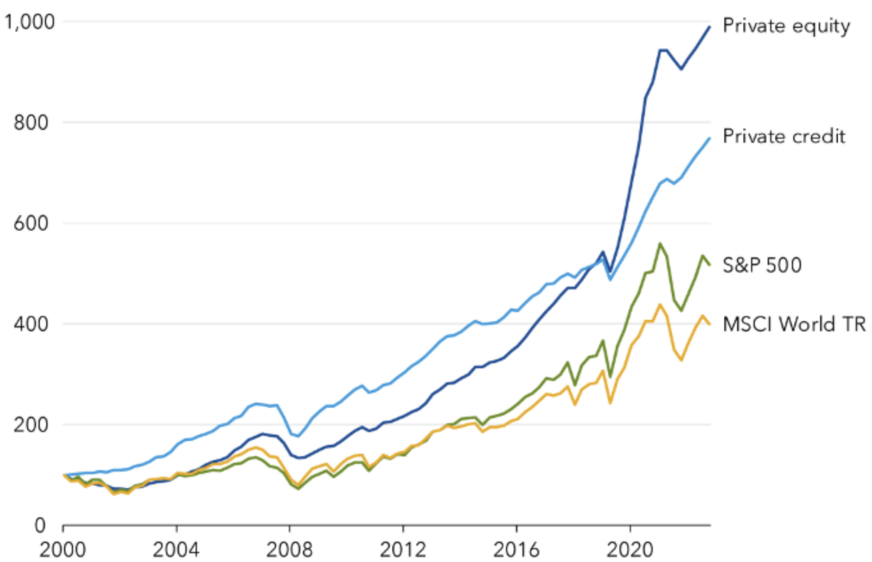
- Non-bank loans and other debt financing provided to a borrower by a non-traditional lender (such as an investment fund, institutional investor, asset manager, etc.).
- Alternative to traditional lending and public markets that has historically capitalized on gaps in the traditional credit markets.
- Broad array of financial products across a variety of industry sectors.

What is Private Credit? The Private Credit Market

- One of the fasting growing capital markets since the GFC, ballooning nearing $2 trillion globally by the end of 2023.
- Expected to grow to $3.5 trillion by 2028.
- Infrastructure, ABL, and “higher-risk” commercial real estate are among the asset types most likely to transition to non-banks.
- Traditional banks have tightened lending standards since 2008 and experienced recent volatility in the public markets (but will continue to dominate the market).
- Attractive yields to private credit investors.

What is Private Credit? The Private Credit Market

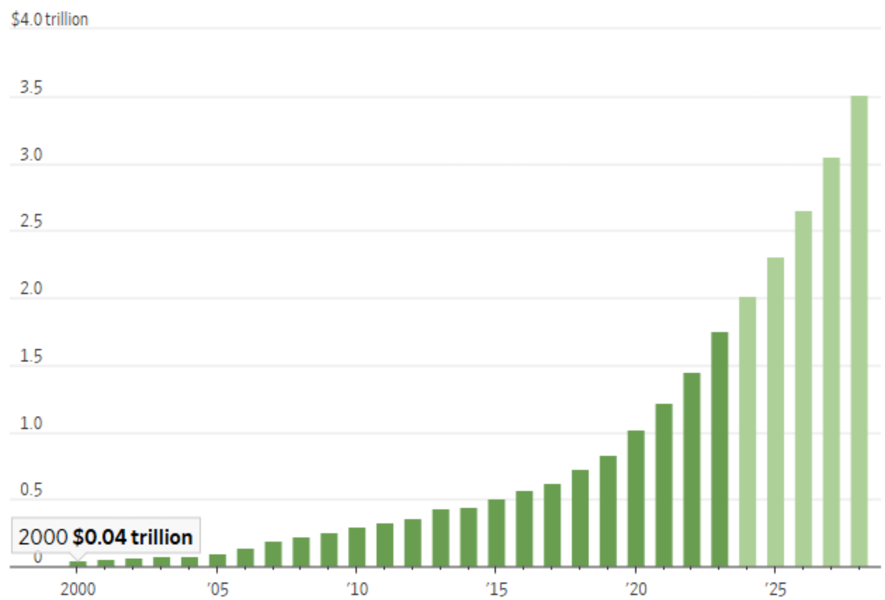
Returns of private equity, private credit, and equity benchmarks
(indices, December 2000 = 100)



Source: Preqin and IMF staff calculations.
Note: Private capital indices are rebased to 100 as of Dec. 31, 2000, and are available until June 2023.

IMF

Private-credit assets under management



Note: Figures after 2023 are estimates.
Source: BlackRock, Preqin

Types of Private Credit Financings: Spanning the Capital Stack

- Direct Lending.
- Mezzanine Debt.
- Equity.
- Blended capital financing packages.

Types of Private Credit Financings: Direct Lending

- Senior secured debt.
  - Mortgage lending, ABL, etc.
- Unsecured debt.
  - Outside scope of presentation.
- Interest rates.
  - Floating.
  - Interest only period.
  - Amortization and conversion to permanent loan.
- Close resemblance to traditional senior debt, but there are more loan covenant flexibility and higher interest rate spreads than traditional senior debt because less regulation limiting decisions of credit committees.
- Standard loan covenants.
  - Affirmative Covenants.
  - Negative Covenants.
  - Financial Covenants.

Types of Private Credit Financings: Direct Lending – Standard Loan Covenants and Key Terms

- Standard affirmative covenants in a real estate loan:
  - Payment.
  - Maintenance of collateral.
  - Insurance.
  - Compliance with laws.
  - Financial loan covenants.
  - Taxes and liens.
  - Leasing covenants.
  - Environmental compliance.
  - SPE covenants.
  - Apprisal of defaults.

Types of Private Credit Financings: Direct Lending – Standard Loan Covenants and Key Terms

- Standard negative covenants in a real estate loan:
  - Restrictions on distributions prior to satisfying financial covenants.
  - Additional indebtedness.
  - Liens and incumbrances.
  - Change of control.
  - Material alterations to or impairment of collateral.
  - Use of loan funds.
  - Violations of law.
  - SPE covenants.
  - Bankruptcy or insolvency.
  - Compliance with approved budget.

Types of Private Credit Financings: Direct Lending – Standard Loan Covenants and Key Terms

- Standard financial covenants in a real estate loan:
  - Debt service coverage ratio.
  - Loan in balance.
  - Loan to value ratio.
  - Guarantor liquidity and net worth.
  - Deposits (may not be applicable to private credit).
  - Stabilization.
  - Right-size remedies.

Types of Private Credit Financings: Mezzanine Debt

- Capital that is subordinate to senior debt but higher in priority than equity.
- Generally unsecured insofar as senior lender has taken an ABA lien. Sometimes, membership interest is pledged. At other times, a mezz investor will require a personal guaranty.
- Common in the real estate financing space – particularly in the middle market.
- Higher yields and opportunities for equity conversions/warrants for mezzanine lender.
- Lighter loan covenants.

Types of Private Credit Financings: Mezzanine Debt (Continued)

- Common legal issues to spot with mezzanine debt:
  - Collateral?
  - Who should consent?
  - Negative and financial covenants in the senior debt often preclude ability to take on mezzanine debt.
  - Mezzanine lenders apply less rigor in vetting debtors than a traditional lender.
  - Restricted securities if part of a larger issuance/sale to a pool of investors; private placements.

Types of Private Credit Financings: Equity

- Private credit lenders and funds frequently offer equity financing products.
- Ownership in projects with returns subordinate to debt.
- Blended debt and equity products.
  - Senior debt, mezzanine debt, preferred equity, common equity.

Types of Private Credit Financings: Equity

- Equity terms and covenants.
  - Management rights and limitations on major decisions.
  - Sponsor/GP co-invest.
  - Compliance with budget.
  - Annual business plan.
  - Distributions.
  - Guaranties of performance and budget guaranties.
  - Capital calls.
  - Removal of sponsor/GP.
  - Affiliate and third-party fees.
  - Stabilization and financial performance.
  - Buy/sell.
  - Investor reps and warranties.
  - Securities law compliance.
- Sample net cash flow waterfall for blended equity (after expenses, trade payables, and senior debt service):
  - Mezz note interest and principal payments.
  - Preferred return.
  - Return of equity capital.
  - Residual profits split among GP and LP.

Advantages of Private Credit

- One lender.
  - Participation risk; ease of amending credit documents; certainty of financing terms.
- More relaxed credit rating process.
- Streamlined diligence and underwriting for faster closing timelines
- Flexibility in financing structure (permitted change in control, bespoke loan covenants, PIK toggle, etc.).
- Improved pricing terms for lender and upside participation.
- Unitranche loans in M&A.
- Financing packages blending first lien, subordinate debt, and equity issuances.
  - Bilateral underwriting and diligence.
  - Full project finance.
  - Upside participation for lender.

Risks of Private Credit

- Lower credit standards.
- Illiquidity.
- Lower regulatory and fiduciary oversight.
- Conflicts of interest.

Q&A

- Questions?

Thank you!

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