Private Credit — July 8, 2025

Introduction. Companies need cash for various purposes and obtain it by (i) selling ownership interests (such as common stocks), (ii) borrowing, and/or (iii) retaining profits. Most companies borrow cash (i) from banks, and/or (ii) from investors who buy those companies' bonds. Those bonds can typically be resold in public markets to other investors who make offers. However, some mid-size, privately-owned companies borrow cash through **private credit** as an alternative to bank and/or bond market sources.

The term **private credit** refers to **loans made directly to private borrowers from non-bank lenders**.[1] This process is typical:

1. A manager creates a fund for lending money directly to private companies, and sells interests in that fund to investors.
2. The manager then: (i) identifies prospective borrowers, (ii) negotiates loan terms, (iii) loans money to borrowers, and (iv) manages the loans (by meeting periodically with borrowers, monitoring compliance with loan covenants, and when borrowers do not pay as agreed, negotiating workouts, foreclosing on collateral, and/or taking control of businesses in default).
3. The borrowers make interest and principal payments to the fund.
4. The manager pays the investors the amounts the fund receives from the borrowers (minus the manager's fees).

Private credit's default risks are typically higher than investment-grade bonds. Also, investors typically cannot resell private credit investments. So, private credit investments are typically not appropriate for situations where there is: (i) a low capacity and/or tolerance for risk, (ii) a time horizon of less than five years, or (iii) a need and/or desire for liquidity in less than five years.

Private credit may provide borrowers with tailored and flexible financing solutions that are not available from banks or bond markets. Private credit may provide investors with attractive returns (compensating for higher risks and illiquidity).

Private credit investing has often (i) been limited to investors with very large sums of money, and (ii) had adverse income tax return consequences (delayed delivery of reporting forms, added complexity, and higher fees for preparing returns). Developers of private credit products are striving to lower investment minimums, reduce adverse income tax return consequences, and improve liquidity.

Kevil Quinley, MBA
Manager

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[1] Additional Resource: Cai, Fang, and Haque, Sharjil (2024, February 23 & 26), *Private Credit: Characteristics and Risks*, Board of Governors of the Federal Reserve System, https://www.federalreserve.gov/econres/notes/feds-notes/private-credit-characteristics-and-risks-20240223.html