

Private Credit Market Update: Semi-Liquid Structures, Redemption Dynamics, and What the Data Is Telling Us

Waterloo Capital | Investment Research | March 2026

Prepared for existing clients of Waterloo Capital. This communication is intended to provide a balanced, factual assessment of the current private credit environment, drawing on publicly available market data and our ongoing monitoring of the strategies in which we are invested. This document is intended for informational purposes only. Past performance is not indicative of future results.

01

Executive Summary

Private credit has grown from a niche institutional asset class into one of the most widely allocated segments of global alternative investing — with total assets under management estimated at approximately **\$1.8 trillion in the United States alone**. For much of the past decade, the asset class delivered compelling risk-adjusted returns, benefiting from the post-2008 retreat of traditional banks from middle-market lending and a sustained period of benign credit conditions.

Today, the environment has shifted. Rising defaults, a wave of redemption requests at major semi-liquid fund platforms, and growing concerns about loan quality — particularly around pay-in-kind (PIK) structures and covenant-lite documentation — have moved private credit from the business section to the front page. At the same time, the structural mechanics of the vehicles through which many investors access this asset class are being tested in a meaningful way for the first time.

This update is intended to explain — plainly and factually — what is happening, why it matters, and how we are thinking about the situation on behalf of our clients. Our view is balanced: private credit is not broken, but it is also not immune from the same economic pressures that affect all credit. We believe the current period calls for heightened diligence, direct communication with our managers, and clear-eyed assessment of each strategy we hold.

<p>\$1.8T</p> <p>U.S. Private Credit AUM Estimated total</p>	<p>9.2%</p> <p>Record Default Rate FY2025 — Fitch PCDR</p>	<p>5.8%</p> <p>TTM Default Rate January 2026 — Fitch</p>	<p>\$252B</p> <p>Semi-Liquid Fund AUM Sep 2025 — N. Trust</p>
--	--	--	---

¹ Reuters, "Private credit strains ripple through Wall Street," March 16, 2026

² Fitch Ratings, "U.S. Private Credit Default Rate Continues Upward March to 5.8%," Feb 23, 2026

³ Northern Trust, "Evaluating Tender Offer and Interval Funds," Dec 2025

02

The Private Credit Landscape: A Brief Overview

Private credit — broadly defined as debt financing provided outside of the public bond and leveraged loan markets — encompasses a wide range of strategies: direct lending, mezzanine debt, asset-based lending, specialty finance, and opportunistic credit, among others. Historically, access to these strategies required large minimum commitments through drawdown funds with 7-to-10-year lock-ups, limiting participation to institutional investors.

Over the past several years, a newer generation of semi-liquid vehicles has democratized access. These structures — principally interval funds and tender-offer funds — are registered under the Investment Company Act of 1940, offer periodic liquidity (typically quarterly), and provide daily NAV pricing with 1099 tax reporting. As of September 2025, semi-liquid and tender-offer assets had grown to approximately **\$252 billion in total AUM**, reflecting strong appetite among wealth management platforms and individual accredited investors.

How These Vehicles Work: Interval Funds vs. Tender-Offer Funds

Feature	Interval Fund	Tender-Offer Fund
Regulatory Structure	1940 Act, closed-end	1940 Act, closed-end
Liquidity Frequency	Quarterly (mandatory)	Quarterly or semi-annual (board discretion)
Redemption Limit	5%–25% of NAV (fund sets level)	Flexible; board-determined; no regulatory minimum
Subscription	Daily at NAV	Periodic, per offering docs
NAV Reporting	Daily	Periodic
Best Suited For	Senior secured loans, liquid private credit	Illiquid strategies: private equity, real assets

Important structural note: Both vehicle types include redemption gates — predetermined limits on how much of a fund's assets can be redeemed in any given period. These gates are not punitive; they are designed to prevent forced asset sales at distressed prices that would harm all shareholders equally. When redemption requests exceed the fund's gate, investors receive their pro-rata share of available liquidity, and unfulfilled requests are carried forward or re-submitted next quarter depending on the fund's policy.

⁴ Morgan Stanley IM, "Semi-Liquid Private Credit: A Quiet Revolution," Feb 2026

⁵ Morningstar, "Semiliquid Funds: Top Vehicles, Asset Classes, and Managers," Jan 2026

03

What the Data Is Showing: Defaults, PIK, and Redemption Pressure

Default Rates: Reading the Data Correctly

The headline number that has dominated financial media coverage is Fitch Ratings' Private Credit Default Rate (PCDR), which reached a record 9.2% for full-year 2025 and stands at 5.8% TTM through January 2026. These figures are real and should not be dismissed — but understanding what they measure is essential before drawing conclusions about the broader asset class.

What Fitch Is — and Is Not — Measuring

Fitch's PCDR is derived from its Privately Monitored Ratings (PMR) portfolio: a universe of approximately 302 companies that Fitch actively tracks. This portfolio skews significantly toward smaller, lower-quality borrowers — the majority of 2025 defaults were concentrated among issuers generating \$25 million or less in EBITDA, a segment of the market that is more financially fragile, more reliant on floating-rate debt with limited hedging, and generally not the profile of borrowers targeted by institutional-grade, sponsor-backed direct lending strategies.

Fitch's own size-based analysis makes this stratification explicit: for the smallest issuers (EBITDA under \$25M), the PMR default rate reached 17.2% — nearly three times the 6.1% MCO rate for the same cohort, which captures larger, better-capitalized borrowers. This single data point illustrates why the aggregate headline rate can be deeply misleading when applied uniformly to the private credit market.

Data Source / Universe	Universe Scope	Default / Loss Rate	Key Characteristic
Fitch PCDR — PMR Portfolio	~302 companies; skewed to issuers <\$25M EBITDA; includes non-sponsored borrowers	9.2 % FY2025 5.8% TTM Jan 2026	Highest-stress segment of the market; limited lender protections in many cases
Fitch PCDR — MCO Sub-Index	Model-based; larger, better-capitalized borrowers within the same universe	4.7% TTM Jan 2026 (vs. PMR's 9.4%)	More representative of mid-market; still elevated vs. historical norms
KBRA Direct Lending Index (DLI) — Sponsored MM	2,416 sponsored MM borrowers; > \$1 trillion in direct lending debt; rated transactions only	~1.8%–3.4% (2025) KMDM: 2.0% by value	Sponsor-backed; active monitoring; lender engagement at early signs of stress
Cliffwater CDLI — Senior Secured Sponsored	\$500B+ in middle market loans; ~40% of U.S. direct lending market; primarily 1st lien	Non-accrual: 1.4% TTM realized loss: -0.61% 20-yr avg loss: ~1.0%	Realized losses below historical average; near- zero unrealized losses

The contrast between the Fitch PMR headline and the CDLI and KBRA data is not a technicality — it reflects a fundamental structural difference in what is being lent to, and how. Senior secured, sponsor-backed lending to companies with meaningful EBITDA is a materially different risk profile than floating-rate unsecured or minimally-protected loans to sub-\$25M EBITDA borrowers with no private equity sponsor maintaining oversight.

That said, we are not dismissing the broader trend. Default rates are rising across the market spectrum, and a roughly \$300–\$350 billion refinancing wall of loans originated in 2020–2022 — many underwritten assuming SOFR near 1% — continues to create pressure as those borrowers approach maturity at rates 400–500 bps higher than underwritten. Software and technology companies face particular scrutiny as AI disruption challenges established business models. These are real risks that require active portfolio monitoring — and we are engaged accordingly.

04

Pay-in-Kind (PIK) Loans: What They Are and Why They Matter

A PIK provision allows a borrower to pay interest not in cash, but by adding the interest amount to the outstanding principal of the loan — effectively issuing an "IOU" rather than writing a check. PIK is a legitimate and long-established tool in private lending; it can be agreed upon at origination to allow growth companies to preserve cash flow, or toggled during the life of a loan when a borrower encounters temporary difficulty.

PIK Type	What It Signals	Risk Level
Origination PIK ("Planned PIK")	Agreed at closing; part of business plan. Common in growth or buyout scenarios.	Lower — expected and priced into the deal
Toggle PIK ("Bad PIK")	Borrower converting cash interest to PIK mid-loan due to cash flow stress.	Higher — indicates potential credit deterioration

The concern today is that unplanned, "bad PIK" interest — where borrowers are forced to toggle from cash to PIK due to cash flow shortfalls — affected approximately 6.4% of private credit loans by late 2025, up sharply from roughly 2% in 2022. At the portfolio level, a useful benchmark is the 10% threshold: when PIK income exceeds 10% of a fund's total income, there is a structural mismatch between cash received and income distributed, which can create liquidity stress — particularly for vehicles structured as regulated investment companies (RICs) that must distribute 90% of taxable income annually regardless of whether that income is received in cash.

6 Reuters / Fitch Ratings, "US private credit defaults hit record 9.2% in 2025," March 6, 2026

7 Verdence Capital, "2026 Q1 White Paper: Private Credit Under Pressure," March 5, 2026

8 Fitch Ratings, "Inaugural Size-Based U.S. PCDR Analysis Finds Smaller Issuers More Vulnerable," Sept 23, 2025

9 KBRA, "Private Credit: Q4 2025 Middle Market Borrower Surveillance Compendium," Feb 25, 2026

10 Cliffwater, "Private Debt Q3 2025 Performance" (CDLI non-accrual 1.4%, TTM realized loss -0.61%)

11 Barron's, "'PIK' Loans Are the Market's Latest Concern," March 12, 2026

12 iCapital, "Painting a PIKture: The Benefits and Risks of PIK in Private Credit," Feb 2025

05

Redemption Dynamics: What Happened and Why the Gates Exist

The first quarter of 2026 has been a stress test for the semi-liquid structure. Beginning in late February and accelerating into March, a wave of investor redemption requests exceeded the standard quarterly gates at several of the largest private credit platforms. The table below summarizes the most widely reported events:

Manager / Fund	Q1 2026 Redemption Request	Amount Fulfilled	Action Taken
Blackstone BCRED (\$82B fund)	~7.9% of fund assets (~\$3.8B)	100% fulfilled (raised limit to 7%; firm covered remainder)	Temporarily increased quarterly limit to 7%
BlackRock HLEND (\$26B HPS fund)	~9.3% (~\$1.2B); exceeded 5% cap	5% cap honored (~\$620M distributed)	Standard gate applied; remainder unfulfilled
Cliffwater CCLFX (\$33B fund)	~14% of fund shares	7% fulfilled (maximum allowed under docs)	Cap exercised at 7% discretion level
Morgan Stanley North Haven PIF	Requests exceeded 5% quarterly limit	~\$169M fulfilled (~45.8% of requests)	5% gate applied; remainder unfulfilled
Blue Owl Capital Corp II	Sustained elevated redemption pressure	Suspended quarterly tender offer	Transitioning to pro-rata asset-sale distributions

These events are significant and deserve direct acknowledgment. That said, it is equally important to understand what they do — and do not — mean:

Gates are functioning as designed. Redemption limits exist precisely to prevent forced asset liquidations that would disadvantage remaining investors. A fund honoring its gate is behaving as its documents specify — this is not the same as a fund failing or becoming insolvent.

The underlying loans are performing in most cases. The redemption surge has been driven primarily by investor sentiment and macro uncertainty — not by a proportional deterioration in loan performance. Funds like CCLFX have reported near-zero historical realized losses and maintained annualized returns near their long-term targets despite the pressure.¹³

Not all semi-liquid strategies are alike. There is a meaningful difference between a fund investing in senior secured, floating-rate loans to large-EBITDA borrowers versus one with concentration in software or covenant-lite structures. Strategy-level diligence is essential and cannot be replaced by broad asset class characterizations.

Bank tightening adds a secondary pressure. U.S. banks had approximately \$300 billion in outstanding loans to private credit firms and \$340 billion in unutilized commitments as of mid-2025. As banks adjust valuations and tighten lending standards, some managers may face reduced access to leverage lines that support fund operations.¹⁴

¹³ Bloomberg / Cliffwater, "Cliffwater \$33 Billion Private Credit Fund Redemptions Reach 14%," March 11, 2026

¹⁴ Reuters, "Private credit strains ripple through Wall Street," March 16, 2026

06

How We Are Approaching This Moment

Waterloo Capital has maintained a thoughtful and deliberate allocation to private credit across both semi-liquid vehicles and traditional drawdown structures. Our semi-liquid allocations span multiple strategies — senior secured direct lending, opportunistic credit, specialty finance, and private real estate debt — chosen specifically to provide diversification across borrower type, collateral profile, and return objective.

We want to be direct with our clients: **we are watching this situation closely, and we are actively engaging with each of our general partners.** These conversations are an ongoing part of how we manage client capital — not a reactive measure. We expect our managers to provide transparent reporting on PIK exposure, default rates at the portfolio level, liquidity positioning, and any material changes to redemption policy. Where we have concerns, we raise them.

What We Look for in Each Strategy

Factor	What We Assess	Why It Matters Now
Loan Seniority	First lien vs. subordinated; loan-to-value ratios	Senior secured loans recover more in defaults; lower LTV provides cushion
PIK Exposure	Cash income vs. accrual; 10% threshold monitoring	Excess PIK can create liquidity mismatches in RIC-structured funds
Sector Concentration	Software / tech exposure; single-name limits	Software is the most scrutinized sector in 2025–2026 credit markets
Covenant Quality	Covenant-lite prevalence; maintenance vs. incurrence	Covenants provide early warning signals and negotiating leverage in workouts
Liquidity Buffer	Cash / near-cash as % NAV; fund-level liquidity	CCLFX reported 21% liquidity vs. NAV at time of gate activation — a positive sign
Manager Track Record	Historical realized losses; workout experience	Experience through 2008 and 2020 is distinguishing in stressed environments

Our Current Positioning

Across our semi-liquid private credit allocations, our current exposure reflects a deliberate mix of strategies selected for differentiation: senior secured direct lending to diversified middle-market borrowers, opportunistic credit targeting less competitive lower middle-market segments, specialty finance with low correlation to traditional credit cycles, and collateralized real estate debt with hard-asset backing.

We have reviewed each holding in light of recent developments. Based on that review, we are comfortable with the quality and construction of the underlying portfolios. None of our current positions have taken actions inconsistent with their stated mandates. Where gates have been activated at market level, those activations reflect the redemption dynamics described above — not impairment of underlying assets. We continue to monitor the situation and remain in regular dialogue with each of our GPs.

Our posture is not one of alarm, nor of complacency. Private credit as an asset class continues to offer compelling income characteristics, low mark-to-market volatility, and diversification benefits that remain intact. The risks are real and must be managed actively — and that is exactly what we are doing. **Clients with specific questions about any individual strategy are encouraged to contact us directly.**

A

Appendix: Key Terms and Definitions

Term	Definition
Private Credit	Debt financing extended by non-bank lenders directly to companies, outside of public bond or broadly syndicated loan markets. Includes direct lending, mezzanine, asset-based lending, and specialty finance.
Direct Lending	The most common private credit strategy: a lender provides a loan directly to a middle-market company, typically as a first-lien, floating-rate senior secured facility.
Interval Fund	A 1940 Act registered closed-end fund that periodically offers to repurchase shares from investors at NAV — typically quarterly, at 5%–25% of fund NAV. Mandatory quarterly repurchase policy; daily pricing.
Tender-Offer Fund	A 1940 Act registered closed-end fund that offers liquidity through board-approved tender offers. Timing and amount are at the board's discretion, offering more flexibility for illiquid underlying assets.
Redemption Gate	A predetermined limit on the percentage of fund NAV that can be redeemed in any given period. If requests exceed the gate, investors receive a pro-rata share of available liquidity. Designed to prevent forced sales.
PIK (Pay-in-Kind)	A loan feature allowing a borrower to pay interest by adding it to the loan principal instead of paying cash. "Planned PIK" is agreed at origination. "Bad PIK" occurs when a borrower switches mid-loan due to stress.
Covenant-Lite	Loan documentation that reduces or eliminates financial maintenance covenants. Provides fewer early-warning mechanisms and less negotiating leverage for lenders in a workout.
Senior Secured / First Lien	Debt with first claim on a borrower's assets in a default scenario. Generally the lowest-risk position in a company's capital structure.
SOFR	Secured Overnight Financing Rate — the standard benchmark for floating-rate private credit loans. Most private credit loans are priced as SOFR + spread (e.g., SOFR + 600 bps).
Default Rate (PCDR)	Fitch Ratings' Private Credit Default Rate tracks defaults across a monitored universe of private credit borrowers on a trailing 12-month basis. The 2025 full-year rate was a record 9.2%.

B

Important Disclosures

This document has been prepared by Waterloo Capital for informational purposes only and is intended solely for use by existing clients of the firm. It does not constitute investment advice, a solicitation to buy or sell any security, or an offer to invest in any fund or strategy. The information contained herein is derived from publicly available sources believed to be reliable; Waterloo Capital makes no representation as to the accuracy or completeness of such information.

Investments in private credit involve significant risk, including the risk of loss of principal. Past performance is not indicative of future results. Semi-liquid vehicles provide only limited liquidity; investors may not be able to redeem all or any of their shares during any given repurchase period. Fund-level gates, board discretion on tender offers, and market conditions may limit liquidity further. All fund-specific data referenced herein is sourced from publicly available fund fact sheets, regulatory filings, and third-party research as of the dates noted.

References to third-party research, news, or manager commentary are provided for context only and do not constitute an endorsement of those sources or the views expressed therein. Waterloo Capital is not affiliated with any of the fund managers or research providers cited in this document. This document may not be reproduced, redistributed, or shared without the prior written consent of Waterloo Capital.

Sources Referenced:

Reuters (reuters.com) · Fitch Ratings (fitchratings.com) · Barron's (barrons.com) · Bloomberg (bloomberg.com) · CNBC (cnbc.com) · Verdecence Capital Advisors (verdecence.com) · iCapital (icapital.com) · Northern Trust (northerntrust.com) · Morgan Stanley IM (morganstanley.com) · Morningstar (morningstar.com) · Cliffwater Funds (cliffwaterfunds.com) · KBRA (kbra.com) · Flat Rock Global (flatrockglobal.com) · Variant Investments (variantinvestments.com) · BC Partners (bcpartners.com). Data as of March 2026 unless otherwise noted.