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# What's Market: 2025 Mid-Year Trends in Large Cap and Middle Market Loans

**by Practical Law Finance**

Status: **Law stated as of 31 Jul 2025** | Jurisdiction: **United States**

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A Practice Note examining the landscape of the US loan market in the first half of 2025. Initial expectations for robust economic activity were tempered by the rollout of the Trump administration's tariff policy. Refinancing and repricing levels did not reach last year's level at the half-way mark and although M&A levels improved, the hoped-for surge did not materialize despite ample amounts of sponsor dry powder. Key market trends including convergence and competition between the broadly syndicated loan market and private credit continued. This Note discusses other notable points including interest rate expectations, default risk, liability management transactions, the implications of new outbound investment rules, and ongoing negotiations around loan terms such as EBITDA add-backs and debt portability.

Following a strong 2024 driven by high refinancing and repricing issuance, finance practitioners were optimistic that 2025 would be just as busy amid a softening of inflationary pressures, a more favorable regulatory environment, and the increased likelihood of some easing of interest rates. Many were bullish that last year's sluggish M&A lending activity would pick up significantly in the new year, especially in the broadly syndicated loan (BSL) market. Practitioners also predicted that dealmakers would be eager to take advantage of more borrower-friendly conditions to deploy the vast amounts of dry powder they had been sitting on for some time. However, the scenery shifted abruptly with the rollout of the Trump administration's tariff policy, and uncertainty continues to predominate.

Although practitioners are still seeing a healthy appetite for credit, many have also seen the market adopt a cautious "wait and see" approach to pursuing new deals, a trend likely to continue as uncertainty persists in the market. Unlike during the pandemic, however, when borrowers scrambled to draw down their existing revolvers and boost their cash reserves in the face of economic uncertainty, market participants have not reported an uptick in revolver drawdowns. For practitioner perspectives on the loan market and the new administration's tariff policies, see Legal Update, What's Hot for 25: Perspectives on the US Loan Market and Article, 100 Days: Finance Attorneys' Views on Transactional Lending Practice.

## Market Trends and Developments

Total US syndicated loan issuance totaled approximately $1.78 trillion in the first half of the year, representing a roughly 3% decrease from the $1.85 trillion reached in the first six months of 2024. Leveraged loan issuance posted $692 billion through June 2025, a decrease of approximately 17% from the same period in 2024. Bank loan issuance increased 26% year-over-year and stood at $306 billion at the six-month mark.

The private credit market continued to show significant growth and now stands at over $1.5 trillion (for more information on private credit, see Practice Note, Direct Lending: Overview). Although the BSL and private credit markets continue to compete for deals, they have also learned to accommodate one another. The number of high-profile partnerships between banks and private credit firms have ticked upwards and this collaboration is likely to continue. Following on the heels of Apollo and Citi's $25 billion private credit venture (Citi and Apollo Announce $25 Billion Private Credit, Direct Lending Program, Sept. 26, 2024), Apollo announced that it has teamed up with JPMorgan and Goldman Sachs to further expand its footprint in the space.

Collateralized loan obligations (CLO) issuance stood at $97 billion in the first half of the year, a slight decrease compared to the same period in 2024 when CLO issuance reached $99 billion. Although there seemed to be a healthy appetite for CLOs in the early months of 2025, expectations have become more muted in the wake of the tariff announcements. BSL CLO issuance continued to outpace middle market CLO issuance.

Covenant-lite (cov-lite) loans completely dominate the leveraged loan market, with cov-lite issuance representing approximately 93% of the total volume of all US institutional leveraged loans issued in 2024. Although cov-lite loans are less prevalent in the private credit space, as the two markets continue to converge direct lenders seem to be more willing to provide cov-lite loans, especially among more competitive and larger/jumbo credits. For more information, see Practice Note, Covenant-Lite Loans: Overview.

Unitranche debt volume has also continued to increase and looks set to remain healthy. According to Morgan Stanley Investment Management (citing data from Prequin), market observers expect the global unitranche market to reach approximately $1 trillion this year. Demand for other alternative financing structures, including mezzanine debt, asset-based lending, and other hybrid funding, is also expected to grow as investors look to diversify and pursue more nuanced investment strategies. For more information on some of these alternative financing structures, see Practice Notes:

- Mezzanine Finance: Overview.
- Asset-Based Lending: Overview.
- Fund Finance: Overview.

## Interest Rates

Although the Federal Reserve (the Fed) issued three interest rate cuts in the latter half of 2024, the higher-for-longer interest rate environment is likely to remain for the foreseeable future, especially as the market continues to face economic uncertainty and the potential threat of tariff-driven inflation. Despite pressure from the administration to bring interest rates down, the Fed has kept rates steady so far in 2025, with the target range currently standing at 4.25% to 4.50%, though the Fed has indicated that additional rate cuts remain possible later this year.

## Refinancings, Repricings, and More

Despite a strong burst in refinancing and repricing activity in the first weeks of 2025, markets have experienced some jolts in the first six months of the year.

Refinancing activity dropped to $95.6 billion in the first half of the year, falling by roughly 46% compared to the same period in 2024, according to data from Pitchbook | LCD. With BSL lenders competing strongly with private credit providers, some companies sought to refinance their direct lending deals with syndicated loans. According to Pitchbook | LCD, 17 private credit borrowers have refinanced their loans in the BSL market in the first half of 2025, amounting to $16.1 billion.

Appetite for amend & extend (A&E) dealmaking also continued in the beginning of the year, and market participants have noted an opportunity for private credit providers in this area. As an increasing number of loans executed during the pandemic near maturity, private credit lenders are hoping to bridge the gap and provide funding for borrowers who are unable to refinance with their original bank lenders. For more general information on A&E transactions, see Practice Note, What's Market: Amend & Extends.

Repricing issuance also dropped year-over-year despite strong volume ($76.06 billion) during the month of January. However, momentum faded in the second quarter amid tariff and other economic concerns. Issuance reached just $155 billion at the midpoint of 2025, a 40% drop compared to the same period last year.

Dividend recapitalization (dividend recap) issuance also surged at the beginning of the year, reaching $22.4 billion in mid-February, a jump of 60% compared to the same period last year, according to Pitchbook | LCD. Similar to other opportunistic financing, however, dividend recap volume was more muted in the second quarter, dropping roughly 52% from the first quarter to contribute to a 14% decline year-over-year. Dividend recap issuance declined a modest 6%, posting $33.2 billion through June 2025 compared to $35.4 billion in the same period last year.

## M&A Activity

Although M&A-driven activity was up year-over-year, this uptick comes off an especially sluggish 2024, and market participants have expressed disappointment that M&A growth continued to fall short of expectations. A jump in M&A issuance in the second quarter helped drive the first-half total to $224 billion, an increase of 40% compared to the same period in 2024. While practitioners are hopeful that the ample amount of dry powder of private credit funds and interest in doing deals spurs further activity in the second half of the year, many predict a "wait and see" mentality will remain in some corners of the market in the face of ongoing economic uncertainty.

## Loan Terms

Deal terms that remained a key focus of loan negotiations during the first half of 2025 centered on many of the following:

- Liability management transactions (LMTs) (see LMTs).
- Outbound investment rules (see Outbound Investment Rules).
- Incremental facility provisions (see Incremental Facilities).
- EBITDA add-backs (see EBITDA Add-Backs).
- Portability (see Portability).
- Prepayment provisions (see Prepayments).
- Payment-in-kind (PIK) interest (see PIK Interest).
- Delayed draw term loans (DDTLs) (see DDTLs).
- Section 899 (see Section 899).
- Disqualified lender (DQ) lists (see DQ Lists).
- Voting Rights: "You Snooze, You Lose" (see Voting Rights).

### LMTs

LMTs continue to be the headline story, and borrowers are increasingly looking for opportunities to employ LMTs to give themselves some breathing space and a chance to avoid a costly and time-consuming restructuring or bankruptcy proceeding. This has prompted many lenders to consider inserting blocker language in their credit agreements to limit the borrower's ability to effect LMTs (for an example, see What's Market, Trinseo Holdings S.à r.l. Credit Agreement Summary). These so-called J.Crew, Serta, and Chewy blocker provisions have become finance-industry jargon and continue to evolve. Practitioners have emphasized the importance of paying attention to specific blocker language, noting that simply inserting a particular buzz word in the credit agreement is not enough to layer in the intended protection.

Practitioners have also reported seeing LMT terms (as well as other loan agreement provisions) increasingly embedded in unexpected places within the credit agreement. For example, Mirion Technologies (US Holdings), Inc. fifth amendment included a clause in its interpretative provisions section expanding open market purchases to include privately negotiated transactions (see SEC: Mirion Technologies (US) Holdings, Inc. Fifth Amendment to Credit Agreement). For more information on this and other distinctive credit agreement amendments, see Practice Note, What's Market: Unusual Credit Agreement Amendments.

In 2025, a significant amount of focus among finance attorneys has centered on the importance of sacred rights provisions, which generally refer to provisions in a credit agreement that require 100% lender vote to amend, including the issue of negotiated exceptions to pro rata sharing. In the wake of the Serta decision, practitioners have also seen some more creative uptiering maneuvers making their way into the market. For example, so-called "extend-and-exchange" transactions permit a borrower to pursue a non-pro-rata term loan exchange without relying on an open-market purchase exception. Creditors are also showing interest in so-called "omni blocker" provisions, which aim to prohibit borrowers from entering into an LMT that has not been offered to all lenders on a pro rata basis, although these may raise other issues, including for borrowers trying to operate in the ordinary course of business, and are not commonly seen in the current loan market.

Another way the market has responded to the rise of LMTs is through increased use of cooperation agreements (Co-ops), which are highly negotiated agreements entered into by groups of lenders (generally majority lenders under their loan agreements). In a Co-op, the lenders typically agree they will not consent to a transaction unless a specified threshold of them support the transaction. There has been talk of borrowers and sponsors challenging this tactic by inserting "anti-Co-op" language in their credit agreements.

To help navigate these complex structures and developments, Practical Law Finance has published several resources on LMTs. These include:

- Practice Note, Liability Management Transactions: Overview.
- Practice Note, What's Market: Liability Management Transactions.
- Article, Expert Q&A on Liability Management Transactions in 2024 and the Outlook for 2025.
- Liability Management Transactions (LMTs) Toolkit.

### Outbound Investment Rules

The outbound investment rules, which took effect on January 2, 2025, restrict US outbound investment in countries of concern. In the context of a credit agreement, the rules apply to the provision of:

> "A 'loan or a similar debt financing arrangement to a person that the U.S. person knows at the time of the provision is a covered foreign person, where such debt financing affords or will afford the U.S. person an interest in profits of the covered foreign person, the right to appoint members of the board of directors (or equivalent) of the covered foreign person, or other comparable financial or governance rights characteristic of an equity investment but not typical of a loan' (31 C.F.R. § 850.210)."

Although it is likely that many lending transactions will be outside the scope of regulation, certain types will be covered, and some credit agreements have been updated to address these risks by including a related representation or covenant (for an example, see What's Market, MSA Safety Incorporated Fifth Amended and Restated Credit Agreement Summary). Outbound investment regulations may also be incorporated in cross-border loan agreements with foreign or sovereign borrowers. For more information on the outbound investment rules, see Standard Clauses:

- Loan Agreement: Representations and Warranties.
- Loan Agreement: Negative Covenants.
- Loan Agreement: Cross-Border Provisions.

### Incremental Facilities

Parties remain focused on the structure and size of baskets permitted under the incremental facility of a credit agreement. Debt capacity may include a fixed dollar amount (which may or may not include a "grower" component so that the fixed amount is the greater of a dollar amount and a percentage of EBITDA) together with an additional ratio-based amount subject to a specified financial covenant. Sponsors are also continuing to seek the ability to reclassify certain incremental debt incurred under the fixed dollar basket as incurred under the ratio-based basket, thereby freeing up or "re-loading" the fixed-dollar basket for use at a later time, perhaps when the borrower may no longer be able to satisfy the ratio-based permission (for an example, see What's Market, GCI, LLC Ninth Amended and Restated Credit and Guarantee Agreement Summary).

Most-favored nations (MFN) provisions continue to serve as protection for lenders in both the BSL and private credit markets, although there may be some differences in the way they operate. In BSL deals, MFN thresholds remained relatively steady at around 50 basis points (bps) although in certain sponsor deals this threshold may be set at 75 or 100 bps (for an example, see What's Market, Emerald X, Inc. Second Amended and Restated Credit Agreement Summary). Practitioners have also seen continued interest in MFN sunset clauses. However, sunsets are mostly seen in the BSL market and are less common in private credit deals. MFN carve-outs also remain a key focus of credit agreement negotiations, with carve-outs for maturity limitations and other debt fairly common.

### EBITDA Add-Backs

Negotiation of EBITDA in a loan transaction remains a core issue for market participants given the pivotal role of EBITDA in financial ratios, loan pricing, and covenant permissions. Pro forma add-backs for items such as projected cost savings and synergies and restructuring and business optimization expenses are key topics of discussion. Add-backs derived from quality of earnings reports are more controversial and generally limited to specific acquisitions. The bespoke nature of add-backs is reflected in the variety of provisions that are agreed, including add-backs that are more industry-specific adjustments. Some practitioners have also observed a renewed focus on adjustments related to compliance with Regulation S-X (for an example, see What's Market, The E.W. Scripps Company Credit Agreement Summary).

In the private credit market, practitioners have reported tighter EBITDA definitions, with caps commonly placed on many of these adjustments, either as a fixed dollar amount or a percentage of EBITDA. This mirrors the more conservative approach taken by many private credit lenders in their underwriting standards. For their part, sponsors sometimes push for adjustments in deals to ensure uniformity of approach across their portfolio companies.

The high-water mark concept, which originated in Europe, is rare in US loan deals, though in a few instances these provisions have cleared the BSL market. The high-water mark feature works as a one-way ratchet to the borrower's earnings, with the highest EBITDA achieved during the life of the loan being used to measure the borrower's compliance with ratio-based permissions for covenant compliance purposes, regardless of any later decline in the borrower's EBITDA. The rationale behind high-water mark EBITDA figures in a negative covenant basket is to provide borrowers with greater flexibility though lenders are generally averse to permissions that ignore the possibility that a borrower's earnings may decline in future periods.

For more information on EBITDA and EBITDA adjustments, see Practice Notes:

- EBITDA Adjustments in Loan Negotiations.
- EBITDA: Introduction for Finance Lawyers.
- EBITDA: Loan Agreement Negotiating Considerations.

## Portability

An increasing number of BSL and private credit providers have shown greater willingness to include a portability feature in their recent loans (for an example, see What's Market, Long Ridge Energy LLC Credit Agreement Summary). Portability is essentially a carve-out to typical change of control provisions, which requires a selling sponsor to repay all its debt obligations when it exits a portfolio investment. A portable debt structure allows a buyer to carry over the borrower's existing debt credit facility, thereby avoiding the time and money required to obtain new debt financing.

According to practitioners, dealmakers have found portability provisions useful in a more muted M&A environment as a way to move deals forward because target companies with financing in place offer easier execution for buyers and can make them more attractive investments. Practitioners have also observed some movement in the timing of portability provisions. Previously, portability was seen as more of a short-term solution, with time periods ranging from one to two years after closing. However, some practitioners have reported seeing portability periods being extended into a two-to-three-year range given that selling assets may be a somewhat lengthy process.

## Prepayments

Practitioners are reporting a greater focus on mandatory prepayment provisions, including excess cash flow and asset sale prepayments. Although credit agreements typically require 100% of net cash proceeds for asset sales to be used to prepay the loans, in the BSL market borrowers continued to successfully negotiate leverage-based step-downs for asset sales, as well as excess cash flow mandatory prepayment requirements (for an example of an asset-sale step-down, see What's Market, Hanesbrands Inc. Sixth Amended and Restated Credit Agreement Summary). Retained amounts can also be added to the "available basket" and used for, among other things, restricted payments, investments, and prepaying junior debt. Carve-outs to the definition of excess cash flow also continued to be heavily negotiated. Whether certain carve-outs are included in any particular deal depends on the creditworthiness and bargaining power of the borrower and the type of transaction.

In deals that include a call protection provision, market observers have noted continued focus on carve-outs, which continue to make their way into credit documents and chip away at lender protections (for an example, see SEC: Knife River Corporation First Amendment to Credit Agreement). With competition from the BSL market, sponsors have been pushing private credit providers to incorporate more carve-outs in their call protection provisions, as well as reduce premiums.

## PIK Interest

PIK interest continued to feature prominently in the private credit market as borrowers look for more flexible ways to service at least some of their interest expenses without draining liquidity reserves in a higher-for-longer interest rate environment. PIK interest provisions allow a borrower to capitalize (or add to the principal balance of their loans) all or a portion of their accrued interest, rather than making current cash payments to their lenders which may be important for companies in a growth stage. Borrowers are therefore able to shore up their liquidity levels and use their cash reserves to meet other obligations or make investments. For an example, see SEC: Eastman Kodak Company Second Amendment to Credit Agreement. See also Practice Note, PIK Interest: Negotiation and Documentation Considerations.

### DDTLs

DDTLs permit borrowers to draw down their term loan commitment during an agreed period after the closing, rather than in a single borrowing at closing. They have become an appealing option for borrowers looking to manage their debt financing costs in the current interest rate environment. The appeal lies in the borrower having committed financing in place on established terms, while paying a ticking fee on the undrawn commitment rather than interest on funded loans. This is attractive to borrowers that wish to draw down their commitments gradually, for example, to complete follow-on acquisitions. Although DDTLs are a popular feature in the middle market and private credit space, practitioners have reported an increased appetite for DDTLs in the BSL market. For an example of a credit agreement with a DDTL feature, see What's Market, Ares Aspen Member LLC Credit Agreement Summary.

Some key points of focus in DDTL negotiations include:

- The duration of the availability period. This generally ranges between 12 and 24 months.
- Structure of the fees. This may be subject to a holiday period, during which time the payment of fees is temporarily suspended.
- Breadth of the use of proceeds. Although traditionally more limited in scope (primarily related to permitted acquisitions), this has expanded in recent years and it is not uncommon to see that a DDTL may be used for general corporate purposes (other than dividends).
- Leverage requirement. Investors usually place a leverage requirement on the DDTL to require that funds may only be drawn if the leverage levels are less than or equal to a specified threshold (on a pro forma basis). This is usually fixed at the closing level.

Another recent innovation in private credit, known as synthetic PIK, involves the borrower making cash interest payments to its lenders on each interest payment date on its primary loan facility using the proceeds of drawings on a secondary delayed draw facility provided by the same lenders. For more information on synthetic PIK, see Practice Note, PIK Interest: Negotiation and Documentation Considerations: Synthetic PIK.

### Section 899

Although the so-called "revenge tax" in Section 899 was ultimately removed from the final version of the One Big Beautiful Bill Act (Pub. L. 119-21, 139 Stat. 72 (2025)), it generated considerable attention as market participants weighed the potential impact it could have on the loan market. Section 899 would have increased the tax rate (including withholding tax rate) imposed on certain US-source and effectively connected income of individuals, entities, and governments of countries that impose unfair foreign taxes. In anticipation, some borrowers proactively modified their financing documents to include a carve-out for Section 899 taxes from their gross-up and indemnity obligations (for an example, see SEC: Mirion Technologies (US Holdings), Inc. Fifth Amendment to Credit Agreement). For more information on this and other distinctive credit agreement amendments, see Practice Note, What's Market: Unusual Credit Agreement Amendments.

### DQ Lists

DQ lists identify certain entities to which lenders are prohibited from assigning loans or commitments under a credit agreement. DQ lists typically exclude certain banks or financial institutions and affiliates (other than bona fide debt funds) as well as competitors of the sponsor from becoming lenders in a given credit agreement. However, sponsors have become more aggressive in recent years in seeking to exclude particular lenders, with the result that DQ lists have dramatically expanded, and it is common to see a large number of disqualified entities included in many deals.

There are also instances in the market where borrowers have designated non-competitors as disqualified lenders or included distressed investors on the list. The expansion of these lists raises a number of issues, including whether the administrative agent, who usually manages the borrower's DQ list and confirms whether or not a particular entity is included, should be liable if they mistakenly provide inaccurate information. Another negotiating point practitioners frequently discuss centers on the ability to amend and supplement DQ lists after closing. Transparency has also been a growing concern, as borrowers and sponsors are increasingly neglecting to post or provide these lists to existing lenders.

### Voting Rights

The "you snooze, you lose" concept, which is more common in the European loan market, is a borrower-friendly clause which gives the borrower protection against lenders failing to respond within a specified time frame to a request for an amendment, consent, or waiver under that credit agreement. The vote of a lender that does not respond to that request within the stated time frame is discounted when calculating whether lenders holding the requisite percentage of the facilities have approved the amendment, consent, or waiver. In a minority of cases, the lender may be deemed to vote in favor of a request if they do not otherwise vote against the proposal within the requisite time frame. For an example, see What's Market, The RMR Group LLC Credit Agreement Summary.

## Defaults, DIPs, and Distressed Debt

The US leveraged loan default rate is expected to trend upwards as the year progresses, with S&P Global projecting an increase from 1.23% in April 2025 to 1.75% by March 2026. Continued economic uncertainty is expected to weigh heavily on some highly leveraged borrowers.

US corporate bankruptcies reached a 14-year high last year, according to data from S&P Global Market Intelligence, and this number continued to climb in 2025. S&P Global Market Intelligence reports 371 new bankruptcy filings have been made at the midpoint of 2025, the highest level since the first half of 2010 in the wake of the global financial crisis. The industrial and consumer discretionary sectors saw the highest number of filings, with 58 and 49, respectively.

Debtor-in-possession (DIP) financing, which reached approximately $13.7 billion in total funding in 2024, remained robust in the first half of the year. An uptick in bankruptcies fuels activity in the market for DIP loans allowing borrowers to maintain liquidity and manage their business operations during Chapter 11 bankruptcy reorganizations. According to practitioners, interest rates have been elevated in many DIP facilities, while DIP structures include more complex and niche features, such as greater use of DIP roll-ups and equity-linked fees. Tariffs are also emerging as an area of concern among DIP lenders. For example, At Home recently included a tariff-focused covenant in its DIP financing that called for revised long-term business projections if tariffs exceeded the threshold in place at the time of its Chapter 11 filing. For more information on DIPs, see Practice Note, DIP Financing: Overview.

## UCC Amendments

In 2022, important amendments to the Uniform Commercial Code (UCC) were proposed to deal with emerging technology (2022 UCC Amendments). The 2022 UCC Amendments revise key UCC terminology (for example, "money," "sign," and "conspicuous") and add a new Article 12 which, together with related revisions to Article 9, provide specific rules for transfers of, and creation and perfection of security interests in, certain digital assets (such as cryptocurrency and non-fungible tokens). As of July 31, 2025, 32 jurisdictions have enacted the 2022 UCC Amendments and six jurisdictions have introduced them. In New York, both the New York State Senate and Assembly have passed a bill adopting the 2022 UCC Amendments (NY State Assembly Bill A3307A). The bill can now be delivered to Governor Hochul and will become law once signed, becoming effective 180 days after enactment.

The 2022 UCC Amendments include a grace period (the adjustment date) for secured parties who had perfected their security interest in a digital asset before the adoption of the amendments by filing a financing statement, giving them time to:

- Perfect their security interest in the digital asset by control once the 2022 UCC Amendments are adopted in the relevant state.
- Ensure their security interest in the digital asset has priority over any other security interests in the asset.

Under the 2022 UCC Amendments, the adjustment date is the later of July 1, 2025, and the date that falls one year after the effective date for a state's adoption of the amendments.

For more information on the 2022 UCC Amendments, including the transition rules and the steps secured parties can take to perfect or maintain the priority of their security interest in a digital asset, see the Proposed 2022 Amendments to the UCC Toolkit and Legal Opinions for Loan Transactions Toolkit.

## Looking Forward

Although the initial fears in the market at the shock of the Trump administration's rollout of its tariff policy have abated somewhat amid delays, exceptions, and with the conclusion of some bilateral trade deals, practitioners expect significant headwinds to remain. The downside risk to the economy generally, and to many business sectors in particular, will likely remain a key focus and may keep M&A issuance on the backburner. In spite of some promising trade developments, uncertainty is likely to persist, against the backdrop of international tension and the fallout from the worsening conflict in the Middle East and the ongoing war in Ukraine. Market participants are also keeping close watch on the Fed, and although there are hopes that rates may ease in the second half of 2025, these may prove overly optimistic.

*The market statistics cited in this article (unless otherwise stated) were provided by LSEG LPC.*

## An Expert's View: Adam M. Dworkin, Cahill Gordon & Reindel LLP

**In your experience, what were the key trends in loan documentation and overall deal structures that occurred in the broadly syndicated loan (BSL) market in the first half of 2025?**

The dynamics in the broadly syndicated loan (BSL) market during the first half of 2025 have been generally a continuation of 2024 dynamics. With the addition of uncertainties caused by tariff announcements and interest rates remaining high in the US, the hope for a meaningful increase in leveraged buyout activity in 2025 so far has not materialized. Rather, the vast majority of BSL market activity in 2025 continues to be from refinancings and repricings of existing BSLs as it was in 2024. As margins in the BSL market began to decrease in the first quarter of 2025, we did see some refinancings of private credit loans in the BSL market. However, that trend seemed to taper off in the second quarter as tariff announcements created uncertainty for borrowers and institutional investors.

With there not being a voluminous amount of new money BSLs closing in the first half of 2025, it is difficult to draw too fine a conclusion with respect to any particular loan documentation term. However, one general trend is that core liability management type protections have become more regular in new money BSLs in the first half of 2025.

In general, liability management exercises (LMEs) over the past few years have been conducted in two different formats:

- An uptiering transaction involves lenders providing a new money loan to a borrower on a senior basis to the BSL and typically also permits these lenders to roll up their portion of the BSL on a senior basis to the portion of the BSL of other lenders that do not participate in the LME.
- A dropdown transaction involves the contribution of material and often liquid assets into an unrestricted subsidiary (a subsidiary that is not bound by the covenants of the BSL) or a non-guarantor subsidiary (a subsidiary that is not required to guarantee the obligations of the borrower of the BSL) and a new money loan that is made to the unrestricted subsidiary or the non-guarantor subsidiary and secured by these material assets.

LMEs are usually conducted when a borrower is facing a maturity wall for a substantial amount of its debt and is unable to refinance this debt in the ordinary course under then current market conditions. As a result of LMEs becoming more common, investors in BSLs have increasingly asked for some form of protection in their loan documentation that limit the borrower's ability to undertake an uptiering or dropdown financing. They include:

- **Serta.** The addition of an all affected lender vote in order for the BSL to be subordinated in right of payment to, or the liens securing the BSL to be subordinated to the lien securing, other third party debt, unless each of the lenders under the BSL are offered the opportunity to participate as a lender under the new third party debt on a pro rata basis and on the same terms as the other lenders. Typical exceptions are for debt permitted as of the closing date to be senior in right of payment or to have a senior lien (typically purchase money debt/capital leases and receivables financings) and debtor-in-possession financings. A typical exception to the "on the same terms" requirement is for bona fide backstop fees and expenses. The effect of the Serta provision is to require the borrower to invite all of its lenders under a BSL to participate in an uptiering on a pro rata basis and on the same terms, other than backstop fees and expenses. This invitation is typically extended after a group of lenders has agreed to support the uptiering and commit to provide the new financing in exchange for a backstop fee.
- **J.Crew.** The addition of a covenant that prohibits:
  - the contribution or other transfer of material intellectual property to an unrestricted subsidiary; and
  - the designation of a subsidiary as unrestricted if it owns material intellectual property.

  There is a fair amount of variability as to how material intellectual property is defined, and there are often exceptions for licenses of material intellectual property. The effect of the J.Crew provision is to limit the leakage of valuable assets outside the obligor group and the protections of the negative covenants of a BSL, where those assets can be separately financed.
- **Chewy.** A subsidiary guarantor is not released from its guarantee on becoming less than wholly owned by the borrower if the primary purpose for the subsidiary guarantor becoming less than wholly owned is to obtain the release of its guarantee. Alternative formulations require a valid business purpose for the release and/or that the sale or distribution of shares must be to a bona fide joint venture on an arm's length basis. The effect of the Chewy protection is to prevent the release of a subsidiary guarantor in order for it to be used for a dropdown financing.

The form and substance of the above protective provisions can vary in material fashions. Not all protective provisions are created equal. However, it is fair to say that some version of each of the above protective provisions has made its way into most new money BSLs in the first half of 2025.

There are other LME protective provisions that are more common in the private credit markets and in uptiering and dropdown financings that have not generally made their way into new money BSLs so far in 2025. They include:

- **Pluralsight.** The expansion of J.Crew to apply to non-guarantor subsidiaries and also sometimes to apply to any material assets.
- **Envision.** Prohibiting the use of non-earmarked investment and/or restricted payment baskets to make investments in unrestricted subsidiaries.
- **Double Dip.** Restrictions on the use of an intercompany loan from a dropdown subsidiary to a borrower on a secured basis to create a second claim on the assets of the borrower and subsidiary guarantors of a BSL.

One other notable item is that, in order for a borrower to undergo an uptiering transaction, the loan documentation for the BSL must permit the borrower to buy back its loans on a non-pro rata basis or permit an exchange of a lender's portion of a BSL on a non-pro rata basis for a portion of the uptiered loan. There has not generally been an effort so far in 2025 new money BSL documentation to limit the ability of a borrower to conduct these buyback/exchange transactions, whether outright or with a majority lender vote.

## An Expert's View: Jennifer Daly, Paul Hastings, LLP

**In your practice, what deal terms have attracted significant attention in the private credit market so far in 2025? What developments do you expect to see in loan document negotiations in the second half of the year?**

So far in 2025, we have seen several key trends continue to shape the private credit landscape. The market has, of course, been digesting everything going on, and pace of deals had been more muted than market participants likely expected (particularly in capital markets and M&A), though we are starting to see a real uptick in the last couple of months and with respect to go-forward pipeline. Moreover, high quality deals have been getting done all year both at the top of the market and particularly in mid to lower mid-market where a number of service businesses have been LBO'd or refinanced at attractive terms. And perhaps unsurprisingly, we are seeing private credit lenders **really** lean in if it is a name they like.

On the structuring front, the increased prevalence of payment-in-kind (PIK) flexibility has been a standout. It has become common to see a portion of the applicable margin on term loans payable in kind for an initial period post-closing, often around two years, which gives borrowers and sponsors welcome breathing room in today's uncertain macro environment. As mentioned, the year to date has been marked by volatility and a more selective opportunity set than some had initially anticipated (particularly in the first few months). Many lenders have viewed PIK as a way to supercharge their investment through increased spread, while sponsors see enhanced opportunities to further invest in newly-acquired businesses and set them up for future growth. To dive a little deeper on PIK, the following is worth noting:

- Often times you see a premium charged for the PIK flexibility (say 25-50bps) and then there is usually a question of whether the premium is on the entire interest payment or just the PIK portion and you see that go both ways.
- Sponsors are definitely seeking more flexibility here, for instance trying to argue in some cases that the PIK portion is not principal for purposes of call protection. They are not always winning that one, but they are trying.

It is often the case that the PIK option exists for a certain period of time, often two years. In the drafting, you want to make sure that you are very precise about how you box that because if you are not careful, a borrower could potentially, say, elect a six month interest period on the last day of the PIK period and effectively extend the PIK period to two years and six months. So, you just need to be careful, and as with anything else in credit documents, the devil is in the details.

In the private credit market, certain private credit lenders agreeing to PIK will nevertheless still require at least some cash pay. This is because, when you are thinking about the behavior of private credit, you have to keep in mind that a lot of the funds are levered. They have their own credit facilities (often borrowing base facilities) where they are the borrower, and, often times, their leverage provider requires cash pay for the loan to stay in the borrowing base and still receive credit (and higher borrowing base value) as a "first lien loan" or "senior secured loan". That is something to keep in mind any time you are requesting to introduce a PIK amendment too, that is likely a significant modification that will require consent from the private credit fund's leverage provider in order to keep the loan's current value in the overall borrowing base. That said, there is really good proof of concept for private credit being particularly nimble as an asset class here because some of this was tested during COVID, and what we saw was that leverage providers were good partners and we did not see a lot of friction around agreeing to those requests.

Like anything else though, with PIK, you absolutely can have too much of a good thing, and if a borrower takes on more than it can truly cover, the PIK can act as an anchor from which it becomes extremely difficult to break free.

We are seeing closing leverage tick up to levels few would have imagined even a few years ago. At the same time, we have not seen much change in terms of spreads, which remain paired with modest closing fees (commonly around 1.00%; in some cases even lower). Lenders are not really trying to use the market volatility as leverage either for economics or otherwise. If anything, these economics reflect fierce competition among lenders to deploy capital.

Document negotiations have also evolved. The letters "LME" have become as commonplace as "ABC" in the leveraged finance ecosystem, with lenders keenly aware of the latest transactions being executed or threatened, and seeking to address documentary risks where possible. They are very focused on understanding and mitigating risk around leakage (the movement of collateral outside of the initially underwritten "credit box" that was key to closing date underwriting) and layering (the ability to get primed on your loan). There has been a lot of evolution, but there is not necessarily a through-thread for what is clearing market. There is heightened focus on capping unrestricted subsidiary investment capacity, frequently through Envision-style protections (only one specific basket can be used for investments in unrestricted subsidiaries and that basket cannot be replenished or refreshed). These protections, together with others like PetSmart/Chewy and J.Crew are intended to curb leakage, but there are now wide ranges of formulations of the protections, with some far more lender-friendly than others. That said, Pluralsight protections (relating to non-guarantor subsidiaries) have been slower to gain traction and we have seen lenders sometimes get comfortable without them for borrowers that do not own a lot of IP.

Similarly, EBITDA adjustments remain a lively battleground, especially add-backs for run rate impacts of new or amended customer contracts and/or revenue synergies, which can meaningfully inflate covenant headroom and debt incurrence capacity.

Meanwhile, borrowers' flexibility to pursue permitted receivables financings and securitizations is increasingly under scrutiny, with lenders focused on tightening language to preserve collateral quality. Another notable development involves attempts by certain sponsors/borrowers to include "DQ law firm" lists in their credit agreements, effectively precluding the lender group from hiring firms known for organizing ad hoc creditor groups. While still emerging, this trend highlights growing lender concern over future workout dynamics.

We are also seeing more room for junior or unsecured debt to be incurred outside the closing leverage, part of the evolving balance between protecting existing lenders and giving borrowers capital structure flexibility.

Looking to the second half of the year, several developments bear watching. We anticipate broader use of structured preferred equity (or Holdco PIK instruments) alongside unitranche debt, with sponsors expecting private credit lenders to participate in both tranches. Portability provisions are also gaining traction, facilitating smoother exits.

In the large cap segment, traditional hard call protections continue to erode, with exceptions not just for IPOs, changes of control, or transformative transactions, but even for refinancings where existing lenders are offered a chance to participate (regardless of whether they ultimately do participate), as well as extending to any payments made with internally generated cash or prepayments below an agreed annual threshold.

At the same time, sponsors are continuing to push for EBITDA high-water mark concepts, seeking to lock in the most favorable metrics for leverage tests and incurrence covenants over the life of the deal regardless of future performance. They are also increasingly seeking to cap individual lender holdings and restrict entry by lenders into cooperation agreements, extending the trend of sponsor control from initial debt arranging to downstream lender interactions. Finally, we are seeing sponsors inject new capital into distressed situations on a pari passu basis with senior secured lenders, which changes traditional rescue capital dynamics.

All of this underscores a market that remains intensely borrower/sponsor-friendly, but with sophisticated private credit investors carefully negotiating guardrails around flexibility that could impact future recoveries in a downside case.