CRESTLINE MANAGEMENT

Private Credit Headlines: What the Data Actually Shows

There have been numerous headlines hypothesizing that private credit is the next catalyst for systemic disruption in the financial markets. These headlines have raised multiple concerns, among them: distressed loan sales driven by retail outflows, mass defaults stemming from weak underwriting, and the potential impact of artificial intelligence on the software industry. These narratives have been loud, alarming, and in our view, largely disconnected from what the data shows.

SYSTEMIC RISK #1: Will retail redemptions from semi-liquid perpetual vehicles cause a "run on the bank" and forced selling at distressed prices?

Retail redemption pressure is the most visible concern and the most frequently mischaracterized. The perpetual semi-liquid structure is designed to prevent exactly this, and the data shows it is working.

- The illiquidity trade-off is a feature of the structure, not a flaw, and it has allowed private credit to deliver a persistent premium over non-investment grade liquid credit for over 20 consecutive years. The Cliffwater Direct Lending Index (CDLI) has returned 9.5% annualized since inception (September 2004) through December 31, 2025, compared to 6.6% for high yield bonds and 5.1% for leveraged loans over the same period[1]
- The closest historical proxy for a retail redemption cycle is Blackstone's BREIT, an equity REIT focused on commercial real estate, which navigated a cumulative 27.0% net outflow over roughly two years. Returns were negative or near zero during that period,[2] a materially worse outcome than what direct lending funds are experiencing today, where annualized returns remain in the high single digits.[2] BREIT had to sell properties to generate liquidity to meet redemptions, a dynamic that simply doesn't apply to direct lending, where loans have scheduled maturities and contractual cash flows that can naturally fund redemptions over time. BREIT's experience shows that even a prolonged redemption cycle, one driven in part by real performance headwinds, ultimately resolved, with the fund returning to positive net flows in 1Q26.[2] In direct lending, where returns have remained in the high single digits throughout this period, we believe the case for resolution is even stronger
- To the extent managers voluntarily elect to sell loans to meet redemptions, the secondary market is far more active and liquid than in prior stress periods. According to Evercore's 2025 Credit Secondary Market Survey, credit secondaries transaction volume reached $20bn in 2025, up 83.0% year-over-year, with GP-led credit transactions averaging 98.0% of NAV, underscoring that the secondary market for private credit has both the depth and the pricing to absorb supply without material dislocation[3]
- The vast majority of the direct lending market, estimated at 80.0-90.0% depending on the source, is held in long-duration drawdown funds, separately managed accounts, and publicly traded BDCs with no on-demand withdrawal mechanism, limiting systemic drawdown risk at the ecosystem level.[2] Notably, that estimate does not even account for the insurance sector, another significant buy-and-hold capital base that further insulates the broader market from redemption pressure
- Goldman Sachs estimates there is over $470bn in undrawn institutional capital available across direct lending and other credit funds, potentially limiting any spillover or systemic risk[2]

SYSTEMIC RISK #2: Are widespread defaults coming?

The question of credit quality is fundamental, and important to address carefully. The direct answer is some defaults will occur, as they always do, but the current data does not support the narrative of widespread credit deterioration at this time.

- Non-accruals at cost across the largest BDCs increased only 5bps year-over-year to 2.1%[4]
- The percentage of investments marked below 80.0% of fair value stands at 3.4%, near historical lows[4]
- PIK income as a percentage of gross investment income ticked up only slightly in Q4 2025, reaching 7.8% at public BDCs and 3.7% at private BDCs, both within normal ranges[2]
- Watch lists at major BDCs remained largely stable, with loans performing below expectations up just 35bps quarter-over-quarter to approximately 5.0% of loans[2]
- Sponsor-backed leveraged loan default rates stand at 0.8% as of January 2026, approximately 30bps below the five-year historical average of 1.1%[2]
- Broader credit markets have faced pressure, but not at a level that reflects the recent narrative. JPM Leveraged Loan Single B spreads stand at ~460bps today, below their five-year average of 478bps and less than half their COVID peak of ~1,060bps, showing no signs of a systemic credit crisis[5]
- Software exposure is a legitimate concern, but we believe the impact will be idiosyncratic rather than systemic. The key differentiator is mission criticality, software that serves core operational functions, where downtime or errors would create immediate financial, legal, or operational risk, is far less susceptible to AI disintermediation than commoditized offerings.[6] The difference between managers will come down to underwriting discipline, which is why we expect performance dispersion across the industry to widen from here

How is Crestline positioned?

In short, we like where we sit.

We are not seeing systemic fundamental weakness in our portfolio, and we attribute the absence of fundamental stress to multiple factors, including our robust underwriting, industry specialization, strong documentation and the **avoidance of investment structures that require immediate deployment.**

- None of this is a surprise to us. When we launched our inaugural BDC, Crestline Lending Solutions ("CLSF"), in September 2025, we were already flagging the risks that are now making headlines. We observed that the largest perpetual BDCs had become victims of their own success, raising capital faster than they could deploy it, pushing managers toward larger, more competitive deals where lenders have less pricing power and negotiating leverage. The result, as we are now seeing across the industry, is **significant portfolio overlap and looser loan structures manufactured to meet investor demand rather than sourced on merit**
- We built CLSF with that dynamic explicitly in mind. **Rather than optimizing for scale, we structured the vehicle to draw capital over time, with a drawdown period of up to two years before uncalled capital is released, ensuring we only deploy when the right opportunities exist, not because inflows demand it**. We would rather grow at a measured pace and deliver alpha than scale quickly at the expense of discipline. The same philosophy governs our other direct lending commingled products, which are exclusively drawdown structures with no interim liquidity, eliminating the risk of the tail wagging the dog

How is Crestline positioned (continued)

Moreover, the proof is in the portfolio. We see the strength of the broader market reflected directly in our own numbers, and in several ways we believe we are better positioned than the industry at large:

- Our fixed charge coverage ratio and interest coverage ratio for the direct lending strategy average 1.69x and 2.26x, respectively, meaningfully above the broader private credit market averages of 1.27x and 1.77x,[6] and up from 1.58x and 2.0x a year ago, reflecting improving borrower health across our portfolio[6]
- We have not seen a meaningful spike in watchlist credits, further evidence that systemic fundamental weakness is not present in our portfolio.[6] To be clear, we anticipate there will be additions over time, as challenges inevitably occur across a diversified portfolio, but we are not seeing signs of broad deterioration
- Our 1st lien direct lending transactions have been underwritten at approximately 40.0% loan-to-value over the last twelve months, providing cushion against downside scenarios[6]
- The same disciplined underwriting approach extends to our sector exposures as well. Large upper-middle-market managers focused on loan manufacturing and scale have accumulated as much as 20.0-30.0% software exposure, our funds are significantly below that, with our two most recent vintages, SLF III and CDLIV, at 13.8% and 10.9% respectively[6]

Where do we go from here?

We remain constructive on the private credit opportunity set, and we believe the current dislocation, driven by sentiment rather than fundamentals, is creating attractive entry points for disciplined lenders. Our pipeline remains active across nearly a dozen industries, with momentum in consumer services, commercial services, and industrials, and new loans continue to be underwritten at conservative LTVs with modest leverage and robust cash flow profiles, consistent with our historical standards.

We remain confident in our positioning and in the long-term case for private credit. Please don't hesitate to reach out with any questions.

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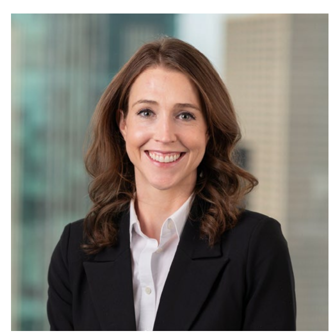

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Footnotes

[1] Cliffwater LLC, 2025 Q4 Report on U.S. Direct Lending (Q4 2025). CDLI annualized total return since inception (September 2004) through December 31, 2025. High yield bonds represented by Bloomberg High Yield Bond Index; leveraged loans represented by Morningstar LSTA US Leveraged Loan Index

[2] Goldman Sachs Global Investment Research, "Asset Managers: At the Epicenter: Private Credit Wealth Dynamics and the Path Forward," March 10, 2026

[3] Evercore Private Capital Advisory, 2025 Credit Secondary Market Survey, January 2026

[4] J.P. Morgan North America Credit Research, "BDC Quarterly Earnings Review: BDC 4Q'25 Wrap Up," April 6, 2026

[5] J.P. Morgan, JPM Leveraged Loan B Index Spread to Maturity, as of April 9, 2026

[6] Crestline Management, LP internal data; Crestline coverage ratios as of Q3 2025, market coverage ratios from Lincoln Lens for Q3 2025; LTV as of Q4 2025; software exposure as of January 31, 2026

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