Private Markets

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Global Credit Weekly:

A bifurcated U.S. consumer

BlackRock

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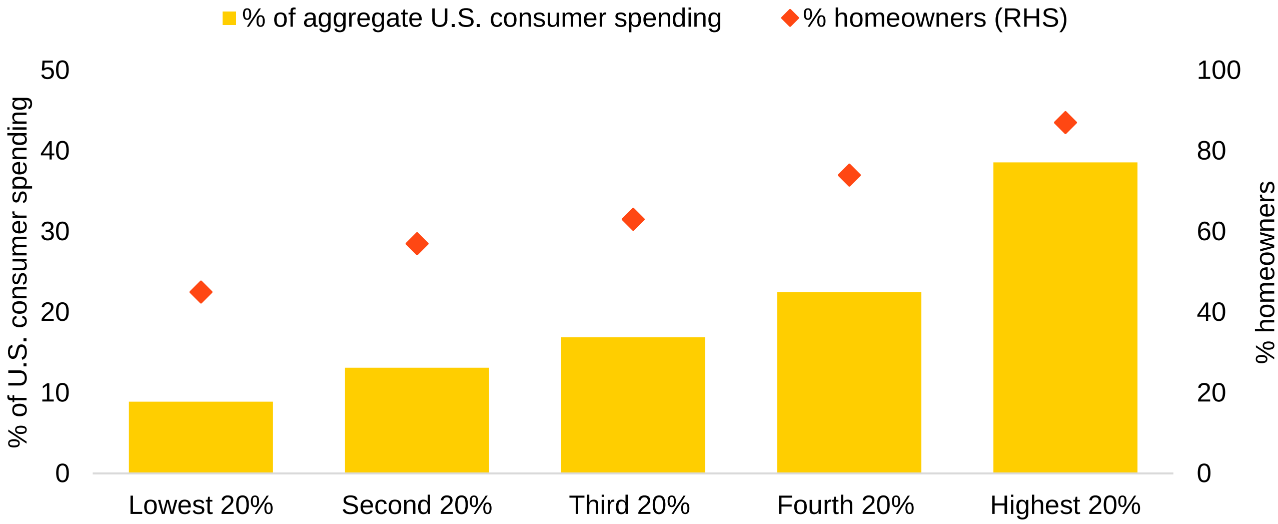
Key takeaways

- One prevailing investing theme over the past few quarters – in the corporate credit and commercial real estate markets – has been elevated dispersion. The U.S. consumer is no exception to this trend and remains notably bifurcated, extending the pattern we last revisited in early March. This helps explain, in our view, some of the “conflicting” data points released about the financial health of the U.S. consumer in recent months (per retail sector earnings, public commentary from U.S. banks, and widely tracked economic data).
- For example, U.S. consumers in the top 20% of the income distribution generated 39% of U.S. spending and 87% of this group are homeowners (Exhibit 1), indicating many likely benefited from home price appreciation over the past few years. Meanwhile, the bottom 20% of the income distribution is more likely to rent and generates a much smaller share of aggregate spending.
- Separately, the growth of the private debt asset class – especially over the past few years – remains a focus. This has caused some market participants to question whether the asset class is expanding *too quickly*. New entrants (i.e., private debt lenders) to the space are frequently cited as one concern, owing to the potential that they may sacrifice underwriting discipline to capture market share.
- But fundraising data from Preqin shows the private debt market (in aggregate) has been discerning in where it has allocated capital in recent years, by prioritizing manager experience amid a high cost of capital environment. New entrants have captured, on average, 2.6% of total fundraising since 2022 – a level well below the 2019-2021 run-rate of 9.5%. Similarly, established private debt managers (i.e., those raising their fourth fund, or later) have raised 84% of capital, on average, since 2022. The average from 2019-2021 was 73%.

Exhibit 1: The U.S. consumer remains bifurcated by spending levels and home ownership
U.S. annual aggregate expenditures by consumer income quintile, and the share of consumers in each cohort that are homeowners (RHS)



Source: BlackRock, U.S. Bureau of Labor Statistics Consumer Expenditure Survey (September 2023 - most recent).

The widespread trend of elevated dispersion

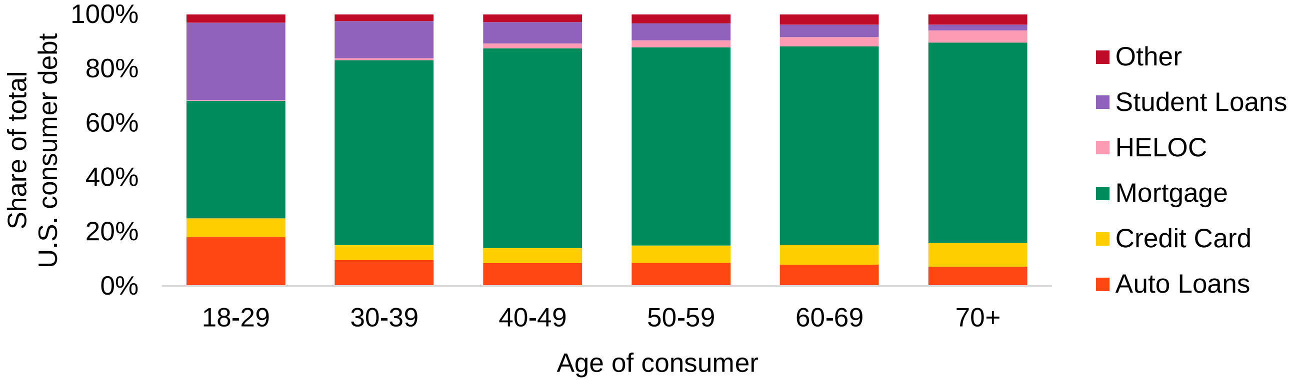
One prevailing investing theme over the past few quarters has been elevated dispersion. For example, while corporate credit spreads have tightened meaningfully since late 2023 and now sit near the low-end of the post-financial crisis range, subsets of the market – such as CCCs – have lagged the overall tightening at the index level. Similarly, the commercial real estate market cannot be painted with a broad brush. The valuation of Industrial properties (per the Real Capital Analytics U.S. Commercial Property Price Indices) has increased 59% since January 2019. Meanwhile, the valuation of Office properties in Central Business Districts has declined 44%, per the same index.

The U.S. consumer is no exception to this trend of dispersion and remains notably bifurcated – extending the pattern we last revisited in early March. This helps explain, in our view, some of the "conflicting" data points released about the financial health of the U.S. consumer in recent months.

For example, U.S. consumers in the top 20% of the income distribution generated 39% of U.S. spending and 87% of this group are homeowners (Exhibit 1), indicating many likely benefited from home price appreciation over the past few years (the S&P CoreLogic Case-Shiller U.S. National Home Price Index has increased 47% vs. December 2019). Meanwhile, the bottom 20% of the income distribution is more likely to rent and generates a much smaller share of aggregate spending.

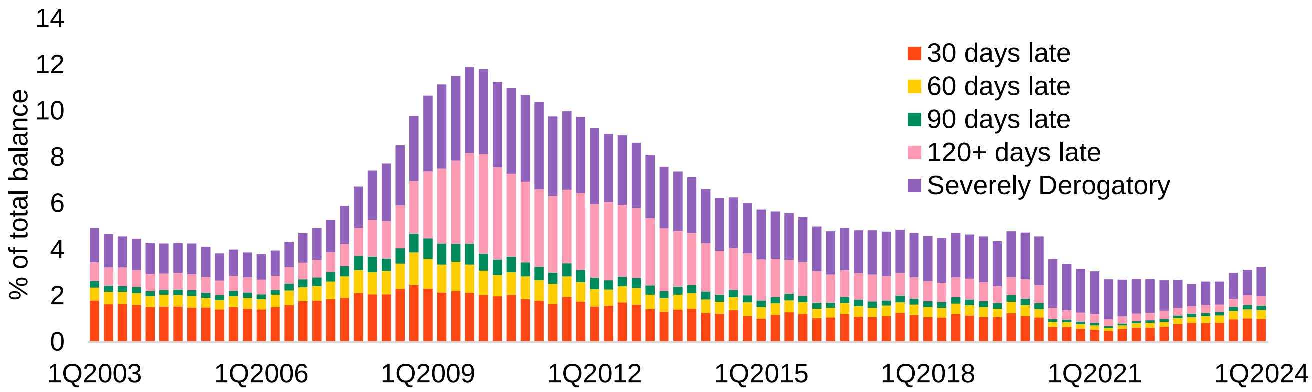
The May 2024 Quarterly Report on Household Debt and Credit from the Federal Reserve Bank of New York (NY Fed) shows a similar trend: the debt of younger borrowers is more skewed towards student and auto loans (Exhibit 2). Older borrowers, meanwhile, have a larger weight toward housing-related debt (i.e., mortgages, home equity lines of credit). And while overall delinquencies remain well below their financial-crisis peaks, they have been gradually increasing over the past few quarters (Exhibit 3).

Exhibit 2: Debt is more heavily skewed towards housing asset exposures for older consumers
Percentage share of total U.S. consumer debt share by product type and age



Source: BlackRock, New York Fed Consumer Credit Panel/Equifax. As of 1Q2024. HELOC = home equity line of credit. The "Other" category includes retail cards and other consumer loans.

Exhibit 3: Delinquencies are rising, and may be understated due to student loan nuances
Percentage share of total U.S. consumer debt by delinquency status



Source: BlackRock, New York Fed Consumer Credit Panel/Equifax. As of 1Q2024. Excludes current balances.

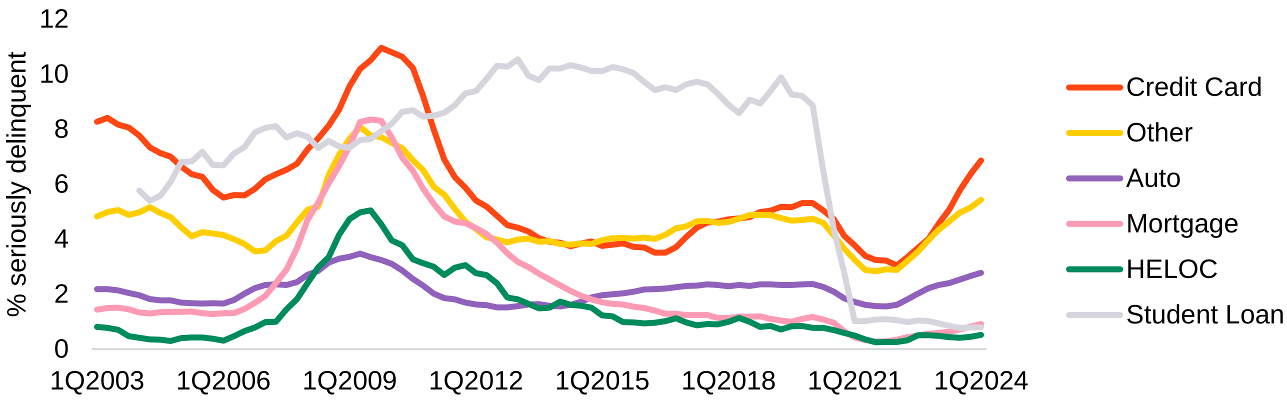
The data shown in Exhibit 3 likely understates the overall delinquency trend, as missed federal student loan payments will not be reported to credit bureaus until 4Q2024 (per the NY Fed report). Indeed, the credit card, other (i.e., retail cards and consumer loans) and auto categories have been the main drivers of the recent uptick in overall delinquencies (as shown in Exhibit 4). But student loan delinquencies may revert closer to their long-term trend, once the grace period for late payments expires.

Another notable takeaway from the NY Fed analysis[1] was the greater share of "maxed out" credit card balances transitioning into delinquency status (Exhibit 5). According to the NY Fed Center for Microeconomic Data, 18% of U.S. borrowers were utilizing at least 90% of their available credit as of 1Q2024 (labeled as "maxed-out borrowers" in the report). Here too, the theme of bifurcation is evident: that same analysis showed that 52% of consumers utilized less than 20% of their available credit.

A large portion of "maxed-out borrowers" – but not all – are already delinquent. When isolating non-delinquent loans, the NY Fed found that "maxed-out borrowers" represented 9% of total borrowers and 16% of total balances. Both levels are modestly below the 2019 average levels of 10% and 16%, respectively.

Exhibit 4: Student loan delinquencies remain suppressed, for now

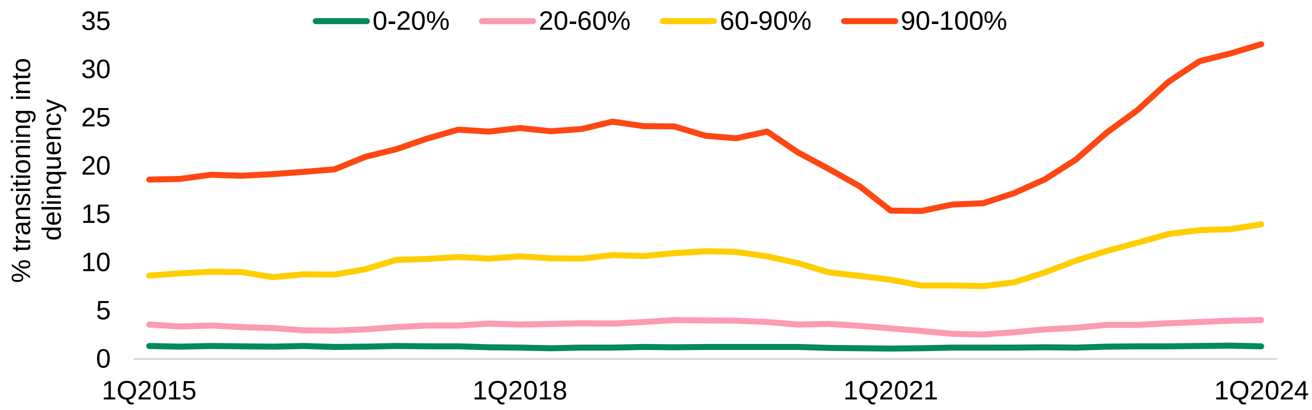
Percentage of seriously delinquent (i.e., 90 or more days delinquent) U.S. consumer debt balances, by type



Source: BlackRock, New York Fed Consumer Credit Panel/Equifax. As of 1Q2024. HELOC = home equity line of credit. The "Other" category includes retail cards and other consumer loans. Student loan data are not reported prior to 2004 due to uneven reporting.

Exhibit 5: A greater share of "maxed out" balances are transitioning into delinquency

Percent of balances transitioning into delinquency by borrower utilization rate



Source: BlackRock, New York Fed Consumer Credit Panel / Equifax. As of 1Q2024. Note: The chart shows balance-weighted transition to 30-day credit card delinquency among borrowers current on all accounts in the previous quarter. A borrower's group is determined by their utilization in the previous quarter. Data are smoothed as four-quarter moving sums to account for seasonal trends.

(1) Andrew F. Haughwout, Donghoon Lee, Daniel Mangrum, Joelle Scally, Wilbert van der Klaauw, and Crystal Wang, "Delinquency Is Increasingly in the Cards for Maxed-Out Borrowers," Federal Reserve Bank of New York Liberty Street Economics, May 14, 2024, https://libertystreeteconomics.newyorkfed.org/2024/05/delinquency-is-increasingly-in-the-cards-for-maxed-out-borrowers/.

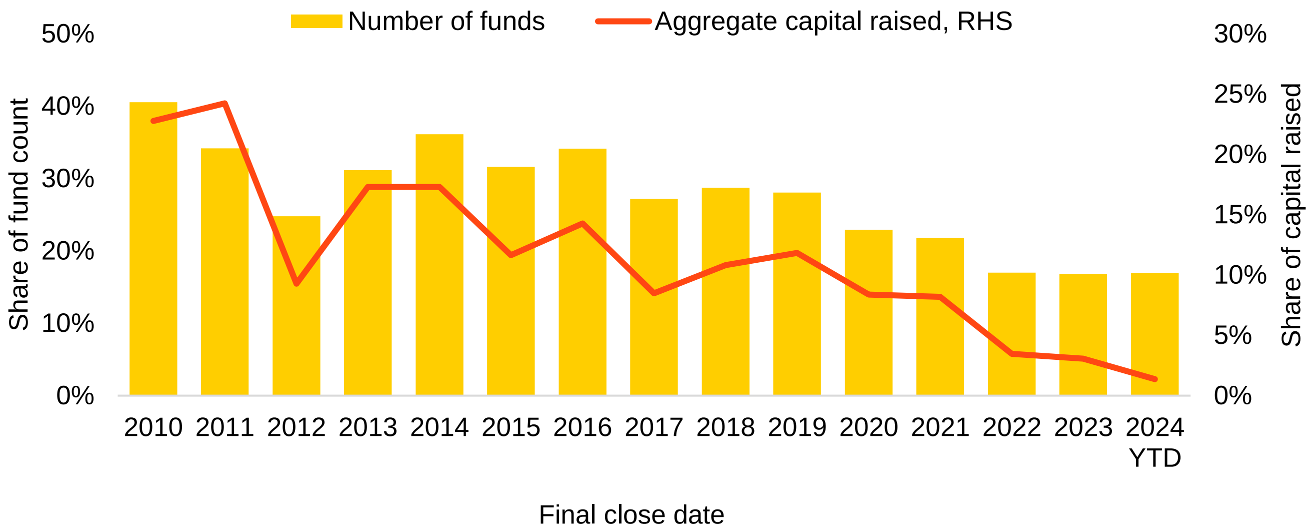
Private debt fundraising: capital allocators are prioritizing experience

The growth of the private debt asset class – especially over the past few years – has caused some market participants to question whether the asset class is expanding *too* quickly. New entrants (i.e., private debt lenders) to the space are frequently cited as one concern, owing to the potential that they may sacrifice underwriting discipline to capture market share.

But fundraising data from Preqin shows the private debt market (in aggregate) has been somewhat discerning where it has allocated capital in recent years, by prioritizing manager experience. For example, Exhibit 6 shows that first-time private debt funds have captured, on average, 2.6% of total capital (per year) since 2022. This is well below the 2019-2021 run-rate of 9.5%. Similarly, as shown in Exhibit 7, established private debt managers (i.e., those raising their fourth fund, or later) have raised 84% of capital, on average, since 2022. This compares to an average of 73% from 2019-2021.

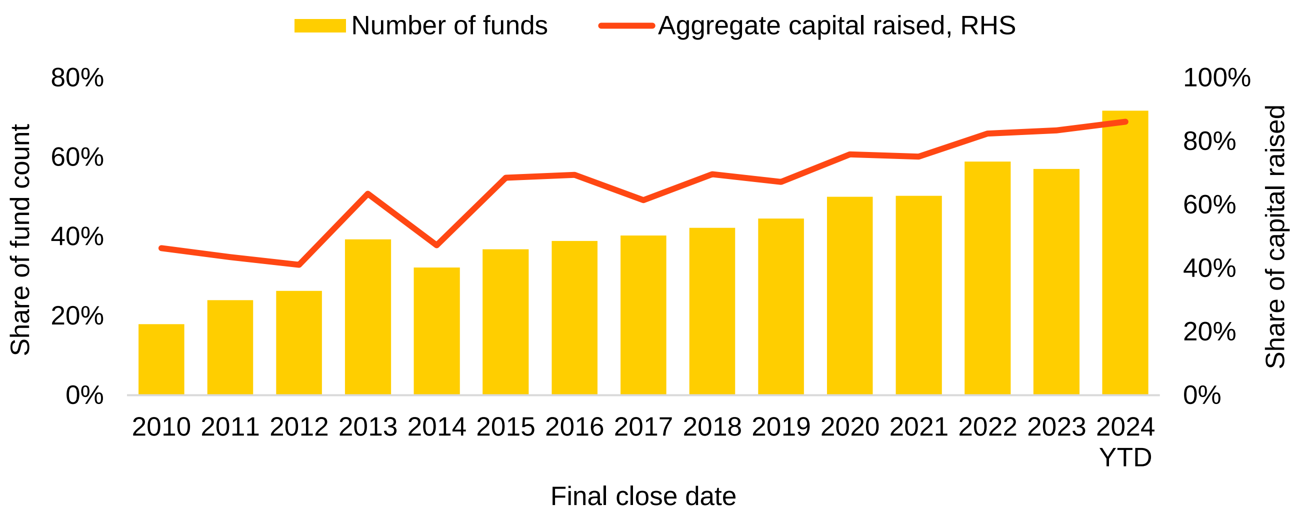
To us, this suggests that the market has become more discerning amid the higher cost of capital environment. While ultra low rates (prior to the start of the Fed's rate hiking cycle) may have resulted in a "rising tide lifts all boats" environment, that is no longer the case in the current macro backdrop.

Exhibit 6: First-time private debt funds have raised, on average, 2.6% of capital since 2022
First-time private debt fundraising as a share of total funds and aggregate capital raised (RHS)



Source: BlackRock, Preqin. Captures data as of May 20, 2024. Captures closed-ended private debt funds.

Exhibit 7: Established private debt managers have raised 84% of capital since 2022
Fourth fund or later private debt fundraising as a share of total funds and aggregate capital raised (RHS)



Source: BlackRock, Preqin. Captures data as of May 20, 2024. Captures closed-ended private debt funds.

Overlapping addressable markets: public and private corporate credit

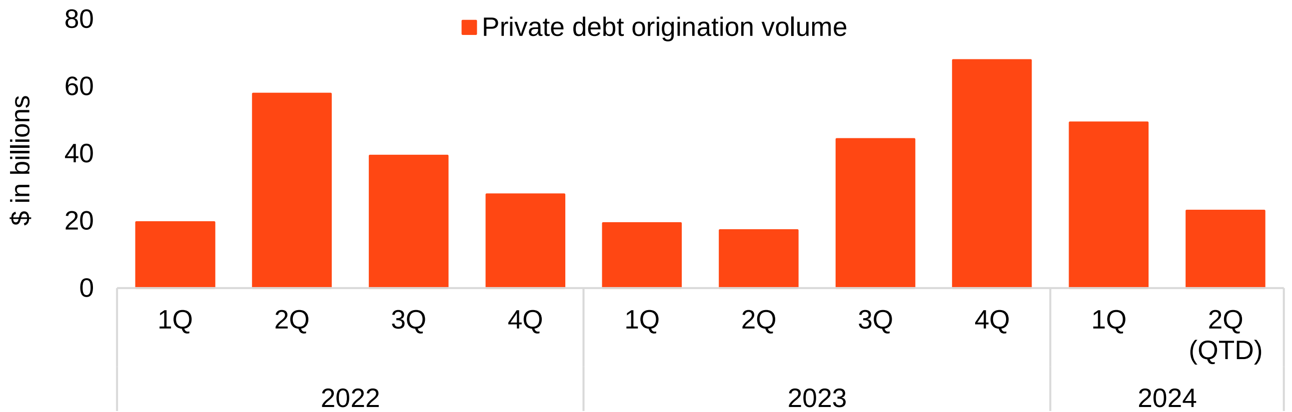
Another frequently cited topic among investors has been the increased overlap – in terms of the "addressable market" of borrowers – between public (syndicated) and private corporate credit. While the USD syndicated markets were largely closed to lower rated (i.e., B- and CCC) borrowers for much of 2H2023, activity has since rebounded (so far) in 2024. As a result, some investors have questioned whether this rebound would lead to a decline in private debt volumes.

Data released by third-party research provider KBRA DLD shows USD private debt origination volumes (defined as new money, senior debt transactions) reached $23.1 billion in April 2024 (Exhibit 8). This represents the most active month since November 2023 ($24.1 billion) and the fourth-highest monthly total in KBRA DLD's three-year dataset. More broadly, while 1Q2024 private debt origination volumes declined from the very active 4Q2023 period, they did not fall sharply.

Similar to the trend we previously highlighted in the syndicated markets, a large share of new issue proceeds have been earmarked for refinancing (resulting in a limited amount of net new issuance). According to KBRA DLD, 46% of April's activity was attributed to refinancing (including repricing), well above the 17% monthly average over the past two years (April 2022 – March 2024; Exhibit 9). In fact, April 2024 marked the third consecutive month that refinancing activity was the largest proceeds category, by volume.

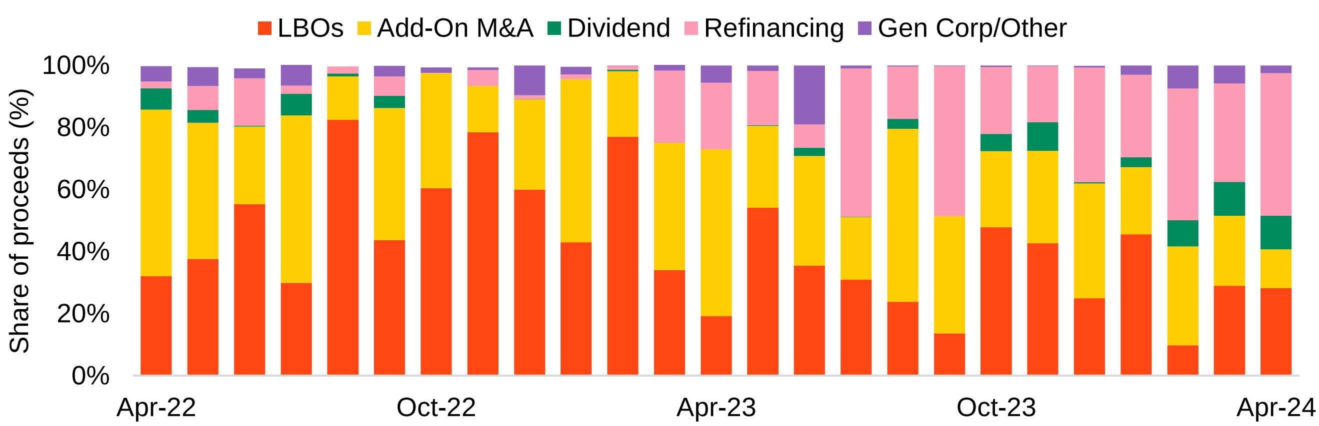
At the same time, acquisition-related activity remains muted as a share of total volume. During April 2024, leveraged buyouts ("LBOs") and add-on mergers and acquisitions ("M&A") totaled to 41% of proceeds, compared to an average of 77% of monthly deal activity over the last two years, according to data from KBRA DLD.

Exhibit 8: Private debt origination volumes in 2024 remain strong, albeit below 4Q2023 peak
Quarterly USD private debt deal origination volume



Source: BlackRock, KBRA DLD Private Data as of April 30, 2024.

Exhibit 9: Refinancing activity holds the top proceeds category for third consecutive month
Percentage of monthly proceeds by activity type, for USD private debt deal origination volumes



Source: BlackRock, KBRA DLD Private Data as of April 30, 2024. Data submissions reconcile quarterly.

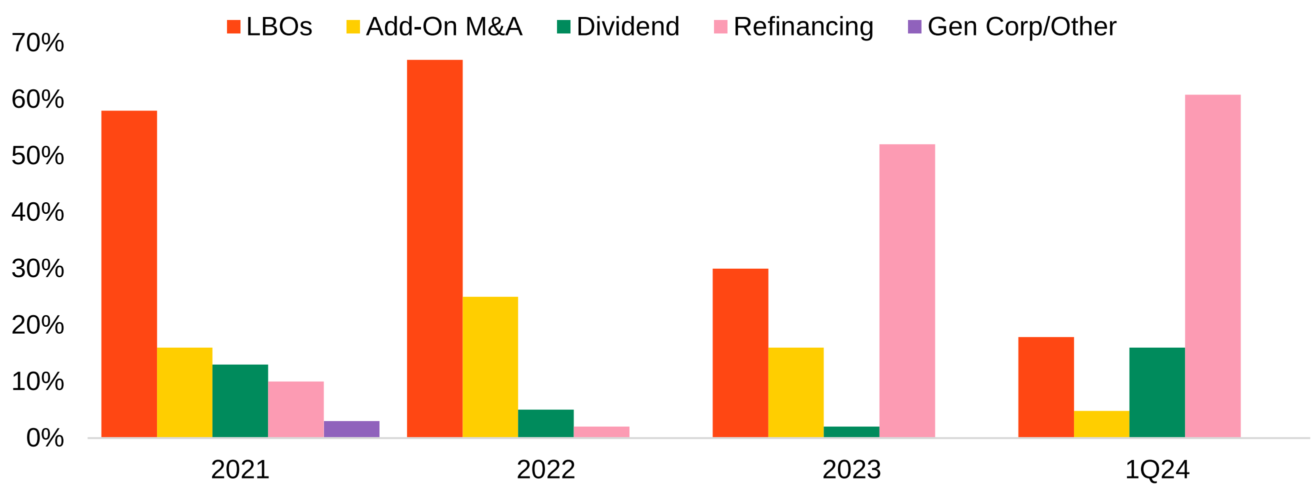
The use of proceeds trends are also evident in jumbo loans, where refinancing accounted for 61% of 1Q2024 proceeds, and LBOs and add-on M&A activity accounted for 23%, per KBRA DLD (Exhibit 10).

In our view, these mix-shifts in the use of proceeds underscore how the rate environment informs borrower actions. Borrowers are prudently refinancing upcoming maturities while the market tone remains receptive. Meanwhile, LBO activity remains subdued as elevated interest rates (at least by post-financial crisis standards) and residual uncertainty related to monetary policy provide some headwinds to the traditional economics of such transactions, which rely in large part on debt financing.

Perhaps even more notable than the use of proceeds distribution has been the amount of *syndicated debt* that has moved into the private debt market in recent months. So far in 2024 (through May 20th), KBRA DLD has tracked $16.4 billion of private debt issuance (across 15 borrowers) that originated in the broadly syndicated loan ("BSL") market (Exhibit 11). 65% of this activity was related to refinancing, with most of the borrowers rated B-.

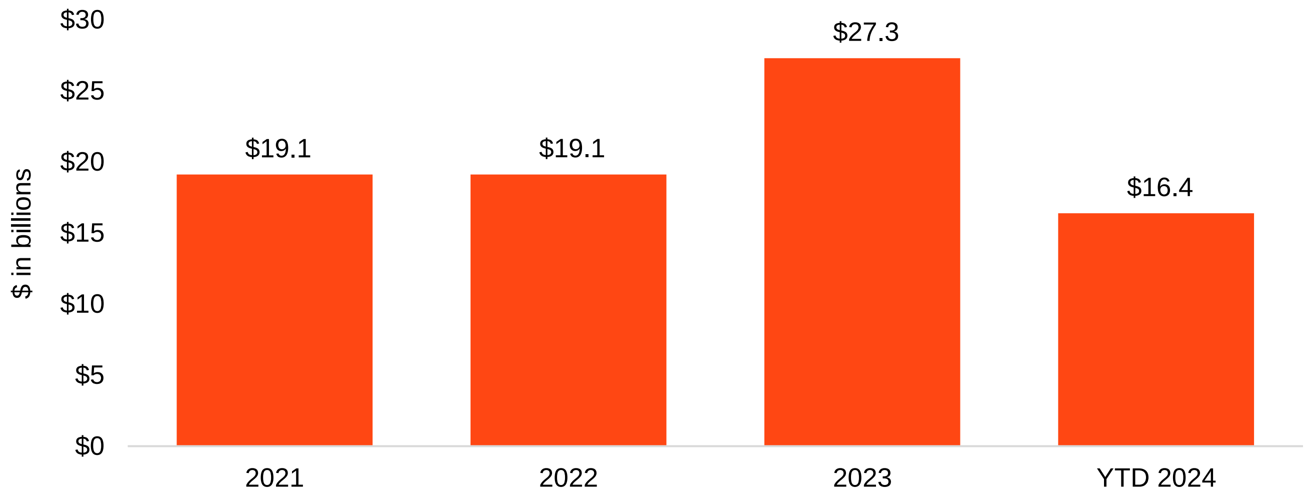
As we have outlined previously, we expect the mix-shift between the private and syndicated markets will continue to ebb and flow over time, in response to market conditions, investor sentiment, and the macroeconomic backdrop.

Exhibit 10: Activity amongst large borrowers has been skewed towards refinancing
Share of dollar proceeds by activity type for USD private market "jumbo" loans (defined as loans $1 billion or larger)



Source: BlackRock, KBRA DLD Private Data as of 1Q2024.

Exhibit 11: Public-to-private financing activity remains robust in 2024
Volume of USD deals that have left the broadly syndicated loan market for direct lender execution



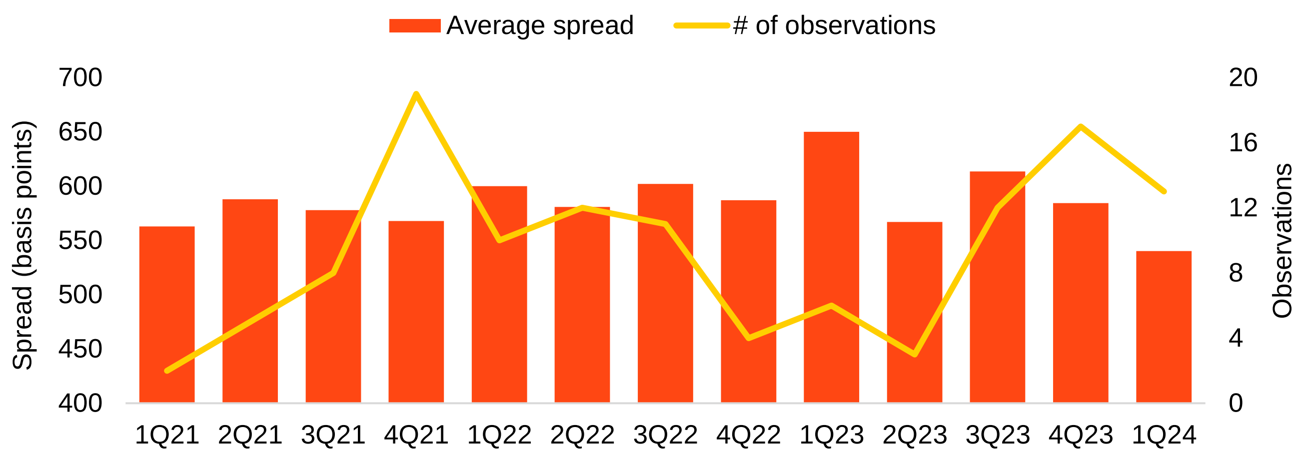
Source: BlackRock, KBRA DLD. YTD 2024 is as of May 20, 2024.

This increased overlap between syndicated and private markets – and the limited amount of net new capital – has kept pricing competitive for large borrowers that are suitable to issue in both markets (generally categorized by KBRA DLD as "jumbo" loans, or loans $1 billion or larger). In practice, these jumbo loans often mean a deal would be large enough to be relatively liquid and index-eligible in the syndicated/public debt markets.

For example, average jumbo spreads fell to S+540bp in 1Q2024 (from S+584bp in 4Q2023), marking the second consecutive quarter of tightening, according to KBRA DLD (Exhibit 12). And new issue prices also increased in 1Q2024 (reflective of smaller issue discounts and fees), as illustrated in Exhibit 13.

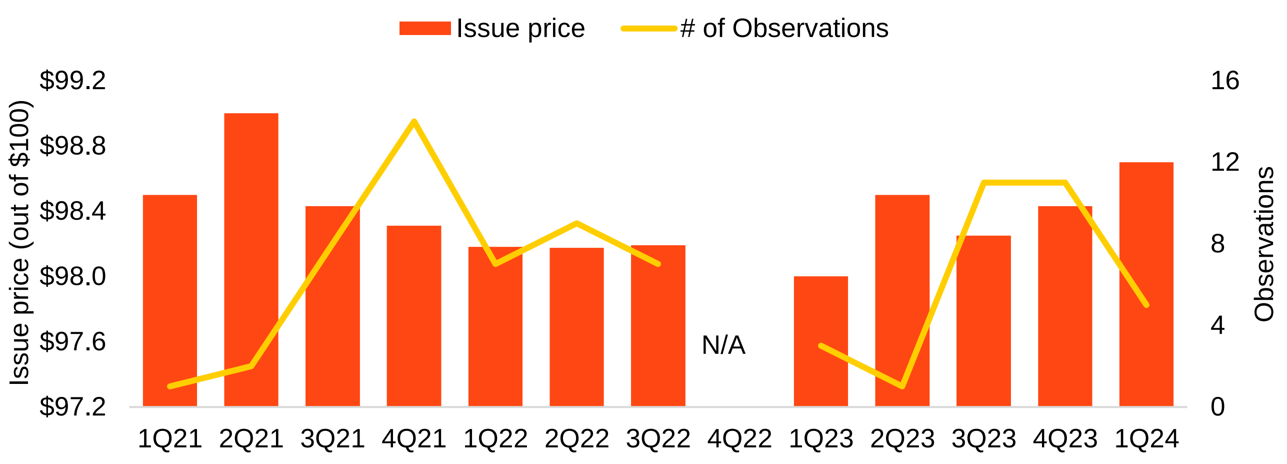
This data is directionally consistent with Lincoln International's Proprietary Private Market Database, which tracks approximately 5,000 U.S. portfolio companies primarily held by private equity sponsors. According to Lincoln (which is an independent valuation advisor specializing in illiquid alternative investments), new debt financings for $40 million - $100 million EBITDA businesses in 1Q2024 were done in a general new issue pricing spread range of S+525bp to S+625bp. This compares to S+575bp to S+675bp in 4Q2023. Similarly, original issue discounts (OID) in 1Q2024 were 100bp to 200bp, compared to 200bp to 250bp in 4Q2023. Equity cushions of 45%+ remained consistent, quarter over quarter. To the extent that syndicated markets remain receptive, we see some potential for further spread compression in the coming months – especially at the high end of the size spectrum.

Exhibit 12: Pricing on jumbo loans tightened for two consecutive quarters
Average spread on jumbo loans (defined as loans $1 billion or larger) issued, in basis points



Source: BlackRock, KBRA DLD. As of 1Q2024.

Exhibit 13: New issue prices on jumbo loans grew during 1Q2024, signaling smaller issue discounts and fees
Issue price on jumbo loans (defined as loans $1 billion or larger), out of par ($100)



Source: BlackRock, KBRA DLD. As of 1Q2024.

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