

# E X P E R T Q & A

*The market for GP-led and LP-led transactions is speeding up, driven by the opportunity to acquire interests in credit funds at a premium, say Henri Lusa, Callum Smith and Tj Bakshi of Partners Group*



## Credit secondaries evolve to meet long-term demand

### **Q** Why is the private debt secondaries market proving particularly attractive to investors right now?

**Callum Smith:** Credit secondaries investments are attracting a lot of attention because they offer investors the opportunity to acquire interests in credit funds at a premium to the return they would get investing in primary credit transactions.

Investors also benefit from access to a seasoned portfolio from day one, with plenty of diversification across issuers, stages, vintages, instruments, geographies, industries and fund managers.

There is also a shorter duration and a quicker pay-off and distribution

profile, as the underlying funds for sale are typically near or past their investment period with a focus on monetisation. This provides attractive discounts and returns with an immediate total value to paid-in uplift, in addition to buyers getting the benefit of any distributions between reference and close date in the form of a reduced price.

You also have the benefit of the portfolios incorporating regular cash payments from interest on the underlying loans. Plus, capital calls tend to happen faster for secondary funds, all of which

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adds up to making these funds really appealing from the buy-side perspective.

### **Q** How would you describe the state of the private debt secondaries market, and what is the outlook for growth?

**Henri Lusa:** We have seen the market accelerating in the past two years – 2024 saw by far the largest credit secondaries volumes achieved to date, driven by the many attractions that Callum outlined, most notably the premiums available to primary investments in private debt.

The growth is also helped by the historic growth of private credit overall, where the current \$1.6 trillion of assets under management has been

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HENRI LUSA

increasing every single year by almost double digits. That has clearly created a vast set of opportunities across different vintage years available for credit secondaries.

What has further accelerated the market is the need for liquidity over the past two years. With M&A volumes significantly reduced, fewer refinancings and a challenging exit market, distributions to LPs have suffered. That has created huge demand for liquidity and portfolio rebalancing, driving LPs to start using credit secondaries in the same ways they have been using the private equity and infrastructure secondaries markets for some time.

In the UK, we see a lot of supply from pension funds that have specific requirements for liquidity, especially if they are going through insurance buyouts.

At the same time, the number of continuation fund transactions has been particularly high over the past six months and that is in part driven by LPs demanding that optionality. Sponsors also increasingly want to hold their best-performing assets for longer.

The continuation vehicles that we see established by credit GPs are now quite sizeable, particularly in the US where portfolios of different funds are getting traded. But there are also smaller transactions happening, for example at around \$10 million in a single fund interest in Europe, and those are still



## Q How would you describe the transactions landscape for credit secondaries today, and what level of pricing is being seen?

**TJ Bakshi:** There is quite significant volume in the market today, with a relatively limited number of players on the buy-side, particularly for smaller transactions. But we see that increasing. The US is already seeing more activity in larger transactions, and those are often more competitive and attract lower discounts.

Average pricing has been increasing over the last 12 months but there is still some bifurcation around pricing quality. On the LP side, for high-quality portfolios in traditional direct lending, pricing spreads have compressed as investors seek out those stable yield opportunities.

For a performing senior debt portfolio, the discount could be low- to mid-single digits, while on more opportunistic portfolios, maybe with some stressed or opportunistic content, you might see double-digit discounts. Those portfolios may be less diversified and therefore include higher return potential.

An attractive continuation fund transaction can price close to par, partly as a result of the quality of information available. A GP will provide a full set of data on the investment portfolio, organise calls with the investment team and answer follow-up questions.

Overall, it's a dynamic landscape and investor appetite is actively shaping pricing to reflect that.

attractive in terms of pricing. There is a notion of scalability, as once you have priced one fund or GP, there is the ability to further transact similar investments with different and multiple sellers.

We clearly see both LPs and GPs becoming more sophisticated, driving supply at the same time as there are more buyers coming into the secondaries market.

## Q Are there any barriers to longer-term growth?

**HL:** It does not look that way. This is still a nascent market, but it is growing fast as the adoption rate continues to increase. We are currently seeing less than 1 percent of global private credit AUM being traded on the secondaries market, versus around 2 percent in private equity, so even if the underlying market doesn't grow materially, that

increasing penetration will continue to support growth.

For now, credit secondaries lag some way behind some of its more mature private markets counterparts such as private equity, infrastructure and real estate secondaries, but we believe there will be a convergence over the coming years.

The obvious question is, if there is a lack of M&A creating this need for liquidity today, what happens as M&A volumes increase significantly? Will people no longer need the credit secondaries market? I would say people now understand this as a market, so any LP with a senior portfolio that is diversified and performing, for example, knows that they can potentially sell it for a low single-digit discount that will not significantly decrease their return.

When LPs enter a primary fund, they are investing for five, six or seven years, so being able to tap into that optionality is crucial for them. They can choose whether to stay invested, to test the market, to sell a part of their position or exit their entire position. They can then reinvest into new vintages or new strategies or roll over their exposures into continuation vehicles. So, we believe credit secondaries are here to stay and will be part of active portfolio management for LPs invested in private credit funds in future.

**TJ Bakshi:** The US is probably more advanced in terms of processes and volumes. When it comes to barriers, in LP-led portfolio transactions based in Europe there are still some transactions where information is more limited, for example, due to the quality of LP reporting, no loan tape available and opaqueness of GP marks.

That has on occasion prevented us from transacting because we didn't have what we needed to perform our due diligence and form a price. However, we do expect this will evolve as the credit secondaries market grows.

By contrast, the continuation fund market tends to provide full

*“Another concept that we are actively observing... is an increase in deferrals to bridge the bid-ask spread”*

**CALLUM SMITH**

information to the potential new investors. We have seen advances in the past 12 months to break down some of those barriers and we expect that progress to continue.

### **Q Where do you expect to see innovations shaping the market in the year ahead?**

**CS:** We are starting to see much larger transactions on the continuation fund side, combining several fund interests, where there is an opportunity for multiple buyers to take pieces of transactions.

Looking forward, and focusing specifically on continuation funds, transactions are being completed to offer liquidity to existing LPs and reset fund dynamics in order to extend the maturity of favourable investments. We see those tools evolving, with more GPs asking for staples for new primary funds or creating recycling facilities or asking for unfunded capital to optimise future performance.

Another concept that we are actively observing, and from speaking to colleagues we know this is also a trend being observed in other asset classes, is an increase in deferrals to bridge the bid-ask spread. Those arrangements mean the buyers are able to achieve better returns and the sellers better headline pricing in some cases.

Different sellers have different objectives but if the number one objective is price maximisation then deferrals are particularly useful. And in line with that, the reference date and closing dates can also be used as strategic levers, though that is not something new.

**HL:** Between the reference date and closing, the buyer gets the benefit of all the distributions, which reduce the adjusted purchase price, meaning they can capture returns while the official headline price remains closer to par. This is a win-win because the buyer still achieves its return and the seller gets that pricing closer to where they would like it to be.

On the capital side, you have ever-green funds increasing their footprint in the market, which means there is a lot of demand for deployment to happen faster. That is driving secondary market participants to move faster, which means looking closely at sourcing and internal investment committee processes.

Auction processes are quite competitive, so speed and certainty of execution is a competitive advantage, especially if you have transacted with the seller or GP before. The ability to speak for an entire portfolio is also key. If you are only interested in the senior debt, you may still need to be able to take on some of the junior debt or special situations in order to provide a comprehensive solution.

You might also need to be able to take equity, real estate or infrastructure positions in order to win transactions. In the current market, that can make a difference in terms of getting a role on a transaction or missing out. This is where Partners Group benefits from its global platform and five asset classes, namely equity, credit, infrastructure, real estate and royalties, to be able to offer solutions for sellers across a full range of asset classes. ■

Henri Lusa is managing director, private credit, while Callum Smith and TJ Bakshi are members of management at Partners Group

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