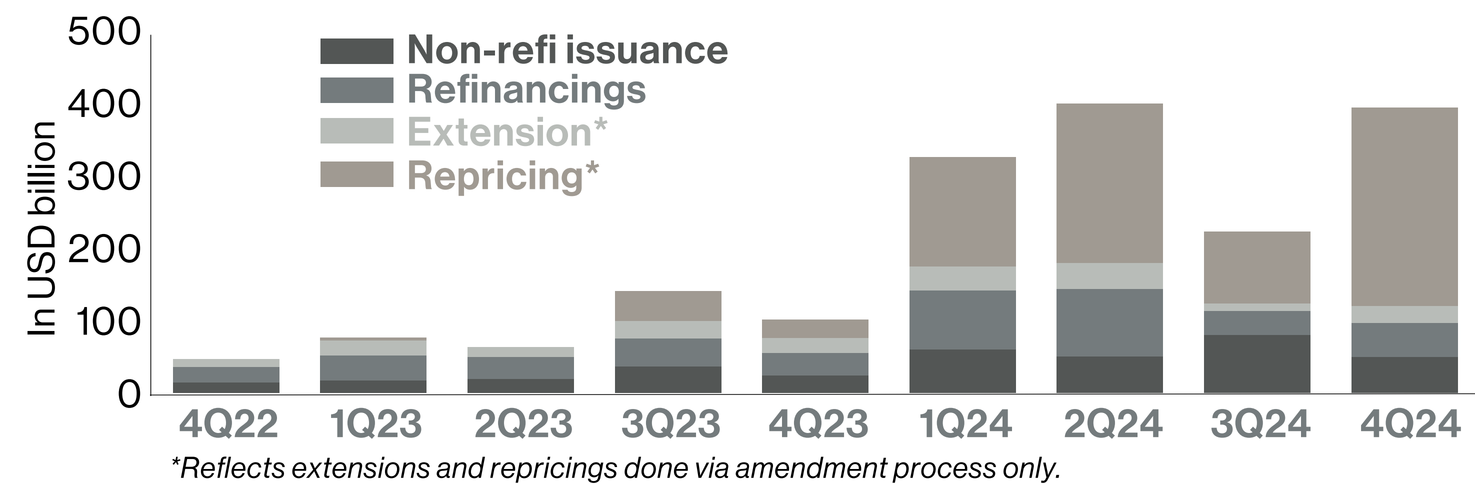
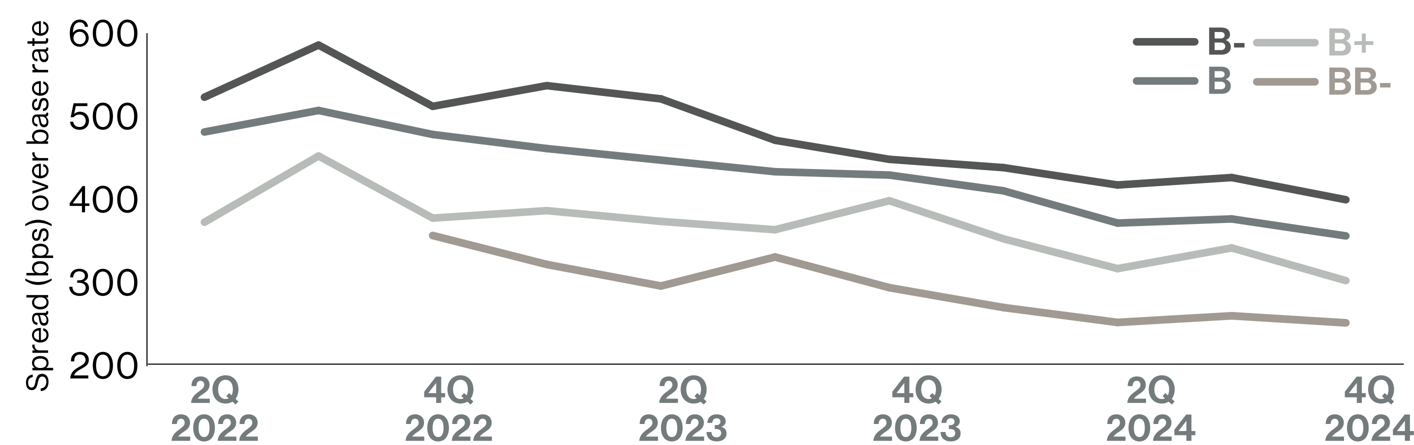
Quarterly Liquid Credit Market Commentary Q4 2024 Issue 22

US new-issue institutional loan volume

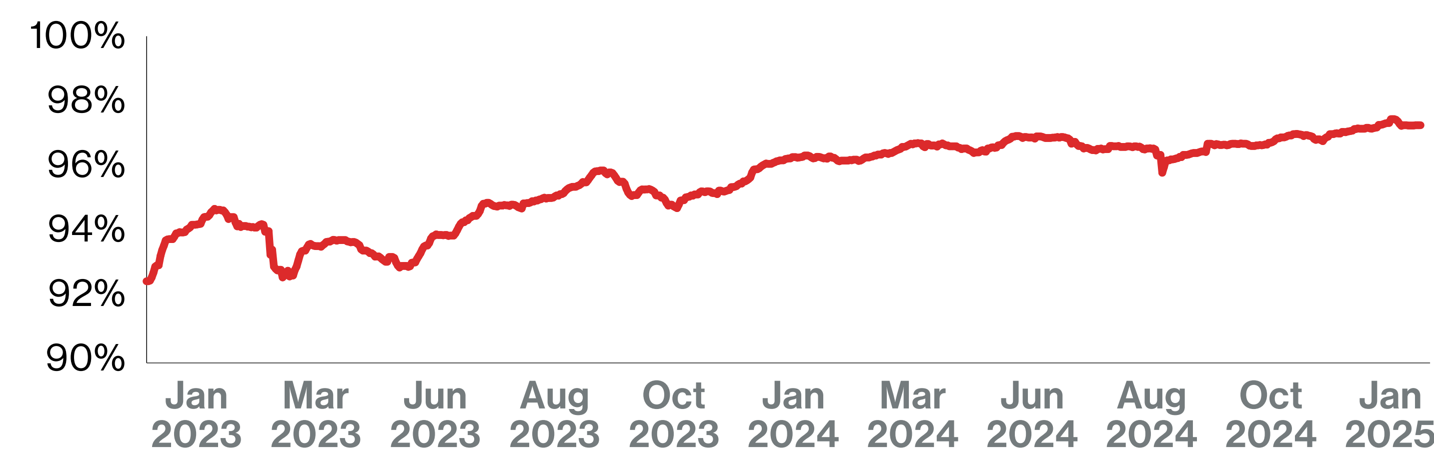


*Reflects extensions and repricings done via amendment process only.

US new-issue loan spreads



US loans index average bid (LLI)



Source: PitchBook | LCD • Data through 31 December 2024. For illustrative purposes only.

US liquid loan market overview

Loan demand exceeds loan supply. This equation sums up the state of the US liquid loan market in Q4 and for much of 2024. Favorable fundamentals – from improving US economic activity (and no recession), the Federal Reserve Bank finally initiating interest rate cuts in Q3 and declining inflation levels – all helped spur a wider 'risk-on' loan investor sentiment. As seen throughout the year, weak new-loan issuance was again insufficient to meet steady investor demand, pushing loan technicals tighter quarter by quarter throughout 2024. Loan investor cash balances escalated from the wave of new collateralized loan obligations (CLO), active loan prepayments and a renewed inflow of cash into retail loan mutual funds and burgeoning CLO ETFs. All of this pushed secondary loan bids higher, creating periods of loan scarcity, especially as M&A volumes failed to contribute to growing loan supply.

Loan issuers were the happy beneficiaries of greater access to financing and lower borrowing costs resulting from recent loan spread reductions and declining interest rates. Issuers also took advantage of these technicals by agressively tacking on incremental loan borrowings when possible. Additionally, many of the loan issuers which secured loan repricings at the start of 2024, came back for another round of reductions during the second half of the year, after their typical six-month non-call window expired. This allowed some loan issuers to extract as much as 75-100bps of loan spread reductions over the full year. Despite the unfavorable impact on portfolio returns, CLO managers and loan investors capitulated to these incessant spread reduction demands, since the alternative was higher cash holdings or redeployment of cash into other overpriced assets.

US new-issue loan issuance

Q4 new-issue loan activity posted the second busiest quarter on record according to Pitchbook LCD. USD 400 billion of primary activity in Q4 fell just short of the quarterly record of USD 405 billion set in Q2 2024. This was an impressive result for Q4 given the period covered the generally quiet Thanksgiving holiday week and a market which effectively shut down by mid-December for the year-end holidays. Notably, out of the USD 400 billion of activity, only USD 49.9 billion was new loan supply, while repricing activity added USD 278.8 billion, refinancings USD 48.1 billion, and maturity extension amendments USD 23.3 billion. Breaking down this Q4 new-issue loan activity further, private equity sponsor driven add-on term loans totaled USD 14.4 billion, while corporate M&A was at USD 5.7 billion and LBOs at USD 8.0 billion, all disappointing results once again for loan market growth.

For the full year 2024, total loan activity hit a staggering USD 1.36 trillion, well in excess of the previous most active year, 2017 at USD 972 billion. But, again, new loan issuance comprised only USD 242.3 billion for 2024, while repricings, refinancings and maturity extensions contributed USD 757 billion, USD 259 billion and USD 103 billion, respectively. Across the year, arranger banks were happy with the volume of activity and loan isssuers were really grateful to easily access capital and for lower loan spreads, while loan investors were the ones left with higher cash balances, weaker portfolio returns and a growing frustration with the endless 'issuer-friendly' marketplace.

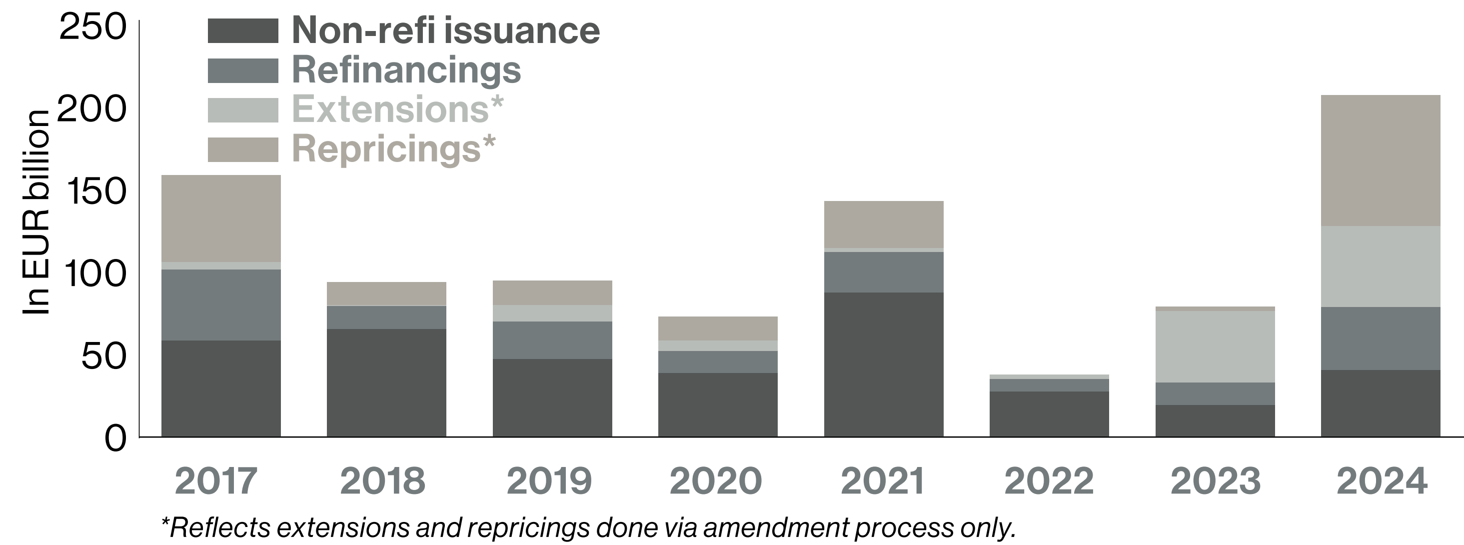
US new-issue loan spreads

Market technicals continued unabated in Q4, as limited new-loan issue supply could not match surging investor demand. Loan issuers across all rating categories were the beneficiaries as investor capitulation to loan repricing demands pushed spreads for higher rated assets (B+ rated higher) to pre-COVID lows, while riskier issuers (B or B- rated) netted levels not seen since the Great Financial Crisis period. Loan spreads on new-issue loans rated BB- declined to 248bps in Q4, compared to 257bps in Q3. Spreads on B+ rated loans dipped to 299bps in Q4, compared to 339bps in Q3, while spreads for loan issuers rated B and B- fell to 353bps and 397bps, respectively, in Q4, compared to 374bps and 424bps in Q3. Collectively across all rating categories, Q4 arguably saw one of the most issuer-friendly market conditions in the past decade.

US secondary loan trading

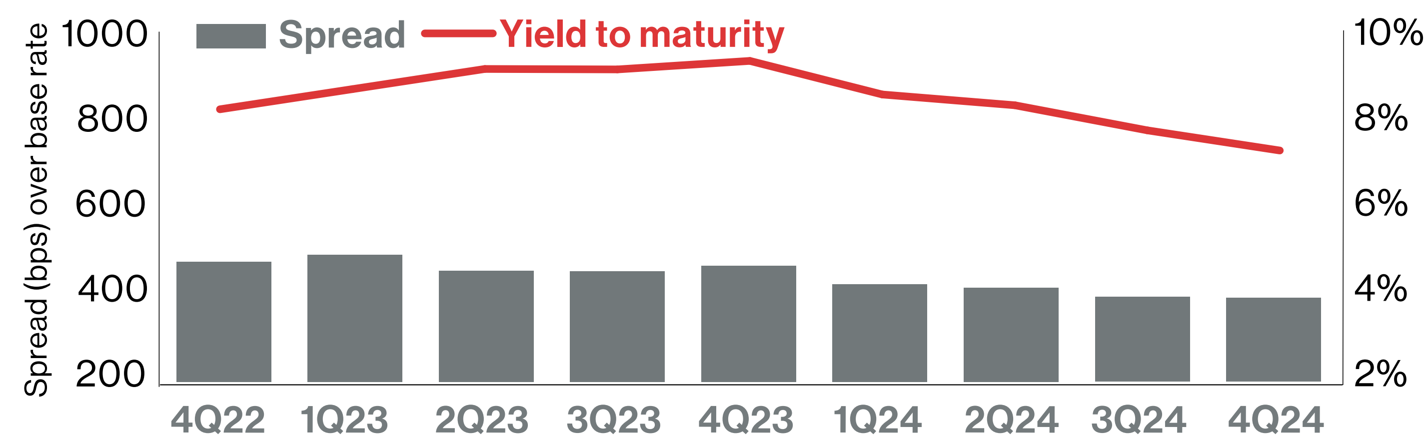
For the third straight quarter, secondary US loan bids, as measured by the Morningstar LSTA US Leveraged Loan Index (LLI), remained relatively range bound. The

European new-issue institutional loan volume

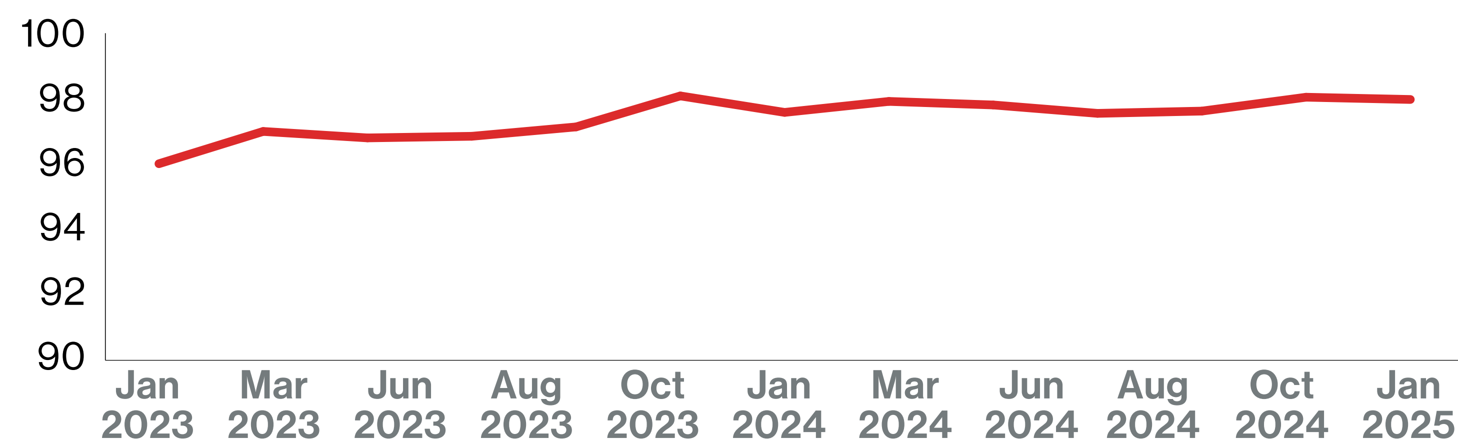


Reflects extensions and repricings done via amendment process only.

European average new-issue loan spreads and yield



European loan index (ELLI)



Source: PitchBook | LCD • Data through 31 December 2024. For illustrative purposes only.

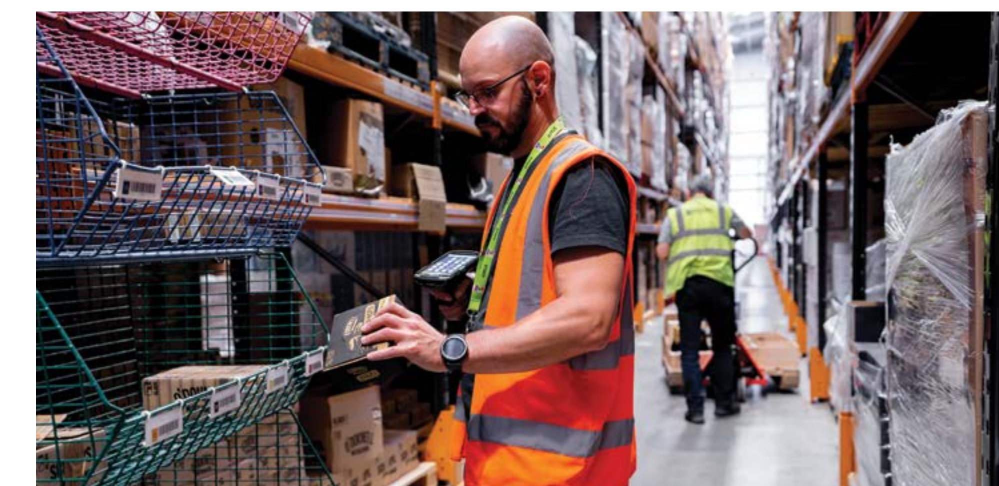
LLI opened Q4 in October at 96.70% and proceeded to creep higher each week, ending at 97.33% in December, for a healthy rise of 0.63%. Given the continued strength of investor demand for loans throughout the quarter, this increase in the LLI may have actually appeared low. However, loan investors have also become increasingly hesitant of over-bidding loans above par, given continuing spread repricings. For Q4, this resulted in the LLI posting a nice gain of 2.27%, slightly above the 2.04% delivered in Q3. For the full year 2024, the LLI realized a healthy gain of 8.95%, the third highest return for the LLI posted in the past decade, trailing only 2023's record-setting 13.32%, and 10.16% from 2016.

European liquid loan market overview

The European market saw a slight pickup in new institutional loan volumes in Q4 and posted a very strong year for 2024 overall, thanks to the same steady inflow of investor cash into the asset class, given attractive loan spreads and floating interest rate base. With record breaking new EU CLO issuance volumes in 2024 and steady demand from single managed account investors and banks, demand for loan assets outpaced supply once again. Similar to the US loan market, European M&A activity, while improved, did not nearly generate the loan supply needed. Secondary loan prices continued to rise. Loan issuers quickly jumped on the opportunity to reprice loan spreads lower, as well as extend maturities when possible.

European new-issue loan issuance

European institutional loan activity for the full year 2024 totaled a record-breaking EUR 207 billion, far ahead of the previous record set in 2017 of EUR 158 billion. However, out of this EUR 207 billion, only EUR 40.3 billion reflected new-money loan issuance. While still a nice increase from the EUR 19 billion of new loans posted in 2023 and EUR 27 billion in 2022, it did not match the levels posted in 2017, 2018 and 2019, nor the COVID-rebound, record year of 2021. Drilling further down into 2024 loan activity, EUR 79.4 billion came from repricing activity, EUR 49 billion was from maturity extensions, and EUR 38 billion were refinancings. And of the EUR 40.3 billion total of new-loan issuance in 2024, M&A activity contributed only EUR 21.4 billion, while LBOs were EUR 15.5 billion. At year-end 2024, the six-month rolling loan supply balance, while much improved, was still EUR -4.8 billion, compared to EUR -19.4 billion in January 2024.



European new-issue loan spreads

As the loan supply-demand imbalance shrunk in Q4 to the lowest levels in 16 months, European loan spreads in Q4 tightened but at a smaller differential. New-issue loan spreads for a typical single-B credit declined slightly to 391bps in Q4, compared to 393bps in Q3. However in Q4, investors exhibited some discipline against issuer pricing demands, with some requests to tighten spreads below E+350bps rebuffed in order to maintain sufficient CLO spread arbitrage. Overall, European investors, much like their US counterparts, were generally coerced to capitulate to loan spread reduction demands by better performing loan issuers to avoid losing the asset altogether via prepayment. This all led to the average yield-to-maturity for new-issue loans to tighten in Q4 to 7.29%, from 7.74% in Q3. This 7.29% yield in Q4 was the lowest observed since Q3 2023.

European secondary loan trading

Secondary European loan trading in Q4 ticked higher as investors continued to redeploy cash into the secondary market, since new-issue supply could not keep pace with demand. However, secondary loan prices remained in a tighter range during Q4, as the supply-demand imbalance shrunk to its lowest levels since Q3 2021. The Morningstar European Leveraged Loan Index (ELLI) began Q4 in October at 97.65%, moved higher during November up to 98.08%, before ending the year at 98.01%. The total return for the ELLI for 2024 was a robust 8.94%, another strong year for European loans, following the record 13.42% return the ELLI realized in 2023.

US collateralized loan obligations

US CLO issuance

Q4 saw record quarterly CLO activity in the US, with USD 59.5 billion in volume from 123 transactions. This incredible total surpassed the highest quarterly activity volumes posted previously (USD 56.3 billion in Q4 2021). For the full year, US CLO issuance volumes were at USD 201.9 billion from 425 transactions, far exceeding the previous record of USD 187 billion and 379 transactions in 2021. The primary drivers for the latest jump in CLO issuance was a combination of: i) the robust performance of US loans comprising CLO collateral; ii) an increasing number of new institutional and retail CLO investors led by an influx of new CLO liability tranche ETFs; and iii) the constant inflow of cash back to investors from CLO amortizations and resets. The decision by CLO investors to reinvest cash at lower liability spreads helped fuel a steady pace of new CLO issuance, despite the rising costs of acquiring CLO collateral. CLO managers eager to maintain or grow CLO AuM in 2024, largely accepted lower initial equity returns to gain AuM and optionality.

US CLO liability spreads

US CLO average coupon and weighted average cost of capital (bps)

Time frame	AAA	AA	A	BBB	BB	WACC
1Q23 (SOFR+)	196	261	335	541	825	261
2Q23 (SOFR+)	198	273	336	549	853	259
3Q23 (SOFR+)	187	260	314	495	790	245
4Q23 (SOFR+)	176	256	302	483	786	235
1Q24 (SOFR+)	156	209	254	390	687	205
2Q24 (SOFR+)	149	189	227	344	633	191
3Q24 (SOFR+)	138	172	201	309	612	176
4Q24 (SOFR+)	135	172	195	297	580	170
Change from 3Q24	-3	0	-6	-11	-32	-6
Change from a year ago	-42	-85	-107	-185	-207	-65

Source: PitchBook | LCD • Data through 31 December 2024. For illustrative purposes only.

US CLO liability spreads

As referenced earlier, CLO liability spreads continued to tighten as market demand for CLO liability tranches accelerated in Q4. The weighted average cost of capital (WACC) for Q4 CLO issuance declined to 170bps in Q4, compared to 176bps in Q3, and was 65bps lower than the 235bps WACC at the start of 2024. In the fourth quarter, AAA CLO liability spreads slid to 135bps compared to 138bps in Q3, and 176bps at the beginning of 2024. Meanwhile, CLO liabilities spreads on tranches rated AA, A, BBB and BB also enjoyed spread tightening during Q4, in the range of -6 to -32bps.

US CLO secondary trading

In Q4, CLO secondary market trading activity continued its downward trend as attention shifted towards the unprecedented levels of new-issuance and reset transactions. Trading volumes experienced a significant decline, dropping nearly 25% year-on-year and 10% from the previous quarter. The reduction in supply contributed to further CLO spread compression and an increasing premium compared to primary market spreads. Consequently, yield-seeking buyers, pursuing higher returns in the current interest rate environment, gravitated towards lower-rated CLO liability tranches. As a result, CLO BB spreads tightened to levels not observed since the latter half of 2018, effectively eliminating any convexity that had existed in the secondary market. Notably, short-duration bonds attracted particularly strong demand.

European collateralized loan obligations

The continuing strong market technicals, driven by older vintage CLO liquidations and prepayments, helped deliver another exceptional quarter of new European CLO issuance volumes in Q4, while reset and refinancing activity picked up as well. The pace of activity for full year 2024 resulted in record European CLO volumes across both new issue and resets/refinancings.

Euro CLO issuance

European CLO new issuance in Q4 totaled EUR 13.1 billion from 31 CLOs, well ahead of Q3 volumes of EUR 10.5 billion and just short of the record level volume of EUR 13.6 billion established in Q2 2024. Additionally, CLO reset and refinancing volumes were strong, posting EUR 14.3 billion from 34 CLOs. For the full year 2024, new CLO issuance volumes hit EUR 48 billlion, well above new-issuance levels of EUR 26.2 billion posted in 2023, and also far outpacing the previous annual new CLO issuance record of EUR 38.6 billion from 2021. Additionally, 2024 CLO reset and refinancing activity was brisk, delivering EUR 33.9 billion to these volumes, compared to the much lower totals posted in 2022 and 2023. However, this still remained well behind the record-setting reset and refinancing volumes of EUR 62 billion achieved during the post-COVID recovery year of 2021.

Euro CLO liability spreads

With the high new-issue and reset volumes realized in Q4, it is unsurprising that the WACC for European CLOs widened slightly out to 206bps in Q4, compared to 200bps WACC in Q3. Despite the increase in spreads, this level still compared favorably against spreads from a year ago in Q4 2023 when WACC was 266bps.

CLO liability spreads in Q4 across the rated liability tranches were generally unchanged or slightly wider

Euro CLO liability spreads

Euro CLO average coupon and weighted average cost of capital (bps)

Time frame	AAA	AA	A	BBB	BB	WACC
1Q23 (E+)	180	297	394	577	728	275
2Q23 (E+)	191	321	410	618	793	296
3Q23 (E+)	174	256	336	513	733	263
4Q23 (E+)	172	266	357	560	789	266
1Q24 (E+)	149	224	276	407	674	227
2Q24 (E+)	146	211	263	377	663	222
3Q24 (E+)	129	194	228	328	614	200
4Q24 (E+)	129	203	244	343	613	206
Change from 3Q24	0	8	16	15	-1	7
Change from a year ago	-43	-64	-113	-217	-176	-60

Source: PitchBook | LCD • Data through 31 December 2024. For illustrative purposes only.

across each rating class, although it is worth noting that for AAA liabilities (the largest part of a CLO's liability stack) spreads remained flat in Q4 at 129bps. With the exception of the BBB rated tranche which dropped 1bp, all other rated tranches experienced wider spreads of 8 to 16bps.

These liability spread increases could be largely attributed to the higher issuance volumes for the quarter, as CLO managers were eager to lock up improved WACC economics before the issuance window closed at year-end. Undoubtedly, the 2024 Euro CLO issuance year was a success for managers, generating terrific issuance volumes, substantially improved liability costs (WACC dropped 60bps during 2024) and helping CLOs deliver above 20% average cash-on-cash LTM returns.

Euro CLO Secondary Trading

During Q4, activity in the European CLO secondary market remained relatively quiet, as investor attention was directed towards the heightened levels of both new-issue and reset transactions. Trading volumes held steady compared to both the previous quarter and the same period last year.

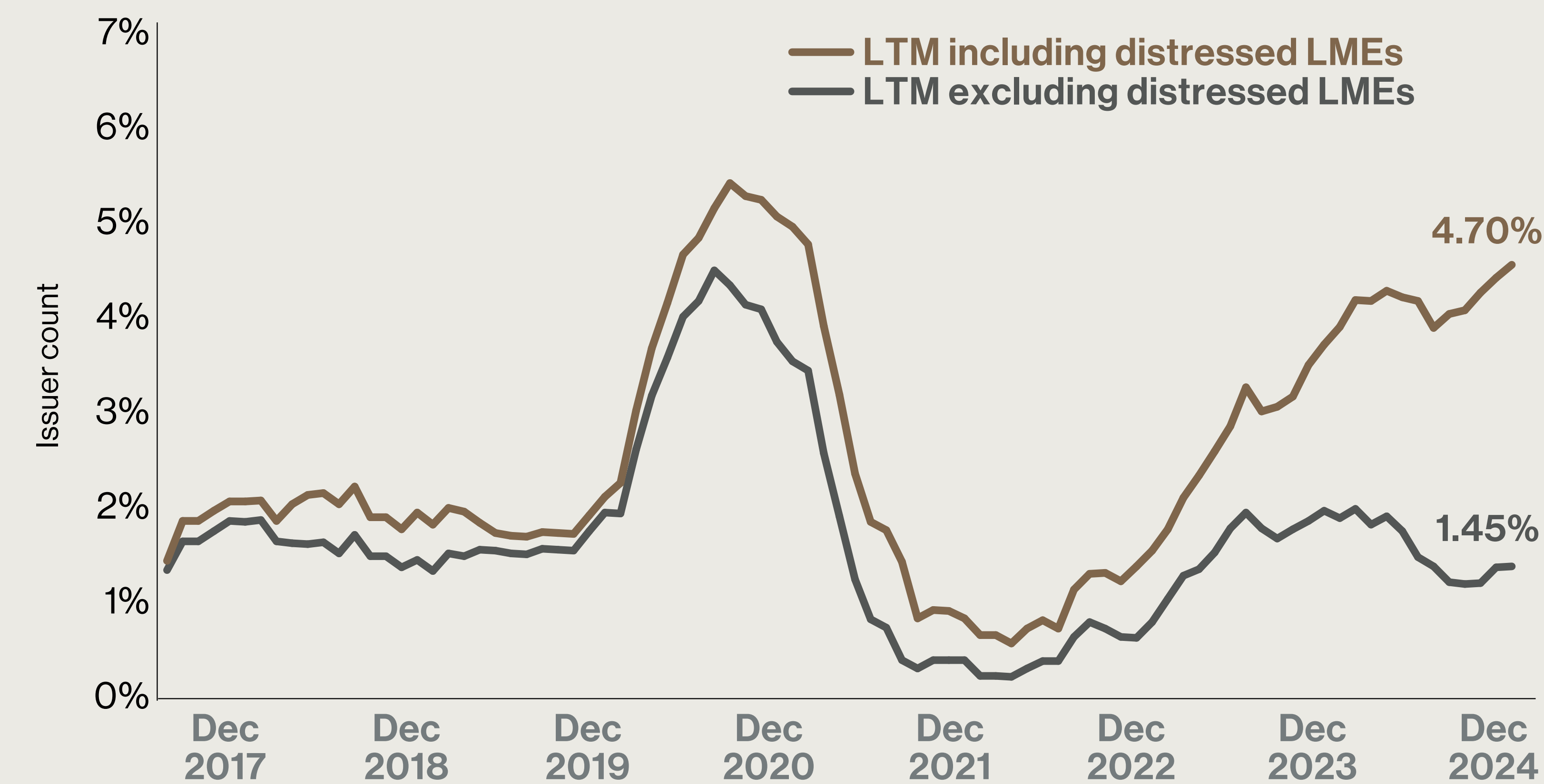
Furthermore, increased engagement by certain investors which typically are just US-focused contributed to an average spread compression of 25bps across the entire Euro tranche structure, resulting in a flattening of the quality curve. In pursuit of yield amidst interest-rate cuts, investors began to favor lower mezzanine tranches, which led to spreads for BB-rated CLO tranches moving into the high-500s, and prices exceeding par.

Spotlight topic:

Where are all the loan defaults?

US loan defaults rates for 2024 reached 0.91% by overall amount and 1.45% by issuer count, according to Pitchbook LCD. As credit defaults are typically a lagging indicator of poor commercial performance by issuers, given the weaker business climate over the past two years these lower default levels are contrary to market expectations of 3.0-4.0% defaults for 2024. What explains the discrepancy? One need not look any further than the highly topical and controversial subject of debt liability management exercises (LMEs), which has become all too prevalent in the US market during the past 18 months (see also previous issues of this report). To summarize, LMEs largely entail stressed or distressed loan issuers utilizing flexibility afforded to them within their credit agreements, to inequitably force first- or second-lien debt write-downs (i.e. debt forgiveness), discounted debt exchanges with or without maturity extensions, loan spread reductions or pay-in-kind conversion, or the much more controversial concepts of debt 'uptiering' (addition of incremental priority senior secured debt) or 'dropdowns' (previously collateralized assets transferred to a new borrowing entity to collateralize new senior secured borrowings).

Dual-track US loan default rate: issuer count



Source: PitchBook | LCD • Morningstar LSTA US Leveraged Loan Index • Data through 31 December 2024. For illustrative purposes only.

These LME actions can result in stressed loan issuers gaining debt relief, interest expense savings, maturity extensions and potential additional liquidity. Without delving deeper into the mechanics and inherent unfairness of LMEs, it is important to at least recognize that LMEs are effectively credit default events also, as they typically result in debt impairment, forced acceptance of loan spread or maturity changes, and potentially the surrender or dilution of loan collateral pledged to existing senior creditors. By adding in the LMEs conducted during 2024, one gets a much truer picture of credit defaults over the past year. When taking the 1.45% defaults by number of loan issuers referenced earlier and adding the total LME activity for the year, effective loan defaults were at 4.70% for 2024, not 1.45%. This higher default total makes sense when considering how many more credit defaults were avoided by these LMEs during 2024.

About the author

Mark Hanslin is a Managing Director & Senior Portfolio Manager who leads Partners Group's Liquid Credit team in New York. He has over three decades of liquid credit underwriting, investment and portfolio management experience for global corporate banks and investment management companies.

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