

Demystifying Private Debt: The Good, the Bad and the Ugly

Invesco Australia | May 2025

Executive summary

Australian Private Debt is facing intense media scrutiny, questioning downside risks in construction related property debt, valuation transparency and whether liquidity will be there when investors need it most. At first glance, it may feel like a case of 'Tall Poppy Syndrome' but, if you take a closer look, the mounting regulatory pressure is warranted.

The recent asset raising success of Australian Private Debt managers with a heavy bias to property related debt has many investors and market commentators talking about private debt like it's all the same. Although the underlying instruments are primarily senior secured and floating rate, there is a huge spectrum of offerings across private debt, meaning not all are created equal. In this paper, we delve into the similarities and differences between two types of private debt offerings, Australian Private Debt and Senior Secured Loans, that investors should keep in mind when allocating to this asset class, focussing on three key areas:

- **Portfolio holdings:** Local property debt vs. global corporates diversified by industry and issuer.
- **Valuation transparency:** Internal credit ratings and quarterly values at par (despite credit deterioration) vs. external credit ratings and daily marked-to-market.
- **Liquidity mechanisms:** Privately held direct loans with monthly/quarterly redemption (subject to gating) vs. large, broadly syndicated loans in highly-traded markets with daily redemption.

In doing so, we hope to demystify the underappreciated spectrum of offerings across private debt and make the case for a more globally diversified, fairly valued and liquid approach. More specifically, the role that Senior Secured Loans can play as the ideal complement to existing Australian Private Debt allocations.

What are Senior Secured Loans?

We define Senior Secured Loans as loans to below investment grade corporates, primarily in the US and Europe, that are at the safest part of the capital structure. In other words, Senior Secured Loans are the senior most obligation and secured by the company's assets, including inventory, property, plants and equipment, and payments owed. They are also first in right of repayment as the company generates free cash flow. Generally, borrowers are corporates and the loans are typically dedicated to corporate purposes (such as capital expenditure), M&A-related transactions or refinancing debt. Importantly, Senior Secured Loans include credit risk mitigation mechanisms, such as comprehensive collateral packages (i.e. share pledges) and covenants.

The Senior Secured Loans asset class is large and highly diverse with approximately 2000 issuers across more than twenty industries and a market valued at approximately US\$2 trillion. Furthermore, valuations are transparent and fair with prices marked-to-market daily, and liquidity is facilitated through a highly-traded market with daily redemptions.

This contrasts to Australian Private Debt which is a fraction of the size at approximately A\$200 billion, highly concentrated by industry and issuer (being dominated by property related debt and banks exposed to the property sector), and currently being subjected to question marks over valuation approaches and whether liquidity has yet been truly tested.

Australian Private Debt vs Senior Secured Loans

Figure 1 on the next page provides a summary of the very few similarities and many differences between Australian Private Debt and Senior Secured Loans.

Demystifying Private Debt: The Good, the Bad and the Ugly

Invesco Australia | May 2025

Figure 1: Australian Private Debt vs Senior Secured Loans

	Category	Australian Private Debt	Senior Secured Loans
Similarities			
	Capital structure position	Senior secured	
	Interest rate profile	Floating rate	
Differences			
Portfolio holdings	Country exposures	Australia and New Zealand	US and Europe
	Industry diversification	Mainly real estate debt, including construction risk	Broadly diversified across more than 20 industries with no real estate debt exposure
	Issuer diversification	Varies from concentrated to diversified portfolios	Highly diversified portfolios across several hundred global companies
	Typical issuer size	Varies by manager/product, but materially smaller than the senior secured loans market	US\$4 billion in enterprise value with US\$425 million in EBITDA
Valuation transparency	Pricing frequency	Typically monthly or quarterly	Daily
	Valuation process	Variable depending on issuer, but often valued at par despite credit deterioration (i.e. impairments not reflected until default occurs)	Daily marked-to-market pricing
	Credit ratings	Often dependent on the managers own internal credit assessment, with the proportion of loans that are independently rated unclear	Vast majority of the market is independently rated by the ratings agencies in addition to managers having their own internal credit ratings
	Transparency	Varies by manager/product	Full portfolio holdings available
Liquidity mechanisms	Origination	Primarily directly originated and not easily traded given lack of local market participants (i.e. illiquid)	Broadly syndicated and highly traded given globally diversified investor base (i.e. liquid)
	Market size & depth	Approximately A\$200 billion with trading volumes unclear	Approximately USD \$2 trillion with annual trading volumes approximately half to two thirds of the market size
	Liquidity	Typically monthly or quarterly redemption with liquidity untested in stressed environments given continuous strong inflows into the sector since inception post GFC	Daily redemption with more than half of the loans on issue trading on any given day, and proven liquidity through market cycles including during the GFC and Covid
	Gating	Often subject to restrictive gating mechanisms given the illiquid nature of underlying investments	Subject to daily redemption limits that typically clear within a few days (rarely triggered)

Demystifying Private Debt: The Good, the Bad and the Ugly

Invesco Australia | May 2025

Consistent with the vast majority of private debt offerings, both Australian Private Debt and Senior Secured Loans portfolios invest in instruments that are primarily senior secured and floating rate. These two core features to the private debt asset class mean that offerings typically invest at the safest part of the capital structure and exhibit low volatility of returns by generating stable income that rises and falls in lockstep with changes to interest rates. Therefore, it's no surprise that private debt allocations have grown significantly over recent years as a strong diversifier to traditional fixed rate bonds within the defensive portion of investor portfolios.

Turning our attention to the many differences from Figure 1 on the prior page, Senior Secured Loans are highly complementary to Australian Private Debt across all three categories, as discussed further below.

Portfolio Holdings

With a USA and Europe market valued at approximately US\$2 trillion, the Senior Secured Loans asset class has significant scale and forms an important element of funding globally for a diverse collection of large companies. With the typical company size being US\$4 billion in enterprise value and US\$425 million in EBITDA, some high-profile brands that have used Senior Secured Loans for funding include T-Mobile, American Airlines, Four Seasons Hotels and Burger King. In the US, the loan market is bigger than the high yield bond market and half of the companies in Invesco's Wholesale Senior Secured Income Fund would be in the fortune 1000 if they were public. The market across the US and Europe is comprised of approximately half private and half public companies with approximately 2000 issuers across more than twenty industries.

Figure 2: Senior Secured Loans market

Industry	(%)	Industry	(%)
Information Technology	15.38	Aerospace	2.68
Service	13.08	Telecommunications	2.43
Financial	10.74	Energy	2.30
Healthcare	10.05	Forest Prod/Containers	2.12
Gaming/Leisure	4.59	Cable/Wireless Video	1.93
Chemicals	4.34	Consumer Non-durables	1.70
Manufacturing	4.11	Broadcasting	1.69
Transportation	4.09	Consumer Durables	1.39
Housing	3.59	Wireless Communications	0.85
Diversified Media	3.12	Metals/Minerals	0.39
Food/Tobacco	3.12	Media/Telecom	0.14
Retail	3.05	Food and Drug	0.12
Utility	3.00		

Source: S&P UBS Leveraged Loan Index as at 31 December 2024.

Figure 2 shows the diversification of the US Senior Loans market by industry. This level of diversification is critically important in an asymmetric asset class like credit where your upside is limited, and your downside can be significant if an industry is in distress, or a company goes into default. This contrasts to Australian Private Debt, which is highly concentrated by industry and issuer, being dominated by property related debt and banks exposed to the property sector.

Demystifying Private Debt: The Good, the Bad and the Ugly

Invesco Australia | May 2025

Valuation Transparency

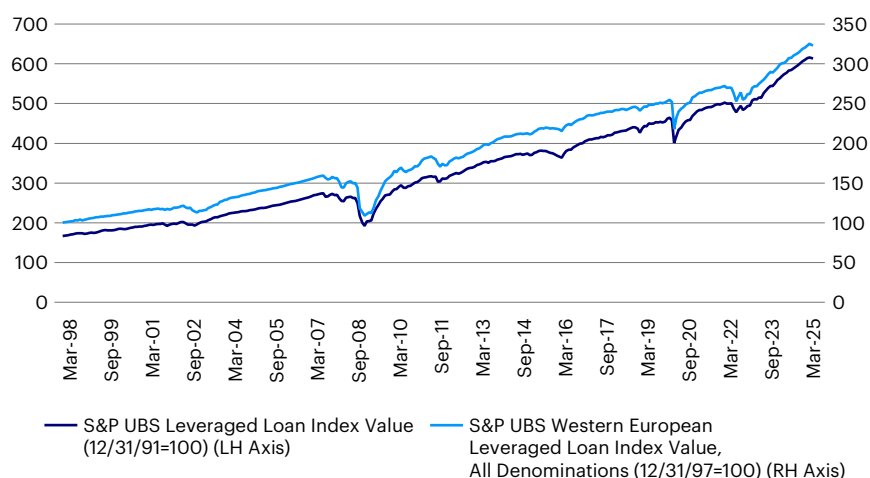
One of the most attractive features of Australian Private Debt for investors is the infrequent valuations with instruments often held at par until refinancing, maturity or default.... regardless of the market environment. In normal times (if there is such a thing these days!), this helps to reduce the volatility of returns and diversify overall portfolio outcomes. But in more challenging market environments, such as what we have experienced recently, there is understandable scrutiny on whether the valuations in Australian Private Debt are justifiable, including whether there is sufficient independence to the credit rating and valuation assessments.

This is particularly problematic in open-ended fund structures that provide daily, monthly or quarterly liquidity as there is a risk that investors redeem at prices that are well above fair or recoverable values. Conversely, when Australian Private Debt is in strong consistent inflows (as it has been since inception post GFC), the approaches to valuations, prevalence of internal credit ratings and lack of transparency creates potential conflicts of interest. The fallout from this has only just started recently, with debt-to-equity swaps, related party transactions and/or other forms of internal refinancings that simply kick the can down the road....hence the growing media and regulatory scrutiny. Given that markets are meant to be efficient, have you ever wondered how Australian Private Debt can offer such healthy yield premiums despite being senior secured with many of the holdings internally classified as investment grade or close to?

In contrast, the Senior Secured Loans market is highly traded and marked to market daily, which does result in more volatility than Australian Private Debt (particularly in stressed environments), but it provides complete confidence that the portfolio and underlying instruments are fairly valued every day, minimising the risk of other investors exiting well above fair value. The level of transparency in Senior Secured Loans (including access to full portfolio holdings) with the vast majority of the market being independently rated by the ratings agencies (more than 90% of the Invesco Wholesale Senior Secured Income Fund is independently rated, in addition to our team having their own proprietary internal credit ratings) means that conflicts of interest are mitigated. The fact that the Senior Secured Loans market is highly traded with a globally diversified investor base also means that related party transactions are far less prevalent....there's no need to buy/sell internally when there are so many external participants to buy/sell with on a daily basis.

Despite being marked-to-market daily, through the vast majority of periods since 1998 Senior Secured Loans have produced a very stable and upwardly sloping return journey, as shown in Figure 3.

Figure 3: Historical loan valuations



Source: S&P UBS as of March 31, 2025.

Demystifying Private Debt: The Good, the Bad and the Ugly

Invesco Australia | May 2025

As can be seen, the mark-to-market downticks in loan valuations during the GFC and Covid were short-lived with very rapid and strong recoveries, which is testament to the senior secured status of the asset class. It's important to note that you continue to get your high level of monthly income through these periods and, if anything, they present as buying opportunities for long term investors. As a result of this high current income, price volatility is buffered with loans having only three years of negative returns over the past 33 years.

Liquidity Mechanisms

Senior Secured Loans offer 'proven' daily liquidity relative to the 'untested' monthly or quarterly liquidity of many prominent Australian Private Debt offerings. By 'proven', we are referring to the 30+ year history of the Senior Secured Loans asset class, which has remained liquid through all market environments including during the GFC and Covid. By 'untested', we are referring to the fact that the Australian Private Debt market emerged post-GFC and has enjoyed strong consistent inflows since, which has facilitated liquidity in open-ended structures despite the clearly illiquid nature of the majority directly-originated underlying loans.

The Senior Secured Loans market has also grown consistently and significantly over the last seventeen plus years.

Figure 4: US loan market secondary trade volumes



LSTA Secondary Market Trade Data Study as of December 31, 2024. Credit Suisse Leveraged Loan Market Statistics as of December 31, 2024.

As shown in Figure 4, the US loan market has nearly tripled from US\$550 billion pre-GFC to be US\$1.45 trillion today and the annual secondary trading volume is approximately US\$800 million p.a. over the last few years. About half of the loans on issue trade each day, whereas for corporate bonds only about 20% of issues trade on any given day. This can be a great complement to the domestic loan market, which is significantly smaller, less liquid and dominated by Australian investors.

The key questions to ask (given the highly concentrated Australian investor base) are, if Australian Private Debt is subjected to strong consistent outflows due to concerns about the property sector, valuation approaches and liquidity; how will the issuers' existing loans be refinanced at, or before, maturity; who will be the buyer on the other side of the trade if a manager has to sell a loan externally, and for what price discount; and at what point, and for how long, will funds need to be gated given the illiquidity of the underlying loans?

Although Senior Secured Loans funds are subject to daily redemption limits, which is in the best interests of remaining investors given the privately traded over-the counter nature of the Senior Secured Loans market, redemption limits are rarely triggered and typically clear within a few days. This level of proven short-term liquidity is expected to be a helpful complement in the event that private debt is out of favour and other less liquid offerings need to gate for extended periods.

Demystifying Private Debt: The Good, the Bad and the Ugly

Invesco Australia | May 2025

Conclusion

The recent asset raising success of Australian Private Debt managers with a heavy bias to property related debt has been impressive. Many Australian investors have enjoyed the high level of consistent income and low volatility driven by infrequent valuations at par, regardless of the market environment. However, it would be an understatement to say that cracks are appearing, with Australian Private Debt facing intense media scrutiny and mounting regulatory pressure, highlighting downside risks in property debt, concerns over valuation approaches and whether liquidity has yet been truly tested.

Although the underlying instruments are primarily both senior secured and floating rate, not all private debt is created equal and we have summarised the very few similarities and many differences between two types of offerings, Australian Private Debt and Senior Secured Loans, focussing on portfolio holdings, valuation transparency and liquidity mechanisms.

At a time when many investors are contemplating change in their private debt allocations, we have shone a light on the underappreciated spectrum of offerings and made the case for Senior Secured Loans as the ideal complement to existing Australian Private Debt allocations, in order to achieve a more globally diversified, fairly valued and liquid portfolio.

Demystifying Private Debt: The Good, the Bad and the Ugly

Invesco Australia | May 2025

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