



## Q3 2025

### Intro

Welcome to this edition of *Credit Conditions*, a quarterly publication from McDermott Will & Schulte that analyzes recent debt market trends.

The third quarter of 2025 saw momentum return to the market with M&A deals rebounding, the broadly syndicated loan market roaring back to record volumes, and private credit evolving structurally with new access for retail investors. Yet beneath the surface, mixed macro signals and distress concerns have kept dealmakers cautious.

Access the full newsletter below.

## In depth

### Key debt market trends

#### Mixed macro signals

- The [Federal Reserve lowered rates in September 2025 by 25 bps to a top-line rate of 4.25% the first cut since December 2024](#). Fed Chair Jerome Powell framed the move as a [cautious “risk-management” step](#) and [noted that there wasn’t broad support for a 50 bps move](#). [Projections now lean toward two additional cuts in 2025, with approximately 86% odds of an October move and a year-end top line rate of 3.75%](#). [The late-August 2025 Bureau of Labor Statistics benchmark revision and a softer September payrolls print reinforced that shift, while Fed Chair Powell’s Jackson Hole remarks flagged a changing balance of risks](#). [Two Federal Reserve governors had already pressed for a July 2025 cut, and Fed Governor Stephen Miran’s September dissent for 50 bps underscored the easing bias even as the statement’s tone stayed firm on inflation](#). [Policymakers, however, continue to emphasize a data-dependent path as well as the challenges that increasing inflation and slowing employment may pose for the Federal Reserve’s dual mandate](#). As a result, an October 2025 cut looks probable, but the cadence beyond that remains contingent on inflation and labor data.
- Other macroeconomic conditions remain mixed. [US GDP grew 3.3% in Q2 of 2025, in line with Q2 and Q3 of 2024 and returning to positive territory after a negative Q1](#), but with emerging signs of slowing domestic demand. The announcement of [trade deals with the United Kingdom, Japan, and the European Union, among others](#), may provide some tailwinds for the US economy. The One Big Beautiful Bill Act (OBBBA) could also provide some fiscal stimulus [via an increase in the interest expense tax deduction limit after the OBBBA changed the calculation from 30% of earnings before interest and taxes \(EBIT\) to 30% of earnings before interest, taxes, depreciation, and amortization \(EBITDA\)](#). [But tariff-driven inflation risks linger as businesses restock pre-Liberation Day imports and begin passing tariff costs onto consumers](#). Further changes to tariff policy also raise concerns of a broader trade war, [029] which could create challenges for US GDP growth and complicate future Federal Reserve rate-cutting decisions.

#### M&A: rebounding top to bottom

- M&A activity is rebounding after a tepid first half of the year, with mega-deals leading the way. [Through July, global deal count is down 16%, with North America at its lowest deal count since 2009](#). But deal value is up 28% globally (\$2.6 trillion this year compared to 2021’s peak of \$3.57 trillion) and up 18% in North America (\$1.05 trillion this year), suggesting a market shift toward bigger deals. Similarly, sponsor-backed deals worth more than \$1 billion are also up year over year, and are on pace to reach 130 signed transactions in 2025 (up from roughly 100 last year).

- Larger deals reflect a hunt for quality assets. In the current high-rate, low-leverage environment, [sponsors have needed to write larger equity checks \(45% to 55% today as compared to 30% to 40% in 2021\) to win deals](#) and thus have been wary about overpaying for assets. Deal activity has accordingly concentrated in [perceived high-quality sectors such as technology and healthcare \(i.e., sectors resistant to tariff and recession risk and with recurring revenue, strong margins, and asset-light business models\)](#). [Both of these industries have seen strong year-over-year revenue growth](#), as well as easier financing, particularly with private credit, which has resulted in [EBITDA multiples for high-quality businesses in these sectors remaining in the 12x to 15x EBITDA range](#). Technology, in particular, has been a bright spot for M&A, [with deal value in North America year over year through June 2025 up 56% \(\\$334.9 billion compared to \\$214.3 billion in the first half of 2024\) and accounting for 32% of total North American volume](#).
- Optimism is building that [M&A will shift into high gear later this year](#). Even amid the current macroeconomic uncertainty, [some market participants believe we have likely avoided the worst-case scenarios from the mid-year turbulence, as tariffs have affected the economy less than originally expected and the US economy has remained strong](#). [Sponsors also continue to have significant dry powder to deploy \(currently valued at more than \\$1 trillion\)](#). Thus, if interest rates continue to fall, a broader uptick in M&A may be in store.
- An improving macro backdrop could also expand the supply of potential targets. Private equity sponsors are currently holding onto a [historic backlog of portfolio companies](#). The overhang has translated into a [decade-high ratio of investments to exits of 3.14x \(i.e., a sponsor sells one company for every three that it buys\)](#). The exit dry spell [has pushed limited partner \(LP\) distributions to 10% of net asset value \(down from a more typical 30%\)](#) and caused LPs to increase pressure on sponsors to return capital. Sponsors have turned to alternative liquidity events to fill the gap, including [dividend recaps \(i.e., debt incurred at the portfolio company level that is then distributed to investors\)](#), net-asset-value (NAV) loans (i.e., debt backed by the PE fund's portfolio for a similar purpose), [and continuation vehicles \(i.e., where a PE fund sells assets into a new fund controlled by the same sponsor to generate liquidity for noncontinuing investors\)](#). Continuation vehicles have been particularly popular, [accounting for \\$41 billion of deal activity in the first half of 2025, which is roughly 19% of all PE exit value during that period and 60% higher than in 2024](#). NAV loans have also seen an evolution, with [some private equity funds using commitments to continuation funds as collateral for NAV facilities](#) and [some LPs entering into their own NAV facilities secured by their portfolio of private equity fund interests](#). But the underlying issue remains that these [lingering portfolio companies will need to be sold at some point, even if potentially at a discount](#), and an improving macro condition may improve the attractiveness of bringing these older vintage assets to market.

## BSL: turning up the volume

- The broadly syndicated loan (BSL) market roared back in Q3 after a sluggish spring. [US leveraged loan issuance skyrocketed in July to \\$222.2 billion, a new all-time monthly record \(surpassing January's \\$206.7 billion\)](#). Primary loan activity earlier in the year had been uneven with Q1 total leveraged loan issuance at \$332 billion (a record first quarter) before dropping to \$114 billion in Q2 amid the April market turmoil. [July's reopening effectively caught up on lost time, clearing out a backlog of hung or postponed deals from Q2.](#)
- [Q3's deal surge was fueled largely by opportunistic repricings and refinancings rather than new buyouts. Repricings through amendments climbed to \\$159 billion in July, overtaking the prior record of \\$152.9 billion in December 2024. The average margin on repriced loans fell to S+322 in July \(compared to S+350 in the first half of 2025\), representing average cost savings of 42 bps. While new financings to support M&A year to date saw a 31% year-over-year increase through the end of July, much of that activity occurred in Q1, with January representing the high for the year at \\$24.7 billion. However, M&A financing activity appears to be picking back up with July hitting a four-month high of \\$14.8 billion.](#)

## BSL vs. private credit: shifting competition

- The BSL and private credit markets continued battling for market share in Q3. The BSL market led the competition with 15 borrowers refinancing \$15.4 billion of private credit deals through mid-June. In the current limited M&A environment, pricing has been the largest driver. Since January 2024, the average borrower saved 192 bps of margin by refinancing in the BSL market. However, [borrowers have also obtained looser terms through BSL refinancings, including by removing maintenance financial covenants due to the dominance of covenant-lite loans in the BSL market.](#)
- Private credit responded, in part, by lowering pricing for the highest-quality deals but more often competed on alternative terms such as [additional leverage \(an average private credit loan carries 1.0x more first lien leverage than the BSL equivalent\)](#), large delayed draw term loans (DDTLs), or payment-in-kind (PIK) options. However, the advantages have narrowed as [the BSL market has begun offering both DDTLs \(albeit with a more expensive ticking fee based on a percentage of the underlying margin rather than the standard private credit flat fee of 1%\) and PIK options \(sometimes structured as a synthetic PIK loan by using DDTL draws to fund interest payments\).](#)
- Private credit has remained very competitive in the leveraged buyout (LBO) market in large part due to private credit's ability to offer greater certainty of closing, even during market volatility. [Through the end of May 2025, private credit financed 49% of LBOs in excess of \\$1 billion, just shy of the record 54% in 2023 but up from 46% in 2024 \(which was up significantly from 20% pre-2021 and 34% in 2022\).](#) Private credit deal sizes have also been growing larger, with the largest now exceeding \$5 billion, which was unheard of five years ago when the largest private credit deals were closer to \$2 billion. Private credit is expected to remain competitive for LBOs

in particular since many sponsors now consistently run dual-track processes for financing acquisitions, considering both the BSL market and private credit options simultaneously.

- Amid this competitive backdrop, borrowers have pushed for increasingly aggressive terms. On the more benign side, strong sponsors have negotiated for portability, which allows debt financing to remain in place, even after the sponsor sells its equity. The term has become increasingly popular due to recent market turbulence since it can reduce the amount of financing a new buyer may need, thus simplifying the sale process and making the portfolio company a more attractive target. On the other hand, some sponsors have pushed for aggressive terms like EBITDA high-water mark baskets (which fix EBITDA to the highest post-closing level regardless of subsequent EBITDA declines), expanded rights to block disqualified lenders (which limit lender assignments), [anti-cooperation agreement terms \(which limit lenders' ability to coordinate to resist a liability management transaction\)](#), and [disqualified counsel provisions \(which prevent or limit the ability of lenders to engage certain counsels in connection with resisting a liability management transaction\)](#). While most lenders have successfully resisted these terms, their repeated proposal demonstrates sponsors' increased bargaining power.

### Private credit: structural evolution

- Retail access to private credit began earlier this year with the launch of [several private credit exchange-traded funds](#) (ETFs). Private credit is now poised to expand even further after an [August 7 executive order opening 401\(k\) and other retirement plans to alternative assets](#). Proponents have championed the change as [a democratization of investment opportunities by providing attractive potential returns](#) as well as [diversification into market segments that would otherwise be unavailable to retail investors](#). Critics, however, have raised [concerns about the risks](#) and the [appropriateness of these investments for retail investors](#). In any event, [with an estimated \\$21 trillion in retirement assets at stake](#), the policy shift represents a seismic and significant expansion of potential capital sources for private credit. Private credit has already begun responding, with [several funds recently announcing plans to provide these retirement products](#).
- Q3 brought a new wave of consolidations and joint ventures to the private credit industry, including: (1) [Fifth Third partnering with Eldridge](#), (2) [Manulife Financial acquiring a majority stake in Comvest Credit Partners](#), (3) [Blackstone partnering with Legal & General](#), (4) [NXT Capital partnering with Cresset Partners](#) and (5) [Man Group acquiring Bardin Hill](#). Tie-ups are expected to continue given the clear benefits: Banks, insurance companies, and other asset managers receive access to private markets at scale while private credit funds gain additional capital to deploy.

## Distress: disguised and diverging

- Distress signals were mixed in Q3. By conventional metrics, distress remains below historical norms. Leveraged loan payment defaults by amount and count were 1.11% and 1.25%, respectively, through the end of July. [However, including liability management transactions increases the default rate by count to 4.56%, up 0.10% from June and 0.20% from May, though still lower than the recent high of 4.70% in December 2024 and the pandemic-era high of 5.58%.](#) Private credit defaults saw a similar increase, [ticking up to 5.5% in Q2 \(from 4.5% in Q1\) before ticking down slightly to 5.2% in July.](#) The shadow default rate for private credit may be higher though, [with estimates closer to 6% \(vs. 2% in 2021\) when using bad PIK \(i.e., when PIK is not available or included at closing but is utilized now\) as a proxy for distress.](#) However, forward-looking signals in the public market are improving, with the distress ratio (i.e., the ratio of downgrades to upgrades) falling to 2.33x in July, down from 3.08x in June and 4.69x in February. So future distress may be limited, particularly if macroeconomic conditions improve.

## Key debt market data on CreditSights & Octus

- [Private Credit Pricing & Leverage Data](#) (September 2, 2025)
- [BSL Leverage Trends Q2 2025](#) (July 7, 2025)
- [BSL Leverage Trends July 2025](#) (August 11, 2025)
- [BSL vs. PC Spread & Covenant Trends Q2 2025](#) (August 5, 2025)
- [BSL Documentation Trends July 2025](#) (August 1, 2025)
- [BSL Aggressive Terms Trends Q2 2025](#) (July 30, 2025)

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