Zeonix Capital

— MIDDLE MARKET CREDIT BRIEF

Q3 2026

# Structured for Today

The Fed hiked, the 10-year touched a 24-year high and oil rose roughly 30%. Headline defaults held, but the cost of carrying leverage went up for every floating-rate borrower at once, and the gap between disciplined credit and everything else widened.

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— Q3 2026 AT A GLANCE

# Nothing broke. The math changed.

Private credit came through the third quarter without a break in the system: Proskauer's default index fell for a second straight quarter, borrower earnings kept growing, and direct lending spreads held. But the quarter was defined by rates. The Fed raised its target range for the first time since 2023, the 10-year Treasury closed at its highest level since 2002, and an energy shock pushed oil up roughly 30%. For floating-rate middle market borrowers, the cost of debt rose without any change in credit terms, and the stress that is building sits where most of them live: smaller companies, 2021 and 2022 vintages, and anything that needs a refinancing before 2029.

| | | |
|---|---|---|
| **2.41%**<br>Proskauer Private Credit Default Index, Q3 2026, down from 2.51% in Q2 | **3.75–4.00%**<br>Fed funds target range after the September 16 hike, the first increase since 2023 | **~5.28%**<br>10-year Treasury at quarter-end, up 80+ bps in the quarter and the highest since 2002 |
| **$129B**<br>Direct lending fundraising in the first nine months of 2026, a record and up 35% y/y (Preqin) | **$49.8B**<br>Estimated Q3 direct lending volume, down 28% y/y (PitchBook \| LCD via Reuters) | **$16.4B**<br>Direct lending loans refinanced into the syndicated market in Q3, a record |
| **12%**<br>Loans to $10–20MM EBITDA borrowers priced below 90% of par, up from ~1% in 2023 (Houlihan Lokey, September) | **6.3%**<br>Fitch U.S. private credit default rate (August), a record on its broader definition | **~43%**<br>Share of KBRA-tracked direct lending loans maturing by the end of 2029 |

## Key themes

- **Rates did the damage, not credit.** All-in unitranche yields rose roughly 35 bps on spot SOFR and more than 80 bps on the forward curve, with spreads unchanged.
- **Record capital, fewer deals.** Fundraising hit a record while direct lending volume fell 28% y/y, and the syndicated market took back the best credits. Competition for quality borrowers is pushing large-cap spreads below S+500.
- **Size and vintage decide credit outcomes.** Defaults and marks are deteriorating among smaller borrowers and 2021–22 loans; larger companies and newer vintages are holding up.
- **Scrutiny is rising.** Non-traded BDC redemptions stayed above caps, the SEC addressed private asset valuations, and the Fed began reporting private credit in its Financial Accounts.

— THE QUARTER IN HEADLINES

# What moved private credit in Q3

| DATE | HEADLINE | WHY IT MATTERS |
|---|---|---|
| **Jul–Sep** | Middle East ceasefire framework stalls; Strait of Hormuz traffic constrained. WTI ends the quarter near $91, Brent near $101. | Energy shock kept inflation sticky (CPI 3.4% in August) and gave the Fed cover to hike. |
| **Sep 10** | Houlihan Lokey: stress among the smallest private credit borrowers up more than tenfold since 2023. | 12% of loans to $10–20MM EBITDA borrowers marked below 90; 6% for $20–100MM, a three-year high. |
| **Sep 14** | Fitch: U.S. private credit default rate hits a record 6.3% (trailing 12 months, August). | Broad definition including distressed extensions and PIK; 41% of defaults were stressed maturity extensions. |
| **Sep 16** | FOMC raises rates 25 bps to 3.75–4.00%, unanimously, the first hike since 2023. | Markets price one to two more hikes by year-end; forward SOFR curve shifts about 100 bps higher. |
| **September** | SEC staff statement on fair value measurement and disclosure for private assets; FSB chair flags private credit risks to financial stability. | More scrutiny on marks, non-accruals and stress disclosure in BDCs and private funds. |
| **September** | Apollo caps redemptions at a private credit fund after 14.7% of investors seek to exit; Australia's Metrics Credit Partners suspends redemptions. | Retail and semi-liquid vehicles remain the pressure point; institutional capital is unaffected so far. |
| **September** | Record high-yield issuance month (~$50B), led by AI and media mega-deals; several trade below issue within days. | Public markets open for large borrowers; middle market companies remain reliant on private and bank capital. |
| **Q3** | Affordable Care completes a restructuring that cuts debt by about 65% and hands ownership to its private credit lenders. | Healthcare services stress, and lenders taking the keys, is the template for 2021–22 vintage workouts. |
| **Q3** | Hayfin ($17.2B), ICG ($14B), Tikehau ($6B) and Bridgepoint ($5.9B) among the quarter's largest closes; nine-month direct lending fundraising reaches a record $129B (Preqin). | Capital is concentrating in the largest managers; sub-$1B funds down 40% y/y. |
| **September** | Federal Reserve integrates private credit into the Financial Accounts of the U.S. with its September release, covering about $1.1 trillion of loans. | First official, system-wide measurement of the asset class. |
| **Q3 data** | Proskauer Private Credit Default Index: 2.41% for July–September, a second straight quarterly decline. | Headline resilience, but trailing 12-month and software defaults rose, and the smallest borrowers worsened. |

Sources: Chicago Atlantic Q3 2026 Update (citing PitchBook | LCD, CreditSights, Morgan Stanley, Goldman Sachs); Houlihan Lokey; Bloomberg; Valuation Research Corp.; The Credit Crunch; Reuters/Preqin; Federal Reserve; Proskauer.

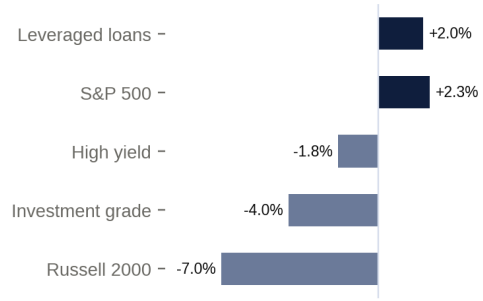
— MACRO AND RATES

# The Fed picked a side

The quarter opened with markets debating the timing of cuts and closed with the first hike in three years. Headline CPI was still running at 3.4% in August, unemployment held at 4.2%, and consumers kept spending. On September 16 the FOMC raised its target range 25 bps to 3.75–4.00%, and the dot plot points to one more increase this year. Futures put the highest probability on a 4.00–4.25% range by the December meeting.

The bond market moved further. The 10-year Treasury rose more than 80 bps to roughly 5.28%, the 2-year about 70 bps to 4.89%, and the three-month SOFR forward curve shifted roughly 100 bps higher, with markets now expecting it to settle near 4.75%. A higher-for-longer path is now the base case, not the risk case.

**Q3 2026 total returns by asset class (approx.)**




Sources: Chicago Atlantic (citing Morgan Stanley, CreditSights); index data. Rounded and approximate.

## Quality got paid, leverage got punished

Floating-rate debt held up best. Loans finished the quarter up about 2%, while fixed-rate paper absorbed the rate move: investment grade lost more than 4% and high yield about 1.8%. Spreads widened modestly at the index level (high yield +37 bps to about 312), but CCC spreads blew out to roughly 1,000 bps and interest coverage among CCC issuers fell to a record low. The market drew a sharper line between strong and weak credits than at any point this cycle.

For middle market borrowers, the lesson is the same as in public markets: capital is available, but it is pricing quality. Each additional hike resets the coupon on every floating-rate loan, and coverage thins quietly, one reset at a time.

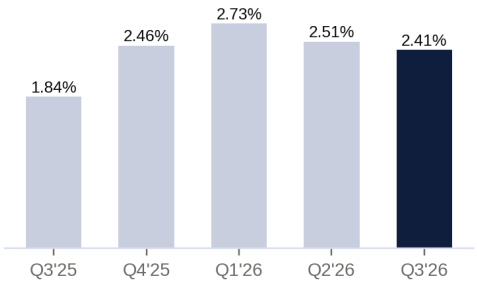
— CREDIT QUALITY

# Headline defaults fell. Size is what matters.

Proskauer's index, covering 746 senior secured and unitranche loans representing $205.7 billion, came in at 2.41% for Q3, the second consecutive quarterly decline. Proskauer noted that trailing 12-month defaults rose, software and technology defaults climbed, and outcomes varied by sector and size.

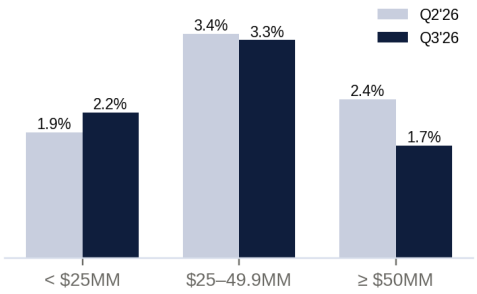
By borrower size, defaults at companies with $50MM or more of EBITDA fell to 1.7%, the $25–49.9MM band held near 3.3%, and the smallest cohort, below $25MM, rose from 1.9% to 2.2%.

**Proskauer Private Credit Default Index**



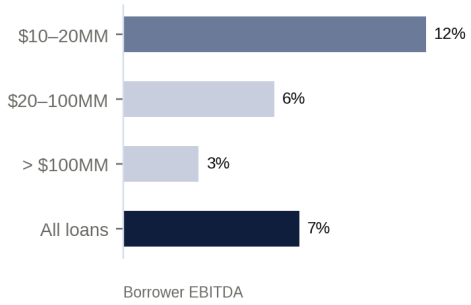

Source: Proskauer, quarterly releases.

**Default rate by borrower EBITDA**




Source: Proskauer, Q3 2026 release (October 27, 2026).

**Share of loans priced below 90% of par**




Source: Houlihan Lokey Private Credit DataBank, published September 10, 2026 (Q2 data).

Marks are moving before defaults. In Houlihan Lokey's latest data (Q2, published September 10), 7% of all private credit loans were priced below 90% of par, more than double the historical average, led by the smallest borrowers. Among the 15 largest BDCs, debt marked below 80 rose 64% over the past year to $6.8 billion, and nearly 10% of portfolios is tied to borrowers with at least one distressed position. Healthcare was the only sector elevated on both count and size-weighted default measures in Houlihan Lokey's data. Fundamentals are not uniformly weak: median borrower revenue grew 6.5% and EBITDA 7.4% year over year, and more than two-thirds of borrowers grew both.

# Why the default numbers disagree

Depending on the source, the private credit default rate in 2026 is anywhere from about 2% to over 6%, and one estimate exceeds 10%. The difference is mostly definitional: whether the measure counts maturity extensions, PIK conversions and other amendments, and whether it weights by loan count or dollars. For a lender or borrower, the useful question is which measure matches the risk being taken.

| MEASURE | WHAT IT CAPTURES | LATEST |
|---|---|---|
| Proskauer Default Index (Q3) | Payment and covenant defaults, senior secured and unitranche | 2.41% |
| KBRA DLD (per VRC, Q3 report) | Direct lending defaults by count / by volume | 2.5% / 2.2% |
| Houlihan Lokey (Sept. release), <$100MM EBITDA | Technical and payment defaults, size-weighted / by count | 3.0% / 3.6% |
| Houlihan Lokey (Sept. release), full market | Size-weighted / by count | 0.8% / 2.5% |
| Fitch private credit (August) | Includes distressed extensions, PIK and missed interest | 6.3% |
| VRC "shadow default" estimate | Defaults plus material amendments, PIK toggles, amend-and-extends | >10% |

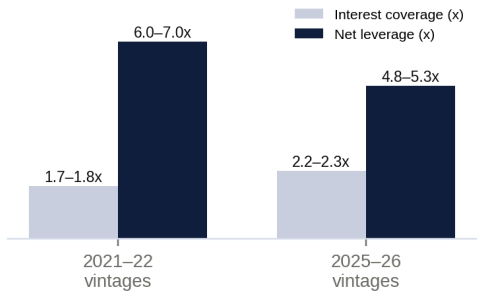
Sources: Proskauer; Houlihan Lokey; KBRA and Fitch as compiled by Valuation Research Corp.; VRC.

## PIK: available, not yet heavily used

PIK features are at record availability, but use remains contained. Houlihan Lokey's September release found that 11.8% of loans (size-weighted) elected some PIK, representing 6.3% of interest dollars, while amended PIK, added after closing and the closest proxy for stress, was 1.6% of interest dollars. The signal to watch is not whether PIK exists in a structure, but whether it was added later.

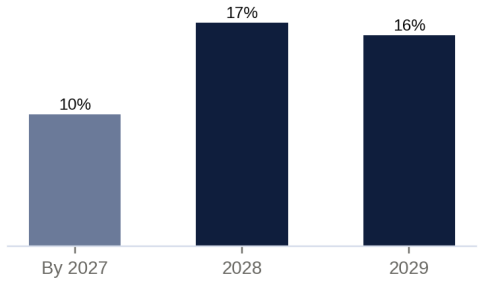
## Vintages and the maturity wall

**Median coverage and leverage by vintage**




Source: VRC proprietary data as of June 30, 2026, published in VRC's Q3 report.

**KBRA direct lending index: share of loans maturing**




Source: KBRA, as cited in VRC's Q3 report.

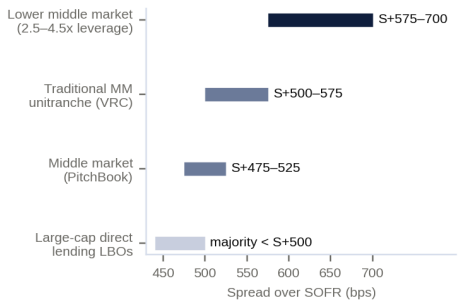
The 2021–22 vintages carry median cash interest coverage of about 1.7–1.8x and net leverage of 6.0–7.0x, against 2.2–2.3x and roughly 5x for loans written since late 2025. Around 43% of KBRA's tracked loans mature by 2029, and a portion will be handled through amendments and extensions that some providers count as defaults.

# Spreads held. The cost of carry did not.

Middle market pricing was stable. VRC held its traditional unitranche range at S+500–575 with OIDs of 98.75–99.25, still 25–50 bps wider than year-end 2025. PitchBook reports middle market spreads generally between S+475 and S+525, while lenders focused on the smallest companies report S+575 to S+700 at 2.5–4.5x leverage. In the large-cap market, a majority of direct lending LBOs this year priced below S+500, and competition for non-software credits pushed parts of that market tighter in Q3.

Software and technology credits continue to price 50–100 bps wide of the broader market. Subordinated issuance remains thin; VRC raised its subordinated yield ranges 25 bps to keep a premium over higher floating-rate yields.

**Direct lending spreads by segment**




Sources: Chicago Atlantic (citing PitchBook | LCD); PitchBook; VRC. Indicative ranges.

## All-in yields moved with base rates

Spot unitranche yields rose to roughly 9.3–10.1% in VRC's matrix, and on the forward SOFR curve to roughly 10.0–10.8%. Covenants, leverage and OIDs were broadly unchanged. The adjustment happened entirely through the base rate, which is why coverage, not spread, has become the binding constraint in underwriting. New deals are being underwritten above 2.0x interest coverage, although 5.0–6.0x leverage remains common in competitive processes.

## Traditional middle market unitranche: Q2 vs. Q3 2026

| TERM | Q2 2026 | Q3 2026 | CHANGE |
|---|---|---|---|
| Unitranche coupon spread | S+500–575 | S+500–575 | Unchanged |
| Original issue discount | 98.75–99.25 | 98.75–99.25 | Unchanged |
| Unitranche credit spread (incl. OID) | S+525–600 | S+525–600 | Unchanged |
| Spot yield (3M Term SOFR) | 8.98–9.73% | 9.33–10.08% | +35 bps |
| Forward yield (3-yr SOFR swap) | 9.22–9.97% | 10.04–10.79% | +82 bps |
| Subordinated yield ranges | — | +25 bps | Raised to keep a premium over floating-rate yields |

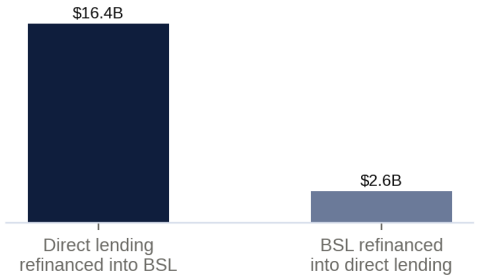
Source: Valuation Research Corp., Traditional Middle Market Pricing Matrix, Q3 2026.

Lower leverage, maintenance covenants and small lender groups are worth more in this environment. They give lenders an early seat at the table when performance slips and give borrowers a faster, more direct path to an amendment if they need one.

# Record capital, fewer deals

Large buyouts stayed on hold through the rate move, and total estimated direct lending volume fell 28% year over year to about $49.8 billion. At the same time, the syndicated market refinanced a record $16.4 billion of direct lending loans, largely higher-quality borrowers that could get cheaper money elsewhere, against only $2.6 billion moving the other way.

**Q3 2026 refinancing flows between markets**




Sources: Reuters; Chicago Atlantic (citing PitchBook | LCD).

The pipeline is improving. Private equity exit value rose about 50% from Q2, though exit counts barely moved and a handful of mega-deals did most of the lifting. VRC reports transaction-related activity up more than 25% year to date through August. Roughly $1 trillion of private equity and $400 billion of private credit dry powder remain available.

For lenders, the result is more capital chasing fewer quality deals at the top of the market, and a lower middle market that continues to operate on its own terms: less software exposure, more industrial and business services borrowers, and real covenants.

## What the syndicated market is telling us

The broadly syndicated market reports in public and close to real time, which makes it a useful early read on where private portfolios are heading. Three things stood out to us in Q3:

- **Restructurings are standing in for defaults.** Conventional payment defaults stayed low, but counting distressed exchanges and other liability management transactions roughly triples the rate, to around 3%. Private credit is on the same path through amendments, extensions and PIK.
- **Weaker credits are paying up.** Lower-rated borrowers saw new-issue spreads widen this year while the strongest names priced tighter, and the weakest credits have done the least to push out their maturities.
- **The CLO bid came back.** CLO formation recovered from a weak second quarter. That matters for direct lenders, because CLOs are a key source of the leverage behind their portfolios.

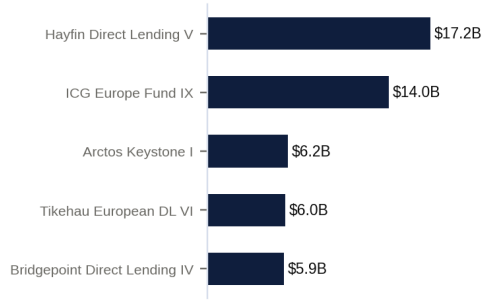
For middle market borrowers with a refinancing ahead, the message is to get in front of it while there is still a choice of lenders.

# Winner takes more

Direct lending funds raised a record $129 billion in the first nine months of 2026, up 35% year over year (Preqin). The growth was concentrated: in the U.S., funds over $10 billion raised about six times as much as a year earlier, the five largest Q3 closes accounted for roughly half of the quarter's capital, and the number of sub-$1 billion funds fell about 40%.

Credit secondaries remained the fastest-growing strategy, as pressure on managers to return capital drove continuation funds and portfolio sales.

**Largest private credit closes in Q3 2026**




Source: The Credit Crunch, Q3 2026 (fund announcements).

## Retail liquidity and regulatory attention

Average redemption requests at 11 of the 14 largest non-traded BDCs eased from 13.9% to about 13.0% of shares in Q3, still well above typical 5% quarterly caps, and many listed BDCs trade 10–20% below NAV. Apollo capped withdrawals at one fund after 14.7% of investors sought to exit, and Australia's Metrics Credit Partners suspended redemptions. Institutional fundraising has so far been unaffected, but semi-liquid vehicles remain the pressure point.

Oversight is catching up with the asset class. The SEC's staff addressed fair value measurement and disclosure for private assets, the FSB chair flagged private credit as a financial stability risk, and the Federal Reserve now reports roughly $1.1 trillion of private credit loans in its Financial Accounts. Expect more questions on marks, non-accruals and stress disclosure, and more value placed on lenders that can show their work.

# Where the structure does the work

## Asset-based and specialty finance

ABS issuance remained robust in Q3, concentrated in data center, aircraft and consumer loan collateral, with strong demand for senior tranches and more selectivity lower in the stack (VRC). CLO issuance stabilized after a weak second quarter and remains an important source of capital for private lenders. Bank and private credit partnerships continued to formalize through the quarter, from originate-and-share programs to liquidity lines and risk transfer (KPMG, July).

For specialty finance companies and asset-heavy middle market borrowers (factors, equipment lessors, receivables-heavy distributors), capital is available against collateral, but on tighter eligibility criteria, advance rates and reporting. Lenders in this segment typically require a bankruptcy-remote vehicle, a first-loss contribution from the originator and cross-collateralization between vintages.

## Commercial real estate and construction lending

The quarter's rate move hit real estate twice. A 10-year above 5% lifts permanent-loan rates and cap rates, which compresses the spread between yield on cost and exit value and makes takeout sizing, not construction risk alone, the binding constraint. In our recent mandates, regional banks have sized construction senior loans to 55–65% of cost with recourse, and the gap to a sponsor's target leverage was filled with mezzanine, preferred equity or, in some states, C-PACE.

Lender stacking rules matter as much as credit. Many banks will not lend alongside a C-PACE assessment, some will not permit any debt recorded behind them, and footprint requirements for operationally intensive assets such as senior housing narrow the field further.

— THE ZEONIX VIEW

### What this means for borrowers in the $10–50 million range

Capital is available. The question is whether the financing still works if growth slows, margins tighten or the refinancing takes longer than planned. In our recent mandates, that has shown up in a few consistent ways:

- **Lenders are sizing to coverage at today's rates.** Regional banks we have worked with recently sized construction senior loans at 55–65% of cost and asked for recourse and full banking relationships, including deposits.
- **The gap is filled with structure, not leverage.** Mezzanine and preferred equity behind a conservative senior are doing the work that a single stretch loan did two years ago, typically priced in the low teens.
- **Lender fit decides outcomes.** Footprint, asset class and stacking rules, such as whether a bank will sit alongside C-PACE, have eliminated more lenders than credit quality has.
- **A strong EBITDA story is not enough.** Lenders want cash flow, collateral and a credible takeout, underwritten on the business as it runs today, not the forecast at its most optimistic.

## Outlook

We expect the fourth quarter to look like the third with more volatility. At least one more hike is priced, the midterm elections and the Middle East conflict add noise, and the 2021–22 vintages keep moving toward their maturities. Headline defaults should stay manageable, while stress continues to concentrate among smaller and more leveraged borrowers and shows up first in marks, amendments and PIK. Record fundraising means capital will remain available for well-run companies, and competition for the best credits will keep pricing tight at the top. For everyone else, the transactions that close cleanly will be those structured for today's rates and today's cash flow, with the right lender lined up from the start.

## What we are watching in Q4

- **The Fed.** The remaining 2026 meetings, with markets at quarter-end leaning toward a 4.00–4.25% range by December.
- **Year-end redemption windows.** Whether non-traded BDC requests keep easing or force more gating and secondary sales.
- **Amend-and-extend volume.** How lenders handle 2027 and 2028 maturities in the 2021–22 cohort, and how much of it is counted as default.
- **Syndicated market take-outs.** Whether the BSL market keeps refinancing the best direct lending credits, pressuring large-cap spreads.
- **Construction and CRE.** Bank appetite for construction as permanent-loan rates track a 5%-plus 10-year.

— SOURCES

# Sources and notes


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- KPMG, "Banking and Private Credit: Balancing strategy and control," July 2026.


Scope: events and data for July 1 – September 30, 2026. Where the latest available data was published during the quarter but measures an earlier period, the period is noted. Figures are as reported by the sources above and have not been independently verified by Zeonix. Returns and some market levels are approximate. Different providers use different definitions of default, PIK and middle market; comparisons across sources should be read with that in mind.

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Middle-market private credit.
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