

Spread Compression and Increasing Occurrence of PIK

This report is excerpted from the *Fourth Quarter 2025 Fixed-Income Sector Views*.

Disciplined underwriting remains critical in navigating structural market changes.

Direct lending spreads compressed further in the third quarter of 2025, averaging the Secured Overnight Financing Rate (SOFR) +485 basis points across the market broadly and averaging SOFR+460 basis points for deal sizes greater than \$1 billion, according to Pitchbook. Consistent competition for deals and limited supply amid muted M&A volumes have contributed to the further compression of spreads. Deal structures and documents in the upper middle market increasingly mirror those in the broadly syndicated market, with covenant-lite terms and payment-in-kind (PIK) features becoming more common, reflecting weakening downside protections.

Sector Commentary

- The residual effects of tariffs and policy uncertainty from the second quarter have persisted into the third quarter, driving continued volatility and a decline in deals financed by private credit loans.
- Private credit deal volume in 2025 has fallen short of expectations, despite initial optimism that the second Trump administration would implement looser regulations to encourage dealmaking.
- The lack of M&A activity has posed challenges for market participants reliant on volume-driven strategies, constraining their ability to deploy capital effectively.
- Among the 12 largest publicly traded business development companies (BDCs), new investment fundings in the first half of 2025 declined by 11.6 percent year over year, while repayments and exits increased by 13.7 percent, reflecting a shift in market dynamics.

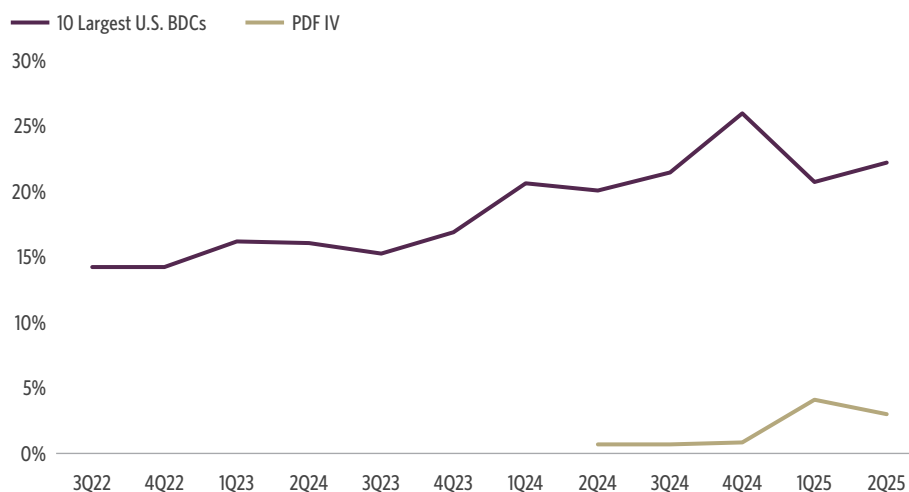
Investment Themes

- The rising use of PIK interest in larger deals is a growing concern, signaling a shift in market practices.
- Among the 13 largest publicly traded BDCs, PIK as a share of net investment income increased from 14.2 percent in the third quarter of 2022 to 22.3 percent through the second quarter of 2025, with some BDCs reporting levels as high as 40 percent, according to Pitchbook.
- PIK interest has become standard in many middle-market transactions, with borrowers often allowed to PIK up to 50 percent of current coupon at the time of origination. We caution against the increasing prevalence of PIK structures.

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PIK as a share of net investment income has increased steadily in BDC vehicles.

Prominence of PIK In Private Debt



Source: Guggenheim Investments, Pitchbook. Data as of 9.30.2025.

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One **basis point** is equal to 0.01%.

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