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Private Credit in *Public Clothing.*

A BDC Bond Primer.

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Key takeaway

Stance. Constructive but selective on senior unsecured debt of large, IG-rated BDCs with conservative leverage (broadly 1.0–1.2x), high first-lien exposure, low non-accruals, ample liquidity, and reliable unsecured-market access. More cautious on weaker capital structures where non-accruals, PIK income, and NAV pressure are visibly building.

Frame. Best underwritten as levered private credit with quarterly marks rather than as plain-vanilla financial-sector debt. The highest coupon is rarely the best credit risk in this sector.

Sector concentration to watch. Software is typically among the largest single-industry exposures across the public BDC universe, reflecting how dominant sponsor-backed software has become in direct lending. How that book performs through the current cycle is one of the more important credit drivers for bondholders.

What we are watching. Non-accruals (at fair value and cost), PIK income share, NAV trajectory, asset-coverage headroom, unsecured funding mix, and the 2026–2028 maturity wall.

Executive summary

Senior BDC bonds sit somewhere between mainstream financial credit and the broader private-credit universe. Treat them as generic spread product and the analysis tends to under-price the cyclical nature of the underlying loans; treat them as opaque private-credit exposures and you miss the meaningful structural protections built into the better names — regulated asset coverage, diversified middle-market loan books, recurring interest income, and increasingly deep unsecured funding access. Fitch's BDC peer review walks down a familiar list of creditor concerns: leverage, asset quality, funding mix, liquidity, and headroom to the asset-coverage requirement.

Our reading of the senior unsecured opportunity is constructive on large, diversified, investment-grade BDCs that carry conservative leverage, high first-lien exposure, low non-accruals, a material unsecured funding mix, and demonstrated market access. We are more cautious on weaker capital structures, where the combination of higher non-accruals, a lower first-lien share, NAV erosion, elevated PIK income, and reliance on secured facilities chips away at the practical cushion sitting in front of unsecured bondholders. In this sector, the highest coupon is rarely the best credit risk.

For bondholders, the attraction is that BDCs are unusual within private credit: they are publicly reporting vehicles operating under a regulatory leverage ceiling and a public-market funding discipline. The trade-off is that the underlying assets are still private loans, so reported NAV, non-accruals, and PIK income need to be read together rather than picked off in isolation.

Regulatory and structural framework

Business Development Companies are closed-end investment companies that elect BDC status under the Investment Company Act. The defining portfolio constraint is the requirement that, in general, at least 70% of total assets be held in qualifying assets before a BDC can acquire non-qualifying assets. That single rule keeps the model anchored to U.S. middle-market and private-company finance rather than allowing it to drift into broader financial-asset trading.

The leverage framework is the part of the regime that most directly concerns bondholders. Prior to 2018, BDCs generally operated under a 200% asset-coverage requirement; the Small Business Credit Availability Act subsequently allowed the requirement to be reduced to 150% with board or shareholder approval and additional disclosure. In practice, 200% asset coverage corresponds to debt-to-equity of roughly 1.0x and 150% to roughly 2.0x — Proskauer's summary frames it as a move from $100 of debt capacity per $100 of equity to $200 per $100.

This statutory backstop is helpful, but it does not, on its own, make a BDC a good bondholder credit. An issuer can sit comfortably inside the legal limits and still look unattractive if headroom is thin, marks are weak, the secured stack is heavy, or non-accruals are drifting in the wrong direction. Fitch's peer-review framework leans on the same intuition, listing leverage, non-accruals, PIK income, first-lien exposure, the unsecured debt mix, liquidity, and headroom to regulatory asset coverage as the key rating drivers.

What the sector has going for it

Regulated leverage and recurring disclosure. BDCs work within the Investment Company Act framework and must satisfy the 70% qualifying-asset test. That delivers more recurring visibility than most private-credit funds, although the usefulness of the disclosure ultimately depends on the quality of NAV marks and the discipline of non-accrual reporting.

Loan-book cash generation. The bulk of BDC portfolios remain floating-rate — OBDC reported 96.1% floating-rate debt investments and FSK reported 88.6% floating-rate investments in their March 2026 materials — which has supported earnings through the higher-rate period. The same tailwind should fade as base rates drift lower and portfolio yields reset.

An improving funding mix. U.S. BDCs have been steady users of the unsecured debt markets, easing their reliance on secured revolvers and freeing up unencumbered assets in the process. Fitch noted BDC unsecured issuance of $9.4 billion in 1H24, against $8.5 billion for the whole of 2023, and credited the robust issuance with reducing near-term funding and liquidity risk.

A manageable ratings backdrop. In its April 2026 peer review, Fitch affirmed all 12 BDCs and kept the Stable Outlooks in place, pointing to resilient performance, generally appropriate capitalization, and continued access to diverse funding sources.

Where we are watching the risks

Private-credit cycle risk. BDCs lend into the same sponsor-backed and middle-market borrower ecosystem that has seen heavier interest burdens, more liability-management activity, and a widening gap between stronger and weaker credits. Fitch flagged rising non-accruals and higher PIK income as signs of asset-quality migration, with median PIK income rising to 9.2% of gross investment income in 2023 from 7.4% in 2022.

NAV sensitivity. Bondholders are not exposed to NAV in the way equity is, but NAV is still the loss-absorption buffer sitting in front of them. OBDC's Q1 2026 NAV decline was attributed in part to unrealized losses from credit-spread widening — a reminder that marks can chip away at creditor cushion before non-accruals start to move materially.

Secured funding and asset encumbrance. Unsecured bondholders need a meaningful pool of unencumbered assets to claim against. Fitch tied robust unsecured issuance to lower funding and liquidity risk and noted that a higher unsecured share reduces dependence on secured revolvers — directly relevant to the encumbrance question for noteholders.

PIK and amendment masking. PIK income is not automatically a bad thing, but a rising PIK share can signal that borrowers are conserving cash. From a bondholder's seat, cash interest coverage and realized exits matter more than accounting income.

Rate-cycle transition. Higher base rates flattered BDC NII; lower rates can compress it, even as stressed borrowers take longer to recover. OBDC's Q1 2026 presentation explicitly cited declining base rates and spread compression when announcing a reduction in its base dividend, even while portfolio performance was reported as continuing.

Software exposure: the sector's single largest tilt

One feature of the public BDC universe that does not always get the attention it deserves is the size of the software-industry exposure. Software has been among the largest single-industry concentrations across most public BDCs for several reporting cycles, reflecting how dominant sponsor-backed software has become in direct lending. The aggregate sector tilt is significant enough that it is worth treating as a standalone underwriting consideration for any bondholder reviewing the space, rather than letting it sit inside aggregate first-lien or non-accrual figures.

Three features make this exposure distinctive. First, a meaningful share of these loans were underwritten on recurring-revenue metrics rather than traditional EBITDA, with valuations supported by ARR multiples that were generous through the 2021–22 software cycle and have since compressed; in some cases, headline LTVs may be higher today than they were at origination even where revenue has continued to grow. Second, software businesses are asset-light, so recovery values in stress tend to rest on the franchise value of the customer base rather than on hard collateral, which raises the importance of sponsor support and renewal dynamics in a downside case. Third, sponsors have been comparatively active in amend-and-extend transactions and PIK conversions within software, which can keep headline non-accrual numbers contained even where underlying cash interest coverage has weakened.

None of this makes software exposure inherently problematic — recurring-revenue software remains one of the more defensible private-credit segments through a broad downturn, and many of these borrowers continue to perform. The point is that the size of the concentration argues for pulling software-specific data — disclosed industry exposure, sponsor concentration within it, and any PIK or amendment activity — separately when assessing a given issuer. Aggregate metrics may understate or overstate the through-cycle picture depending on how software is moving inside the book.

Issuer differentiation

Issuer selection tends to matter more than sector beta. The stronger names usually combine scale, conservative leverage, low non-accruals, high first-lien exposure, ample liquidity, and demonstrated unsecured market access. The weaker names tend to display some combination of higher non-accruals, a lower first-lien share, NAV pressure, narrower market access, and a heavier reliance on secured funding. A few names from the recent disclosure cycle help illustrate where the dispersion is showing up; these are not intended as a survey of the universe, and the figures cited are point-in-time.

On the cleaner end of the asset-quality spectrum, Blackstone Secured Lending (BXSL) reported a $12.8bn portfolio at fair value in Q1 2025, with 98.2% first-lien senior secured exposure, an average loan-to-value of 47.4%, and minimal non-accruals. That kind of first-lien concentration sits at the high end of the disclosed public-BDC range, and is the sort of profile that tends to read well from a senior unsecured bondholder's seat — though leverage, liquidity, and maturity detail were not fully visible in the press-release text reviewed, and would need to be picked up from the supplementary filings before drawing any firmer conclusion.

Blue Owl Capital Corporation (OBDC) offers a useful illustration of why marks deserve attention even when underlying credit appears fine. As of 31 March 2026, OBDC reported a $15.3bn portfolio at fair value across 230 portfolio companies, 72.1% first-lien exposure, 1.0% non-accruals at fair value, debt-to-equity of 1.13x, $4.1bn of liquidity, and a 53.0% unsecured debt share. NAV nevertheless moved from $14.81 to $14.41 over the quarter, and management attributed the unrealized losses to spread widening rather than credit deterioration — a reminder that NAV-mark behaviour can chip away at the cushion sitting in front of unsecured bondholders even where non-accruals stay contained.

At the other end of the dispersion, FS KKR Capital (FSK) is a useful case in point for what a softer profile can look like in the same reporting period. FSK reported $12.3bn of investments at fair value, net debt-to-equity of 1.31x, non-accruals of 4.2% at fair value, first-lien senior secured exposure of 59.6%, $2.3bn of pro forma liquidity, and a 51% unsecured debt share as of 31 March 2026. Compared with the BXSL/OBDC cohort, that combination — higher non-accruals, lower first-lien share, higher leverage — is the type of mix that tends to invite a wider spread to compensate for the additional carrying risk and would warrant closer attention to NAV trajectory in subsequent quarters.

Main Street Capital (MAIN) is worth flagging not as an example of stronger or weaker, but as a reminder that the public BDC space is not homogeneous. MAIN's internally managed structure and lower-middle-market equity component create a different shape from the typical senior-loan-focused peer, so the same headline ratios — non-accruals, leverage, NAV — do not necessarily mean quite the same thing across issuers. References to peer-average metrics tend to be more useful as a starting question than as a conclusion.

All figures above are drawn from issuer disclosures and Fitch commentary for the periods stated and change over time. They are presented to illustrate the dispersion the sector has been showing rather than to rank issuers and should be re-checked against the most recent filings before being relied on.

Bondholder lens by instrument type

Senior unsecured institutional notes are the cleanest way to express a constructive view on the stronger BDC credits. The underwriting questions tend to be familiar: how large the unencumbered asset base is, how heavy is the secured stack, where does the maturity wall sit, what does liquidity coverage look like, how much regulatory asset-coverage headroom is there, and how reliably can the issuer reach the unsecured market.

Baby bonds and exchange-traded notes can offer attractive nominal coupons but tend to trade with worse liquidity, more retail-driven price action, and less efficient relative-value behaviour than institutional notes. They are worth sizing for mark-to-market volatility and exit liquidity rather than for headline yield alone.

Shorter-dated bonds reduce exposure to credit-cycle and NAV-mark uncertainty but can be vulnerable to refinancing windows where the issuer has a concentrated maturity wall. Longer-dated bonds offer more spread and duration but ask for more confidence in underwriting discipline, NAV resilience, and recurring unsecured-market access.

Fixed-rate coupons look attractive when spreads are wide and rate cuts are expected; the same rate cuts, however, can weigh on BDC NII and dividend flexibility. Floating-rate liabilities may align better with floating-rate assets but can become expensive if funding spreads widen at the same time as asset yields compress.

Independent credit assessment

Taken in the round, the sector seems to merit a selective rather than a blanket stance — expressed through stronger issuers and senior unsecured structures rather than across the board. Large IG BDCs with low non-accruals, high first-lien exposure, leverage near 1.0x to 1.2x, and meaningful unsecured debt access offer what looks, on the disclosed data, like a reasonable balance of income and structural protection.

A blanket overweight is harder to argue for. Private-credit underwriting quality is likely to disperse further, and the combination of rising non-accruals, higher PIK income, spread-driven NAV markdowns, and lower base rates points to a phase where credit selection counts for more than sector carry.

Looking across the names reviewed, BXSL and OBDC stand out for high first-lien exposure, low non-accruals, and substantial liquidity. MAIN looks different in kind — internal management, healthy liquidity, and an LMM equity component that supplies long-term upside but asks for closer NAV attention. FSK's disclosed data sits less comfortably against the others, with higher non-accruals, lower first-lien exposure, higher leverage, and a NAV that has moved over the observed period. The intent here is to describe what the data shows rather than to rank names; the appropriate position size and structure will depend on the reader's own mandate.

Key watchpoints

- **Net debt-to-equity**: a sustained move above the issuer's stated target range, particularly above 1.25x, is generally a moment to reassess.
- **Asset-coverage headroom**: the cushion to the regulatory limit matters more than mere compliance with the legal threshold.
- **Non-accruals at fair value and cost**: fair-value non-accruals show current carrying pressure; cost non-accruals reveal the original exposure at risk.
- **PIK income**: a rising PIK share is one of the earlier signals that borrowers are conserving cash.
- **NAV trend**: declines driven by spread widening are less concerning than credit-driven markdowns, but both reduce the creditor cushion.
- **First-lien mix and equity exposure**: a higher first-lien share generally helps downside protection; equity and preferred exposure tend to add NAV volatility.
- **Unsecured funding ratio**: a higher unsecured share generally improves flexibility for senior unsecured bondholders by reducing asset encumbrance.
- **Software exposure**: disclosed software-industry exposure, sponsor concentration within it, and any PIK or amend-and-extend activity inside the software book are worth pulling out as a discrete data point given the size of the sector tilt.
- **Liquidity coverage**: cash plus undrawn capacity should comfortably cover near-term maturities and unfunded commitments.
- **Maturity wall**: 2026–2028 maturities are worth tracking carefully; refinancing access is one of the clearer differentiators in stress.

What would change the view

The picture would brighten if stronger BDC issuers held NAVs steady through a downturn, kept non-accruals low, reduced secured-debt dependence, and refinanced maturities at reasonable spreads while keeping leverage discipline. It would also improve if pricing widened far enough to compensate for private-credit opacity without a corresponding deterioration in portfolio credit metrics.

It would darken if sector non-accruals accelerated, PIK income rose materially, dividend pressure pushed managers toward riskier portfolio rotation, NAV declines turned credit-driven rather than mark-to-market-driven, or unsecured markets closed to all but the strongest issuers. Aggressive use of the 150% asset-coverage regime would also weigh on the view, since legal leverage capacity is not the same thing as bondholder-safe leverage.

Bottom line

BDC bonds can play a useful role in a credit allocation, but the case rests on issuer discipline rather than on sector beta. The cleaner expression tends to be senior unsecured debt of large, liquid, IG-rated BDCs with strong first-lien portfolios, low non-accruals, conservative leverage, and reliable unsecured-market access. It is more useful to underwrite the sector as levered private credit with quarterly marks than as plain-vanilla financial-sector debt.

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