

Private Credit at the Crossroads

America's \$1.3 trillion shadow lending market was built on software loans. Now AI is starting to challenge the assumptions that helped make it so powerful.

The headlines. Recent headlines highlight concerns around the exposure of the private credit industry to SaaS default risk. In practice, the market is highly complex, and features both deep distress as well as attractive opportunity for firms that know how to hire, underwrite, and manage through complexity.

The main issue is concentration, which is actually worse than the headline numbers suggest. Software companies make up roughly 22% of U.S. private credit exposure on a self-reported basis. But that figure understates reality. Diameter Capital's analysis of BDC portfolios found that when loans are reclassified according to their actual functionality vs. self-reported description, true software exposure at some BDCs exceeds 50–60%. That means many portfolios have a single-sector concentration two to three times larger than their reporting implies, underwritten at median leverage much higher than other sectors. Among the largest of those deals, only 38% retain maintenance covenants and 44% include PIK toggles, making the exposure not just significant but underprotected.

Those loans were built on a specific thesis: that SaaS borrowers with high gross margins, contractual recurring revenue, and 90%+ net retention rates were nearly annuity-like credits. While this makes sense, AI has rapidly transformed the playing field, replacing much of the functionality. Even though there is still “stickiness” among SaaS clients given the switch costs inherent in a longtime embedded enterprise system, SaaS pricing power in general will be reduced on an industry level, and given the widespread high leverage, this creates a problem for private creditors. Case in point; as reported by the Wall Street Journal, Q1 2026 saw more than \$14 billion in total redemption requests, with over half going unmet. When a fund can't meet redemptions, it either gates investors or sells assets into a thin market. Meanwhile, leverage providers to private credit are adding software concentration limits and reducing borrowing bases, which forces further selling. The result is a negative feedback loop where liability pressure drives asset sales that depress prices that trigger more liability pressure.

The opportunity. Given that the dislocation in the market is driven by both endogenous (industry) and exogenous (capital markets) factors, creating double pressure for redemptions, the conditions are ideal for favorable secondaries pricing offered by illiquid sellers on healthy assets. This is the definition of a pricing dislocation, and it will not last. As the market normalizes, forced selling subsides, and NAV discounts narrow, the spread between price and value compresses. The firms best positioned to capture the opportunity are the ones that can move quickly, underwrite on a forward-looking basis, and deploy capital while others are still managing their way through redemptions.

The solution – targeted hiring. Anticipating the future of SaaS will require forward-looking and discerning talent. It will require analysts who can stress-test a SaaS business against AI displacement, structurers and lawyers who can read distress signals before they appear in default data, and risk professionals with systems that monitor portfolios in real time. The ability to differentiate between performing and distressed credit will be a defining capability in secondaries. Firms that get this right will do so by hiring professionals with deep, trusted GP relationships who can underwrite with conviction and be trusted to make the correct calls.

Secondaries specialists may be the most critical hire of all. Buying individual loans out of distressed portfolios requires someone who can separate the performing credits being sold for liquidity reasons from genuine sinking ships. That judgment depends on relationships with sellers, deep familiarity with documentation, the ability to underwrite individual borrowers on short timelines, and enough market knowledge to differentiate between liquidity-based and fundamentals-based selling. The talent pool with that combination of skills is small, it was built in adjacent markets like distressed debt and structured credit, and it is being recruited aggressively right now.

Private credit built this market on relationships and patience. The firms that get the talent right for the second half of 2026 will come away with the best asset prices by investing in talent that can find the signal in the noise.

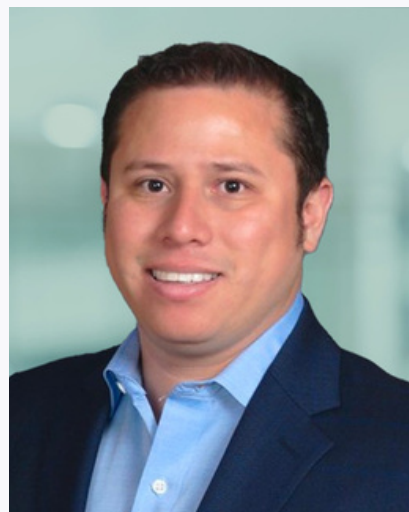
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