Private Credit's Evolution: Stability, Opportunity, and the Road Ahead

Zach Lewy
Founder, CEO and Chief Investment Officer, Arrow Global

Private credit has undergone a transformation in recent years, and as we head into 2025, the opportunities ahead are clearer than ever. At Arrow Global, we manage and service over €110bn in assets, giving us a deep, data-driven understanding of market performance. The landscape today is shaped by a combination of historical pressures and new trends, and investors who recognise these dynamics will be best positioned for success.

One of the most significant shifts we are seeing is the challenge faced by businesses, loans, and investments made before 2022. These assets have had to withstand a perfect storm – COVID, inflation, and rapid interest rate changes – making refinancing in today's environment particularly difficult. Banks that were once comfortable extending credit are now reconsidering, and in many cases, the answer is no. This is leading to a surge in restructurings, with many borrowers experiencing payment distress at levels comparable to the peak of the pandemic.

This is where private credit plays a crucial role. We are stepping in to support banks, either by managing restructurings or providing additional capital to bridge the gap. At the same time, equity investment is regaining momentum. With global elections behind us, many investors are moving forward with greater clarity, eager to transact before the next wave of macroeconomic uncertainty arrives.

The key concern for any investor is capital preservation. The fundamental question isn't whether private credit is attractive—it's how to maximise returns while ensuring capital remains protected. Quality, transparency, and simplicity go hand in hand. The most experienced investors prioritise opportunities that are easy to understand, straightforward to track, and backed by strong fundamentals.

Risk management in private credit is evolving as the asset class matures. Investors today have a growing range of options when it comes to structuring their exposure. Some prioritise capital efficiency and ratings requirements, opting for senior positions in the capital stack. Others are willing to take on slightly more risk in exchange for higher returns. With interest rates remaining elevated, there's less pressure to stretch too far to meet return objectives.

Another principle that is becoming increasingly embedded in investor thinking is that transparency equals quality. The best private credit opportunities are those where the investment thesis is clear, and performance can be tracked with precision.

Real estate has long been a key area for private credit, but it is also a sector where risk assessment is vital. We look at two fundamental factors when evaluating investments. First, can the asset generate cash flow? Second, is there a liquid market for that cash flow?

Take offices, for example. While tenant demand has stabilised, liquidity remains a challenge. If you surveyed global investors on their current office exposure versus where they want to be in five years, you'd see a massive overhang of sellers. Even if cash flow is strong, an excess of sellers means values may still decline.

Data centres present a different, but equally complex, dynamic. AI-driven demand for processing power is increasing, making the sector an attractive long-term bet. However, the customer base is highly concentrated – dominated by just five hyperscalers. The scale of investment required is significant, and exit options are limited unless the asset can be placed into a public REIT.

Residential real estate, by contrast, passes both key tests. Demand is broad, supply remains constrained, and individual units are relatively small, making them easier to manage. It may not be as high-profile as some emerging sectors, but it is built on solid fundamentals.

Beyond real estate, private credit is expanding into a broader range of strategies. Direct lending remains the dominant approach, largely because it evolved naturally from private equity. Investors became comfortable with private credit through their exposure to senior debt in buyout transactions.

However, other strategies – such as bridge loans against residential property – are arguably more mainstream than leveraged buyouts, yet they remain underutilised. Over the next decade, the focus will shift from categorising private credit strategies to evaluating them based purely on risk-adjusted returns. As the market matures, investors will become less constrained by the historical dominance of direct lending.

Geographically, Southern Europe is an increasingly attractive investment destination. Traditionally, Northern Europe has traded at a significant premium, but since 2022, performance in the south has caught up. The discount that once defined the region is no longer justified.

Several factors are driving this shift. Demographic trends, technological advancements, and economic developments are all creating sustained tailwinds. One of the most promising areas is hospitality, where remote work, international travel, and lifestyle migration are reshaping demand.

Private credit has a vital role to play in financing the development and refurbishment of hotels, resorts, and related infrastructure. But success in this space requires more than just capital – it demands local market expertise, from sourcing granular transactions to navigating operational complexities.

Technology is another major force shaping private credit. The use of data-driven decision-making is now fully embedded in the industry, but the next boundary is artificial intelligence. At Arrow, we already use AI to drive the first pass of underwriting on Italian construction claims.

The real question is: How far do we take it? Many underestimate the medium-term consequences of AI becoming the dominant factor in business processes. The cultural impact within organisations is profound – some employees embrace AI as an opportunity, while others resist it entirely. As we integrate these technologies in financial services, we must also navigate the regulatory and security challenges that come with them.

This brings us to the long-term future of private credit. Some question whether its rapid growth poses systemic risks, but I take the opposite view. The industry is evolving on a structurally sound foundation, not a fragile one.

Consider traditional banking. Banks fund themselves overnight yet provide five-, 10-, or even 20-year loans. Meanwhile, life insurance companies and pension funds have liabilities that extend 30 to 40 years. In theory, they should be the natural providers of long-term credit.

At the same time, asset managers are growing in scale, reputation, and influence. As firms continue to expand, their ability to structure and manage credit will only increase. We are moving toward a system where large investment houses provide expertise and efficiency at a level that makes them indispensable. The capital they manage is a natural fit for private credit, creating a framework that is more robust, not more fragile.

Rather than worrying about whether private credit's growth is sustainable, the real question we should be asking is: Could it be growing even faster?

ARROW
GLOBAL