Middle-Market Private Credit & Structured Capital

2026 Mid-Year Update

Private Credit Turbulence Creates Opportunity and Caution for Lenders and Non-Control Investors

Bankers, private lenders and structured capital investors are weighing two critical issues entering the second half of 2026 relating to interest rates and loan quality. On the plus side, interest rates are expected to remain firm or even increase in the next six months as inflation remains a top concern and asset prices continue to defy gravity. Loan spreads have widened 50–100 basis points since late 2025 resulting in better pricing and lenders are becoming more selective about credit quality. With a large amount of equity dry powder still on the sidelines, hybrid funds and minority sponsors continue to hunt for new targets as deal activity trends upward.

In contrast to the last few years, however, credit performance has deteriorated significantly in some areas putting caution to the wind for both banks and private credit firms. With the rapid acceleration of AI in the past year, the SaaS/software market has been particularly impacted resulting in liquidity concerns at some large funds. For well-positioned companies with strong fundamentals, capital is available on attractive terms; for everyone else, the market rewards preparation, credibility, and experienced guidance. In this environment, the difference between a successful financing and a stalled process often comes down to positioning, timing, and access to the right capital partner.

Private Credit / Direct Lending

- **Scale:** The private credit market continues to expand despite recent challenges and is forecasted to reach $3T by 2028
- **Terms:** 2026 has tilted towards a more lender-friendly environment with as spreads are 50–100 basis points wider than late 2025 with firmer covenants and documentation
- **Pros for Borrowers:** The core middle-market is viewed as the most rewarding segment for private credit managers which provides competition and flexibility. Lenders compete by providing speed and certainty of close, structural flexibility, and value-added relationships. Also, banks are increasingly partnering with private credit managers rather than hold risk. In exchange, lenders are conducting thorough due diligence with concerns being fully addressed in documentation.
- **Potential Risks:** Late cycle stress is visible in some segments including many credits from the aggressive, covenant-lite years of 2020-21. A lender shakeout of some proportion is expected in the second half so borrowers need to align with the right, healthy partner. Pricing remains wide of bank alternatives for the strongest credits, but structure may still win the day subject to company priorities.

Minority Equity / Structured Capital

- **Market Overview:** Competitive credit and equity markets with favorable pros and cons for both issuers and lenders/investors continued the uptick in recaps from 2025 into 2026. Junior capital is increasingly being used for partial realizations via minority recaps and refinancings. Sector-focused firms can provide critical strategic relationships to expand sales and improve operations in addition to a strong M&A network and deal expertise.
- **Structure Trends:** Redeemable preferred equity with cash/PIK dividends plus warrants has become a leading structure in 2026. This type of security provides downside protection and mid-teens return profiles for investors. Issuers gain flexibility by having the right but not the obligation to repurchase the stock, subject to interest rates.
- **Owner's Benefit:** Liquidity is created that can provide diversification without a sale. Good tool to provide minority shareholder redemptions to clean up Cap Table with partial exits. Increases availability of growth capital to grow enterprise value for primary shareholders to benefit from a sale in 3-5 years.
- **Disadvantages:** Preferred terms sit senior to common in a downside scenario. Debt-like security with dividend obligations that can constrain cash flexibility, so generally reserved for well-performing companies that can enhance growth with this structure. Must pay strict attention to deal structure and terms to avoid future financing constraints that reduce flexibility in uncertain economy.

Bottom Line

2026 has proven to be a selective but well-capitalized market. Structured capital — private credit paired with minority equity or preferred — lets strong middle-market companies raise substantial capital while retaining control, but wider spreads, tighter documentation, and investor-favorable preferred terms put a premium on running a competitive process and negotiating structure, not just price.

Industry Commentary

Sector-specific observations on middle-market lending and investment

Healthcare & Life Sciences

- **Standout:** Healthcare and Life Sciences investments were the most resilient sector for PE deployment in 1H 2026 with platform roll-ups and take-privates continuing on pace with 2025. The segment is also one of the largest and fastest-growing private credit end markets with ~16% share and ~10% CAGR. Non-discretionary demand drives confidence levels, though diligence is intense on reimbursement and labor costs.

Software & Technology

- **Repricing:** As highlighted in conversations around fund redemption requests, SaaS and software spreads have increased dramatically driven by AI-disruption uncertainty. Most software issuers now price at an additional ~75bps premium. The sector is still favored for recurring revenue, but lenders are differentiating hard between AI-resilient and AI-exposed models.

Industrials & Manufacturing

- **Core market:** Industrials remains the largest private credit end market with ~20% share. Many existing and new funds are attracted by the asset-heavy collateral which supports conservative loan-to-values. Corporate carve-outs are surging in North American industrials, energy, and utilities as companies restructure around core operations.

Consumer & Retail

- **Cautious:** Concern over discretionary demand and margin pressure weighed on the consumer & retail sectors in 1H 2026. Both equity investors and lenders proceeded cautiously with structures leaning toward heavier covenants and lower leverage.

Business Services

- **Favored:** Non-cyclical, sponsor-backed services companies with recurring or contracted revenue remained a defensive favorite with lenders. Equity investors continue to pursue roll-up platforms in HVAC, roofing, landscaping and other highly fragmented service markets.

Infrastructure, Energy & Digital

- **Growth engine:** As reported heavily, AI-driven data center expansion is accelerating financing demand across power, transport, and digital networks. Transportation & logistics is the fastest-growing lending vertical (~13.5% CAGR). Private capital is increasingly the funding source of choice for energy transition and grid investment

Financial Services / Wealth Management

- **Consolidation:** RIA and wealth platform consolidation continues to attract minority equity and structured capital. Family offices, PE, and private credit are all competing to back acquisition platforms, often via combined equity/debt facilities.

Sources: McKinsey Global Private Markets Report 2026; Morgan Stanley IM Private Credit 2026 Outlook; Lord Abbett 2026 Midyear Outlook; With Intelligence Private Credit Outlook 2026; Wellington Private Credit Outlook 2026; PineBridge Direct Lending Outlook 2026; McDermott Will & Schulte Private Markets Update 2026; PGIM Private Capital (minority recapitalization series); Aligned IQ Guide to PE Recapitalization 2026; PwC Private Credit Survey 2026 and US Deals 2026 Midyear Outlook; VRC Q2 2026 Private Markets Trends; State Street Q2 2026 Credit Research Outlook; GM Insights Private Credit Market Report 2026.

Jon Doehr
612.810.7311
jd@walnutlakepartners.com

Minneapolis, MN
www.walnutlakepartners.com