

The ABCs *of* BDCs

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As investor appetite for income and private credit exposure grows, BDCs remain a powerful tool—but higher-for-longer rates, credit concerns, and shifting portfolio dynamics are making manager selection more critical than ever.

Business development companies (BDCs) have long offered investors an attractive blend of income potential, private market exposure, and access to the engine of the US middle market. Their structure—designed to distribute the majority of taxable income—can make them an attractive option for income-seeking investors across market cycles.

However, earlier in 2025, several cautionary signals began to emerge in the BDC space, with non-accruals ticking higher, payment-in-kind (PIK) income increasing, and tighter lending spreads pressuring net investment income. Looking ahead, some investors are concerned that the higher-for-longer rate environment, rising borrower stress and diminishing credit cushions could trigger a wave of distribution cuts if portfolio performance weakens.

This piece highlights how BDCs are structured, where they differ and what current market conditions could potentially signal about the evolving opportunity set.

Overview of BDCs

BDCs were created by Congress in 1980 as part of an amendment to the Investment Company Act of 1940. The goal was to stimulate economic growth by improving access to capital for small and mid-sized American businesses—

companies often underserved by traditional bank lending. Since their inception, BDCs have evolved into a vital part of the private credit ecosystem and now span three distinct categories (**Exhibit 1**).

Exhibit 1: The Different Types of BDCs

	PUBLICLY TRADED	PERPETUAL-LIFE	PRIVATE PLACEMENT	
Legal Structure	Regulated under the 1940 Act; trades on public exchanges	Regulated under the 1940 Act; offered continuously	Regulated under the 1940 Act; offered as private placement	<ul style="list-style-type: none">• Publicly Traded BDCs – Listed on national stock exchanges, daily pricing and liquidity• Private Placement BDCs – Available to institutional or accredited investors, typically with limited liquidity windows• Perpetual-Life, Non-Traded BDCs – A continuous offering of shares, often structured for retail platforms with quarterly liquidity
Offering Type	Fixed offering; shares trade daily on an exchange post-IPO	Continuous offering at NAV (open to new investors)	Closed-end or limited offering to qualified purchasers	
Liquidity	Daily liquidity through public markets	Quarterly liquidity via repurchase offers (typically up to 5% of NAV)	Limited liquidity; may have longer lock-up periods	
Transparency & Reporting	Extensive public SEC reporting and real-time pricing	Extensive public SEC reporting and real-time pricing	Public SEC reporting	
Investor Eligibility	Open to all investors via brokerage accounts	Often open to accredited or retail investors (via RIAs)	Typically limited to qualified purchasers/institutional	
Pricing	Market price may diverge from NAV	NAV	NAV	
Lifecycle	Permanent capital; no set end date but trades continuously	Evergreen—no fixed maturity	May be term-limited with a planned exit	

Source: Apollo Analysts. For illustrative purposes only.

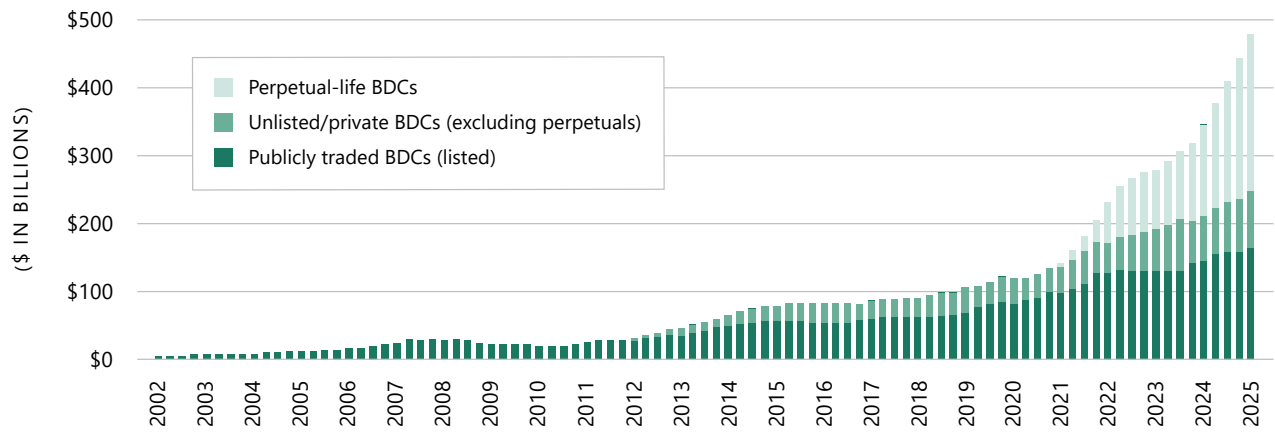
Sizing the Market

Public BDCs are listed on national stock exchanges and trade daily like equities, offering investors more liquidity, but also greater exposure to market volatility. Shares of publicly listed BDCs may trade at meaningful premiums or discounts to net asset value (NAV), reflecting market sentiment rather than the

intrinsic value of the underlying portfolio. The S&P BDC Index includes 43 publicly listed BDCs¹ and as of 1Q25, the total assets under management (AUM) for publicly traded BDCs was \$164 billion (**Exhibit 2**).

Exhibit 2: Demand for Non-Traded BDCs Has Soared

Growth in BDC AUM



Source: BDC Collateral and Wells Fargo Securities.

¹ Source: Standard & Poor's.

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As **Exhibit 2** highlights, since 2020, the BDC market has experienced significant growth, fueled by investors' increasing adoption of non-traded BDCs. As of 1Q25, the total AUM for BDCs is \$475 billion, with non-traded BDCs accounting for \$311 billion of total BDC AUM, or 65%. Perpetual BDCs experienced a 73% year-over-year (YoY) increase in AUM to \$226 billion across 41 funds as of 1Q25. By comparison, non-traded and private BDCs increased 26% YoY to \$85 billion over the same period.²

Non-traded BDCs can offer investors a potentially more stable experience by avoiding the daily price swings of public BDCs. This relative stability has been a key factor behind the significant growth of non-traded BDCs since 2020, as institutional and retail investors alike have increasingly sought out income strategies with less public market volatility.

Lending Segmentation: Where BDCs Invest

BDCs offer financing to companies by raising capital from both institutional and individual investors and then subsequently use it to originate loans. The interest income generated from these loans flows back into the BDC, which must distribute at least 90% of its taxable income to investors to avoid corporate-level taxation at the portfolio level and maintain its tax-efficient status. **Exhibit 3** segments the BDC lending universe by corporate borrower size, with each segment carrying potentially distinct risk/reward characteristics.

Periods of market volatility and economic downturns often put pressure on corporate borrowers. In these environments, loan performance becomes increasingly dependent on the quality and resilience of the underlying borrowers. While BDCs are required to invest at least 70% of their assets in private US companies with market capitalizations under \$250 million—and have historically focused on the middle market—many are now broadening their scope to include larger borrowers as well.

This shift reflects the growing demand for private capital from larger corporations, many of which have turned to private markets for flexible, customized financing solutions. These large-cap borrowers, often generating more than \$1 billion in annual revenue, tend to exhibit characteristics that potentially enhance credit durability during periods of stress: Stable cash flows, diversified earnings, more balance sheet flexibility, and well-established business models. As market uncertainty persists and higher-for-longer interest rates weigh on borrowers across the spectrum, we believe larger companies with scale and established business models are an effective way to complement traditional middle market exposure.

Exhibit 3. The BDC Corporate Borrower Universe

SMALL-CAP

<\$25M EBITDA

Higher yield, higher risk and often the first to show stress in tightening cycles

TRADITIONAL MIDDLE MARKET

\$25M–100M EBITDA

Core target for BDCs

LARGE-CAP

\$100M EBITDA

Stable cash flows, diversified earnings and well-established business models

² Source: BDC Collateral and Wells Fargo Securities.

Evaluating Risk in Today's BDC Landscape

Understanding today's BDC risk environment means looking beneath the surface of income distributions. Below are a few key areas to monitor.

Vintage Risk: Pre-2022 Loans Under Pressure

Many BDC portfolios contain loans originated during the 2018–2021 period, when underwriting standards were looser, spreads were narrower, and base rates were near zero. As refinancing windows narrow and debt costs climb, these older vintages—especially those without covenants or strong lender protections—may face increasing pressure.

Diverging Credit Metrics

Risk is far from uniform across the BDC landscape. Key indicators such as interest coverage and loan-to-value ratios vary widely, and not all BDCs apply the same credit discipline. For example, the following items can vary across BDCs:

- Interest coverage, to assess borrower resilience in the face of higher debt service costs
- Loan-to-value (LTV) ratios, which can provide insight into asset protection levels
- Fund-level leverage, as excessive use can magnify losses during downturns
- First lien vs. second lien exposure, with first lien investments typically offering stronger downside protection

The Rise of PIK Interest

Payment-in-kind (PIK) allows borrowers to defer cash interest payments by adding such payments to the loan's principal. The use of PIK interest in BDC portfolios is currently elevated—a trend that warrants close attention. As of 1Q25, gross PIK as a percentage of net investment income and total investment income averaged close to 14%³ in the BDC market, and is most pronounced in BDCs with more exposure to legacy vintages (2018-2021).

While PIK is not inherently risky in our view, its use should be monitored to ensure that it's not obscuring borrower weakness and compounding credit risk over time. Ultimately, the usage of PIK is a portfolio construction question and it is paramount to confirm that managers appropriately manage portfolio, industry sector and issuer level PIK exposures.

Structural and Incentive Risks

Certain BDCs charge management fees on gross assets rather than net assets, potentially misaligning incentives. Others make use of joint venture leverage, which can obscure portfolio-level risk and limit transparency for end investors.

Distribution Sustainability

While many BDCs emphasize high income distributions, maintaining those payouts could become increasingly difficult for some BDCs. Rising funding costs, higher PIK levels and growing non-accruals all eat into the cash flow available for distributions. This highlights the need to evaluate both income quality and the durability of underlying cash flows.

Conclusion

While BDCs can be an attractive way to potentially boost portfolio income, we believe now is a time to review portfolio holdings and assess the risk factors identified above. While historical returns have been favorable, dispersion in credit metrics is creating significant dispersion among BDCs.

If used thoughtfully, we believe BDCs can replace public fixed income. At the same time, in a market with stretched equity valuation metrics, these vehicles may also be interesting public equity replacements.

³ Source: BDC Quarterly Earnings.

ABOUT THE AUTHOR



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Alexander Wright is Partner, and Global Wealth Strategist. Previously, Alexander was a portfolio manager for Apollo's closed-end funds, CLOs and private BDC. Prior to joining in 2011, he was with GSC Group where he served in a variety of different roles, most recently as Chief Administrative Officer, Chief Financial Officer and Head of US Corporate Debt. Before that, Alexander was with IBJ Whitehall Bank & Trust Corporation and Chemical Banking Corporation.

Alexander graduated from Rutgers College with a BA in Political Science and a minor in Economics and earned his MBA from Fordham University. Alexander serves on the Fordham University President's Council and is Chairman of the Fordham Gabelli School of Business Alternative Investment Council.

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The Standard & Poor's (S&P) BDC Index is a market-cap weighted index that tracks the performance of publicly traded Business Development Companies (BDCs) listed on major US exchanges. It serves as a benchmark for investors interested in this specific asset class, which typically invests in small and medium-sized businesses. Index performance and yield data are shown for illustrative purposes only and have limitations when used for comparison or for other purposes due to, among other matters, volatility, credit or other factors (such as number of investments, recycling or reinvestment of distributions, and types of assets). It may not be possible to directly invest in one or more of these indices and the holdings of any strategy may differ markedly from the holdings of any such index in terms of levels of diversification, types of securities or assets represented and other significant factors. Indices are unmanaged, do not charge any fees or expenses, assume reinvestment of income and do not employ special investment techniques such as leveraging or short selling. No such index is indicative of the future results of any strategy or fund.

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