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The surge of private credit in the Middle East: A new financial era

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Over the past five years, the adoption of private credit by global market participants has seen a meteoric rise. Assets under management (AUM) have more than doubled to over US$2 trillion since 2019,[1,2] with financial powerhouses such as BlackRock and Blackstone forecasting a potential US$30 trillion[3] addressable market in the near future. Private credit is now expanding into the Middle East, with local investors seeking to diversify their returns after decades of wealth derived from hydrocarbons.

Several sovereign wealth funds, including the Public Investment Fund (PIF), Abu Dhabi Investment Authority (ADIA), Abu Dhabi Developmental Holding Company PJSC (ADQ), and Mubadala,[1,2,3,4] have partnered with some of the largest global credit houses to access attractive risk-adjusted returns. As this emerging asset class continues to grow within the Gulf Cooperation Council (GCC), an increase in transactions, regulatory requirements, financial reporting burdens, and investor transparency is anticipated. This article outlines the components of this asset class, its appeal to market participants, and how local markets are accelerating its adoption through regulatory reforms.

Private credit is an umbrella term that refers to lending outside traditional banking channels and public syndicated debt markets. Instead, this capital is provided by non-bank financial institutions, such as private equity firms, private credit funds, and alternative asset managers. Most private credit borrowers are highly leveraged small and medium enterprises (SMEs) considered too risky or too large for regional bank financing, or too small for public bond markets.

This asset class includes a broad range of products, such as floating rate direct lending, real estate loans, collateralized loan obligations, and specialized financings like venture debt, infrastructure debt, consumer asset-backed securities, and last-mile financing. Within the GCC, direct lending and venture debt — the latter being a more flexible financing option for early-stage borrowers that often includes equity incentives — make up the majority of private credit issuances.

The consensus among local market participants is that the potential of this asset class within the region is only just beginning to be realized. Local investors are drawn to the premium it offers over its public counterpart, which primarily compensates for increased illiquidity. This aligns with the "higher-for-longer" mantra that governs central banks' medium-term monetary policy.

Local investors also see significant opportunities to deploy capital within the region, alongside two fundamental issues that regulators are addressing. The United Arab Emirates' 40 free zones and relaxed visa processes are government-led efforts to reduce reliance on oil and are expected to create funding opportunities for private credit providers, with unbanked SMEs in the region projected to be worth approximately US$200 billion by 2030.[4]

Globally, banks allocate around 22% of their loans to SME funding. In contrast, banks in the Middle East and North Africa (MENA) region allocate less than 10% to SMEs, with GCC banks allocating less than 2%.[5] Local credit funds observe that banks remain primarily focused on government-backed contracts, well-known entities, and large family groups, where personal guarantees are easier to secure compared to engaging with smaller businesses. This focus is partly driven by the substantial funding needs of large government infrastructure projects in regions like Saudi Arabia and the UAE, which are reducing liquidity in the banking sector. Consequently, access to capital for ambitious entrepreneurs and growing companies remains a largely unresolved challenge in the region.

From a borrower's perspective, unbanked SMEs benefit from the flexibility, availability, and confidentiality provided by private credit, which often offers more favorable capital terms than traditional financing for early-stage businesses. Private credit frequently serves as an attractive alternative to founders, allowing them to retain greater equity in their businesses while serving as a vital bridge between start-up funding and traditional bank financing.

A significant driver of growth in the Middle East has been the introduction of the Private Credit Fund Rules in 2023. These rules, along with the 2023 bankruptcy laws, the alignment of Dubai International Financial Centre (DIFC) and Abu Dhabi Global Market (ADGM) laws with common law, and the emergence of institutional debt investors under the regulatory framework for enforcement actions, have facilitated the flow of debt financing throughout the region. Combined with the increasing demand for debt financing, these developments have positioned private credit as a key asset class for regional players in 2024 and beyond.

As a result of these developments, global and international players are rapidly entering the market. Chimera's US$2 billion private credit joint venture with Alpha Wave in 2022[6] was followed by the establishment of Lunate, a US$110 billion alternative asset manager reportedly interested in acquiring a minority stake in global private credit leader HPS Partners, according to Bloomberg.[7] Mubadala has formed at least seven partnerships with Apollo, Ares, Blackstone, and Goldman Sachs, committing over US$5 billion to private credit investments both domestically within the UAE and internationally.[8,9,10] Local entities like Rasmalah,[11] Ruya Partners,[12] Shorooq Partners,[13] Jada Fund of the PIF,[14] and Qatar Investment Authority (QIA)[15] have all made significant advances into the asset class, with new entrants emerging each month.

In summary, private credit encompasses a diverse range of debt instruments that are becoming increasingly integral to financing the region's revenue diversification efforts. Growing investor demand is being matched by increasing funding needs in the SME segment, facilitated by structural regulatory changes implemented by the government. Viewed from a broader perspective, this development closely resembles the state of private equity in the Middle East two decades ago. The growing demand for increased transparency, expertise within private debt funds, and specialized advisory services is expected to parallel the growth of private equity, presenting significant growth opportunities for private credit and related services.

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Endnotes

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