Six private credit checks advisers should not skip

Private credit has become one of Australia's fastest-growing investment sectors, offering investors access to income opportunities outside traditional bank lending.

But as the sector expands, it is also attracting greater scrutiny around transparency, asset valuations, liquidity and risk management.

While private credit can provide an important source of funding and support economic growth, not all private credit strategies carry the same risk. The term can cover a wide range of lending activities, from construction finance and first mortgage lending to mezzanine debt, corporate direct lending, consumer finance and other specialist credit strategies.

For advisers and investors, the challenge is understanding what sits underneath the label.

According to Princeton Financial Services, one of the biggest risks for investors is assuming private credit is a single, uniform asset class.

"One of the biggest misconceptions in the market is that all private credit is the same," says Craig Anderson, Princeton Financial Services.

"In reality, private credit spans everything from construction facilities and first mortgages to mezzanine debt, corporate direct lending and consumer finance. Each has different collateral, enforcement mechanisms, liquidity profiles and risk considerations.

"Manager experience is not optional. In construction lending, sponsor selection, active monitoring and workout capability are critical. An inexperienced manager can materially increase loss risk, which is why advisers and investors need to understand not just the return on offer, but the structure, security and experience behind it."

So what should advisers and investors look for when assessing private credit opportunities?

1. **Sponsor quality and experience**

Construction risk is highly sponsor-dependent. Advisers and investors should assess the borrower's track record on similar projects, balance sheet strength, delivery capability and ability to fund cost overruns.

A strong sponsor with relevant experience can materially reduce execution risk, while a weaker or inexperienced sponsor can increase the likelihood of delays, cost pressures or underperformance.

2. **Purpose, duration and exit strategy**

Short-duration construction facilities carry different risks to stabilised, income-producing loans.

Investors should understand the purpose of the facility, expected term, drawdown schedule and repayment pathway. This includes whether the loan is expected to be repaid through a sale, refinance, presales or another clearly defined exit strategy.

3. **Security structure and enforceability**

The word "secured" can mean different things. Investors should look closely at what security sits behind the loan and whether it is first-ranking, properly registered and enforceable. A first-ranking mortgage over real property is very different from a second-ranking position, unsecured corporate exposure or a general charge over a business.

Understanding the security position is critical because it determines what rights the lender has if something goes wrong.

4. **Loan sizing and stressed LVRs**

Loan-to-value ratio, or LVR, is one of the key measures of risk in real estate debt. A conservative LVR can provide a buffer against cost overruns, delays or market value falls. Advisers and investors should look not only at the current LVR, but also how the loan performs under downside scenarios.

Asking for both current and stressed LVRs can help reveal whether the investment has sufficient protection if market conditions change.

5. **Underwriting, monitoring and governance**

Strong private credit management does not stop when a loan is written.

Investors should look for a disciplined credit assessment process, independent valuations, construction monitoring, drawdown controls, covenant triggers and an experienced credit committee.

Ongoing monitoring is particularly important in construction lending, where project conditions can change throughout the life of the facility.

6. **Liquidity, investor terms and transparency**

Investors should understand how and when they can redeem their investment, including notice periods, redemption windows, gating provisions or side-pocketing policies.

Transparency is equally important. Advisers and investors should ask how often the manager reports, what portfolio metrics are shared, and whether stress testing or asset-level information is available.

The more transparent the manager is prepared to be, the easier it is for advisers and investors to understand the risks they are taking.

Private credit can play an important role in diversified portfolios, but it should not be treated as a single, uniform asset class.

For advisers and investors, the key is to look beyond the headline return and understand the underlying borrower, asset, security, duration, governance and manager capability.

In a market where private credit is attracting both interest and scrutiny, the managers that can demonstrate transparency, discipline and clear risk controls are likely to stand apart.