

# Double-Digit Private Credit: Where 15 to 20 Percent Coupons Come From in GCC Real Assets

*A structural decomposition of high coupons in Gulf real-asset lending, and why the headline yield is a payment for identifiable risks rather than a free lunch.*

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## ABSTRACT

International credit investors are increasingly drawn to the Gulf by coupons that, on real-asset transactions, frequently sit in the fifteen-to-twenty per cent range, well above the high-single-digit yields available on comparable developed-market direct lending. This paper asks a deceptively simple question: where does that coupon come from, and is it compensation for risk or evidence of mispricing? Using a stylised, transparent decomposition framework, the paper breaks the all-in coupon on Gulf real-asset credit into five priced components: the risk-free rate, a term and illiquidity premium, a complexity premium, an origination and structuring component, and a credit spread that compensates for expected loss. We argue that the elevated Gulf coupon is overwhelmingly a structural feature of a market that is young, intermediation-light and collateral-rich, rather than a sign that lenders are being paid for risk they do not understand. The headline number is real, but so are the risks it pays for; the investor's task is to verify that the spread compensates for the loss, complexity and illiquidity actually borne. The framework is illustrated with modelled figures across deal types and risk tiers, decomposing gross coupons, translating them into net-of-loss-and-fee returns, and stress-testing the result. The analysis is intended for credit and special-situations funds and for family-office allocators sizing a first or scaling allocation to Gulf private credit. All figures are modelled and illustrative, not forecasts, and are calibrated to publicly observable market structure rather than to any individual transaction.

JEL Classification: G23, G24, G12, G32, O16

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## 1. INTRODUCTION

The first reaction of most international credit investors to the Gulf private-credit market is disbelief. Coupons that would signal acute distress in a developed market, fifteen, eighteen, occasionally twenty per cent, are quoted on transactions secured by completed, income-producing or readily saleable real assets, arranged for established sponsors, in a jurisdiction with a four-decade currency peg to the US dollar and an investment-grade sovereign backdrop. The instinctive response is that something must be wrong: the collateral must be weaker than it looks, the borrower more fragile, the enforcement regime less reliable, or the yield simply unsustainable. That instinct is healthy, and a serious investor should not deploy capital until it is satisfied. But the instinct can also be misleading, because it implicitly assumes that the price of credit is set in the Gulf the way it is set in New York or London, by deep, competitive, intermediation-heavy markets in which any persistent excess return is quickly competed away.

That assumption does not hold, and understanding why it does not hold is the key to understanding the coupon.

This paper sets out to decompose the Gulf real-asset credit coupon into its constituent parts and to ask, of each part, whether it represents compensation for a real and identifiable risk or an unexplained residual that should worry a lender. The exercise matters because the alternative ways of reacting to a high coupon are both costly. An investor who dismisses the yield as implausible foregoes one of the more attractive risk-adjusted opportunities in global private credit. An investor who chases the yield without decomposing it, treating eighteen per cent as eighteen per cent regardless of what sits beneath it, will eventually fund the one transaction in which the coupon was in fact compensation for a loss that duly arrives. The disciplined middle course is to treat the coupon as a sum of priced risks, to estimate each component, and to fund only those transactions in which the total payment comfortably exceeds the total risk borne.

The central proposition of the paper is that the elevated Gulf coupon is, to a first approximation, a structural rather than a credit phenomenon. It arises principally because the market is young and thinly intermediated, because bank balance sheets retreat from precisely the situations, land, pre-completion development, transitional and time-sensitive assets, where sponsors most need capital, and because the resulting supply-demand imbalance allows non-bank lenders to command a scarcity premium on top of a genuine credit spread. The collateral underpinning these loans is frequently strong; what is scarce is not security but speed, flexibility and a counterparty willing to underwrite complexity. The coupon, on this reading, is largely a payment for providing scarce capital into an inefficient market, with a smaller and identifiable portion compensating for expected credit loss.

This is not a claim that Gulf private credit is risk-free or that every double-digit coupon is safe. It is a claim about the composition of the coupon, and the composition has direct implications for how an investor should select, structure and price transactions. If most of the coupon is a structural illiquidity and complexity premium, then the investor is rewarded for building origination capability, underwriting discipline and structuring expertise, and is exposed mainly to the risk that the market matures and the premium compresses. If, by contrast, a large part of the coupon is in truth a credit spread on fragile collateral, then the investor is exposed to loss and the high yield is a warning rather than an opportunity. Distinguishing the two, transaction by transaction, is the analytical heart of investing in this market.

The remainder of the paper is structured as follows. Section 2 reviews the relevant literature on credit risk pricing, illiquidity premia, market segmentation and the economics of private lending, and develops five propositions that the subsequent analysis examines. Section 3 sets out the data and the stylised decomposition methodology, including the base-case assumptions that drive the illustrative figures. Section 4 presents the results: a component-by-component decomposition of the coupon, a comparison across deal types and risk tiers, and a translation of gross coupons into net-of-loss-and-fee returns. Section 5 subjects the conclusions to robustness and scenario analysis. Section 6 discusses implementation, sourcing, structuring, monitoring and portfolio construction. Section 7 concludes with a statement of limitations and directions for further work.

## **2. LITERATURE REVIEW AND PROPOSITIONS**

The analysis draws on four established strands of the finance literature: the theory of credit risk and the decomposition of credit spreads; the literature on liquidity and illiquidity premia; the

literature on market segmentation and limits to arbitrage; and the more recent body of work on the economics of private credit and non-bank lending. Each strand contributes a component to the framework used in Section 3, and together they motivate the propositions set out below.

## **2.1 The Decomposition of Credit Spreads**

The starting point for any analysis of a risky coupon is the recognition that the spread over the risk-free rate is not a single quantity but a sum of compensations. The structural approach to credit risk, originating with Merton (1974) and developed by subsequent authors, models default as the event in which the value of a borrower's assets falls below its obligations, and shows that the credit spread compensates the lender for the expected loss arising from that possibility. Expected loss itself factors into a probability of default and a loss given default, the latter governed by the value and enforceability of collateral. A central empirical finding of this literature, often called the credit spread puzzle, is that observed spreads are typically far larger than can be justified by expected default loss alone; the residual compensates for risk premia, illiquidity and other frictions. For the present paper this finding is foundational: it implies that even in efficient markets, the coupon is mostly not expected loss, and that in inefficient markets the non-loss component can dominate.

Elton and co-authors (2001) decompose corporate spreads and attribute a substantial portion to factors unrelated to default, including tax and systematic risk premia. The implication carried into this paper is methodological: to understand a coupon, one must decompose it, and the decomposition will typically reveal that the credit-loss component is smaller than the headline spread suggests. The Gulf real-asset coupon is an extreme case of a general phenomenon.

## **2.2 Liquidity and the Illiquidity Premium**

A second strand concerns the premium investors demand for holding assets that cannot be sold quickly or cheaply. Amihud and Mendelson (1986) established that expected returns rise with illiquidity, so that less liquid assets must offer higher yields to clear. Private credit is, by construction, highly illiquid: loans are bilaterally negotiated, rarely traded, and typically held to maturity. The lender therefore demands compensation not only for the possibility of loss but for the certainty of being locked in. In a young market such as the Gulf, where no secondary market for these loans exists, the illiquidity premium is correspondingly large. This premium is genuine economic compensation, but it is compensation for a risk, the inability to exit, that a long-horizon investor with stable funding is unusually well placed to bear. The illiquidity premium is thus a recurring theme: it is real, it is large in the Gulf, and it accrues disproportionately to patient capital.

## **2.3 Market Segmentation and Limits to Arbitrage**

A third strand explains why a premium can persist rather than being competed away. The literature on market segmentation and limits to arbitrage, associated with Shleifer and Vishny (1997) among others, shows that excess returns survive when capital cannot flow freely to the opportunity. Frictions, information costs, regulatory constraints, the specialised capability required to underwrite a given asset, and the simple absence of intermediaries, keep capital out and returns high. The Gulf private-credit market is segmented along precisely these lines. International capital faces information and access frictions; local banks face regulatory and balance-sheet constraints that steer them away from development and transitional risk; and the underwriting of complex, collateral-heavy local transactions requires capability that few possess.

The premium persists because the market is young and the suppliers of the right kind of capital are few, not because the opportunity is hidden.

## 2.4 The Economics of Private Credit and Non-Bank Lending

The fourth strand is the growing literature on private credit as an asset class and on the migration of lending from banks to non-bank institutions. This work documents how post-crisis bank regulation, by raising the capital cost of holding certain loans, pushed whole categories of lending, construction, transitional, sub-investment-grade, toward direct-lending funds, which earn a premium for supplying capital that banks can no longer profitably provide. The same dynamic operates in the Gulf, intensified by the conservatism of local banks toward real-estate development and by the speed at which sponsors need to act. The non-bank lender earns an origination and complexity premium for doing work, sourcing, structuring, monitoring, that the banking system has vacated. This is the component of the coupon most directly tied to the lender's own effort and capability.

## 2.5 Synthesis and Propositions

Taken together, these literatures imply that the Gulf real-asset coupon should be understood as the sum of a risk-free rate, an illiquidity premium, a complexity and origination premium arising from market segmentation, and a credit spread compensating for expected loss. They further imply that in a young, segmented, collateral-rich market the non-loss components should dominate, and that the premium should compress as the market matures. These implications motivate the following propositions, which the rest of the paper examines.

*Proposition 1. The all-in coupon on Gulf real-asset credit can be decomposed into a risk-free rate, a term and illiquidity premium, a complexity and origination premium, and a credit spread, and these components are individually identifiable and estimable.*

*Proposition 2. The credit-loss component is a minority of the all-in coupon for well-secured, well-sponsored transactions; the majority is compensation for illiquidity, complexity and the provision of scarce capital.*

*Proposition 3. The coupon rises with deal complexity, structural subordination and time-sensitivity, and falls with collateral quality and sponsor strength, in a manner consistent with priced risk rather than mispricing.*

*Proposition 4. After deducting realistic expected losses, servicing costs and fund-level fees, the net return to a disciplined Gulf real-asset credit investor remains materially above developed-market direct lending at a comparable risk tier.*

*Proposition 5. The premium is structural and will compress as the market deepens and intermediation increases, so that early, capable entrants capture an excess return that later entrants will not.*

## 2.6 How the Propositions Relate

The five propositions form a chain. Proposition 1 asserts that the coupon is decomposable; Proposition 2 asserts that the decomposition assigns most of the coupon to non-loss compensation; Proposition 3 asserts that the way the coupon varies across transactions is consistent with priced risk; Proposition 4 asserts that what remains after losses and fees is still attractive; and Proposition 5 asserts that the opportunity is time-limited. If all five hold, the investment case is clear: the coupon is real, it is mostly compensation for bearing illiquidity and

supplying scarce capability, what remains net of loss is attractive, and the window to capture it is open but finite. If Proposition 2 fails, the coupon is largely a credit spread and the market is simply risky; if Proposition 4 fails, the gross coupon is an illusion dissolved by losses and fees. The empirical and modelling sections are organised to test each link in turn.

## **2.7 The Currency Peg and the Pricing of Gulf Credit**

A feature specific to the Gulf, and easily overlooked in a generic analysis of private credit, is the role of the currency peg in shaping the coupon. Because the dirham and several of its regional peers are pegged to the US dollar, a dollar-based lender into Gulf real assets bears little of the currency risk that ordinarily inflates emerging-market coupons. In most emerging markets a large part of the headline yield is, in substance, compensation for the risk of devaluation; strip that out and the real credit spread is far narrower. In the Gulf the opposite holds: the coupon is high despite the absence of currency risk, which means the premium must be explained by something other than the exchange-rate fear that explains it elsewhere. This is a central piece of evidence for the structural interpretation. The coupon cannot be a currency-risk premium, because the peg has removed the currency risk; it must therefore be an illiquidity, complexity and scarcity premium, exactly as the decomposition proposes.

The peg also changes the character of the lender's residual risk. A dollar-based investor lending into a dollar-pegged market earns a dollar coupon on dollar-equivalent collateral, so the return is not eroded by the currency translation that quietly consumes emerging-market yields. The small FX and hedging cost in the framework reflects only the residual, the cost of managing the remote possibility that the peg is abandoned, rather than the large, continuous drag that characterises unpegged emerging markets. The peg, in short, is what allows a high local coupon to survive translation into a high investor return, and it is part of why the Gulf opportunity is structurally different from superficially comparable high-yield markets elsewhere.

## **2.8 Why the Banking System Vacates the Space**

The complexity and scarcity premia in the coupon exist because banks do not compete for the transactions that earn them, and it is worth being precise about why. Bank lending against real-estate development and transitional assets carries a high regulatory capital charge, because such exposures are volatile and hard to value; the same loan that is unattractive on a bank's risk-weighted balance sheet can be attractive to a non-bank lender that funds itself with patient equity. Banks are also constrained by internal concentration limits, by the speed of their credit processes, and by a cultural conservatism toward construction and land risk that has, in many institutions, hardened after previous property cycles. The combined effect is that a whole category of creditworthy demand, sponsors with good assets and good plans but a need for speed, flexibility or a structure the bank cannot offer, goes unserved by the banking system.

Non-bank lenders step into precisely this gap, and the premium they earn is the price of supplying capital the regulated system cannot profitably provide. This is the same dynamic that built the private-credit industry in the United States and Europe after the global financial crisis, transposed to a market that is earlier in its development and where the retreat of banks from development risk is more pronounced. The implication for the durability of the premium is nuanced: so long as bank regulation and conservatism keep the banking system out of the space, the premium will persist; it will compress not when banks return, which is unlikely, but when enough non-bank capital enters to compete the scarcity component away.

### 3. DATA AND METHODOLOGY

This study is analytical and structural rather than econometric. Its purpose is to make the composition of the Gulf coupon explicit and to show how plausible assumptions about each component combine into the observed headline yields, not to estimate a statistical model on a proprietary loan dataset. The approach is deliberately transparent: every figure can be traced to a stated assumption, and the assumptions are calibrated to publicly observable features of the market, the level of US dollar base rates, the conservatism of local bank lending, the typical structure of real-asset transactions, rather than to any individual deal.

#### 3.1 Data and Inputs

The qualitative inputs, the structure of the Gulf lending market, the categories of transaction, the typical security packages and the behaviour of local banks, are drawn from the established characteristics of the market and from the general literature on private credit and emerging-market finance. The quantitative inputs, base rates, premium ranges, default and recovery assumptions, and fee levels, are set at the centre of plausible ranges and are clearly labelled as illustrative. Where a single figure is used, it should be read as the midpoint of a range, and the robustness analysis in Section 5 varies the key inputs across their plausible spans. No figure in this paper should be interpreted as a forecast of the return on any specific transaction or fund.

#### 3.2 The Coupon-Decomposition Framework

The core of the methodology is an additive decomposition of the all-in coupon. The coupon is expressed as the sum of four components above the risk-free rate: a term and illiquidity premium, compensating for the lock-up and the absence of a secondary market; a complexity and origination premium, compensating the lender for the specialised work of sourcing, underwriting and structuring a transaction the banking system will not; and a credit spread, compensating for expected loss, itself the product of a probability of default and a loss given default. Formally, coupon equals base rate plus illiquidity premium plus complexity premium plus credit spread, where credit spread is approximately the probability of default multiplied by loss given default plus a credit risk premium. The decomposition is stylised, the components are not perfectly separable in practice, but it is analytically useful precisely because it forces each part of the coupon to be named and estimated.

#### 3.3 Translating Gross to Net

A gross coupon is not an investor return. To move from the coupon a borrower pays to the return an investor keeps, the framework deducts four items: expected credit loss, the through-the-cycle average of realised losses; servicing and operating costs, the expense of administering and monitoring a loan book; currency and hedging costs, modest given the dollar peg but not zero; and fund-level fees and carry, the largest single deduction for an investor accessing the market through a fund rather than directly. The net return is what survives all four. A central discipline of the paper is to report net rather than gross figures wherever an investor return is the relevant quantity, because the gap between the two is exactly where naive analyses of high coupons go wrong.

#### 3.4 Deal-Type and Risk-Tier Taxonomy

The analysis distinguishes six broad transaction types, senior development lending, bridge and pre-development finance, mezzanine, bulk-inventory take-out, special situations, and stretch

senior, and three risk tiers defined by loan-to-value and sponsor quality. The taxonomy allows the coupon to be examined as it varies across the two dimensions that economic theory predicts should matter most: the seniority and complexity of the claim, and the quality of the collateral and counterparty. If the coupon varies across these dimensions in the predicted direction, rising with subordination and complexity, falling with collateral and sponsor quality, that is evidence of priced risk; if it varies randomly, that would suggest mispricing.

### 3.5 Base-Case Assumptions

Table 1 sets out the central assumptions used throughout the analysis. They are deliberately conservative on the components that favour the investment case, the credit-loss assumption in particular is set above what well-secured Gulf real-asset lending has typically experienced, so that the net-return conclusions are not artefacts of optimistic inputs. The full parameter set, including the ranges used in the robustness analysis, appears in Appendix A.

Table 1. Base-Case Assumptions for the Coupon Decomposition

| Parameter                              | Base-case assumption                                  |
|----------------------------------------|-------------------------------------------------------|
| US dollar base rate                    | 4.5% (risk-free reference for a dollar-pegged market) |
| Term / illiquidity premium             | 1.5%-3.0% rising with tenor and lock-up               |
| Complexity / origination premium       | 2.0%-5.0% rising with structuring intensity           |
| Credit spread (senior, strong sponsor) | 3.0% (PD ~3%, LGD ~25% plus risk premium)             |
| Probability of default (through cycle) | 3%-8% by tier                                         |
| Loss given default                     | 20%-45% by tier and security                          |
| Servicing & operating cost             | 0.5%-1.0% of assets                                   |
| FX / hedging cost                      | 0.2%-0.4% (dollar peg)                                |
| Fund fee load (mgmt + carry equiv.)    | 2.0%-3.0% return-equivalent                           |
| Representative tenors                  | 6-48 months                                           |

*Indicative, illustrative assumptions used to drive the analysis; not forecasts and not drawn from any single transaction.*

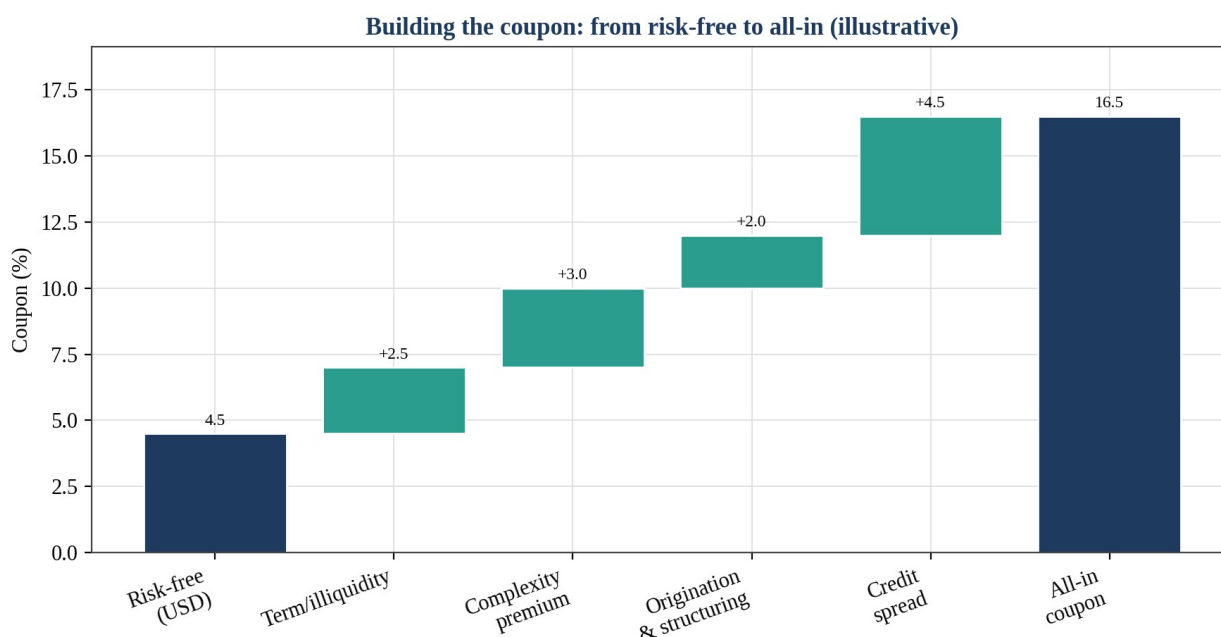
## 4. RESULTS AND DISCUSSION

This section presents the decomposition results in the order of the propositions. It begins by building the coupon component by component, then shows how the coupon varies across deal types and risk tiers, compares the Gulf coupon to developed-market direct lending, and finally translates gross coupons into net-of-loss-and-fee returns.

### 4.1 Building the Coupon

Figure 1 builds a representative senior-plus coupon from the risk-free rate upward. Beginning with a dollar base rate of around four and a half per cent, the framework adds a term and illiquidity premium for the lock-up, a complexity premium for the structuring work, an origination component for sourcing the transaction, and a credit spread for expected loss, arriving at an all-in coupon in the mid-teens. The visual makes the central point of the paper immediately: the credit spread, the part that compensates for the borrower defaulting, is only one of several blocks, and not the largest. The bulk of the coupon is compensation for illiquidity and for the lender's specialised work.

Figure 1. Building the Coupon: From Risk-Free to All-In



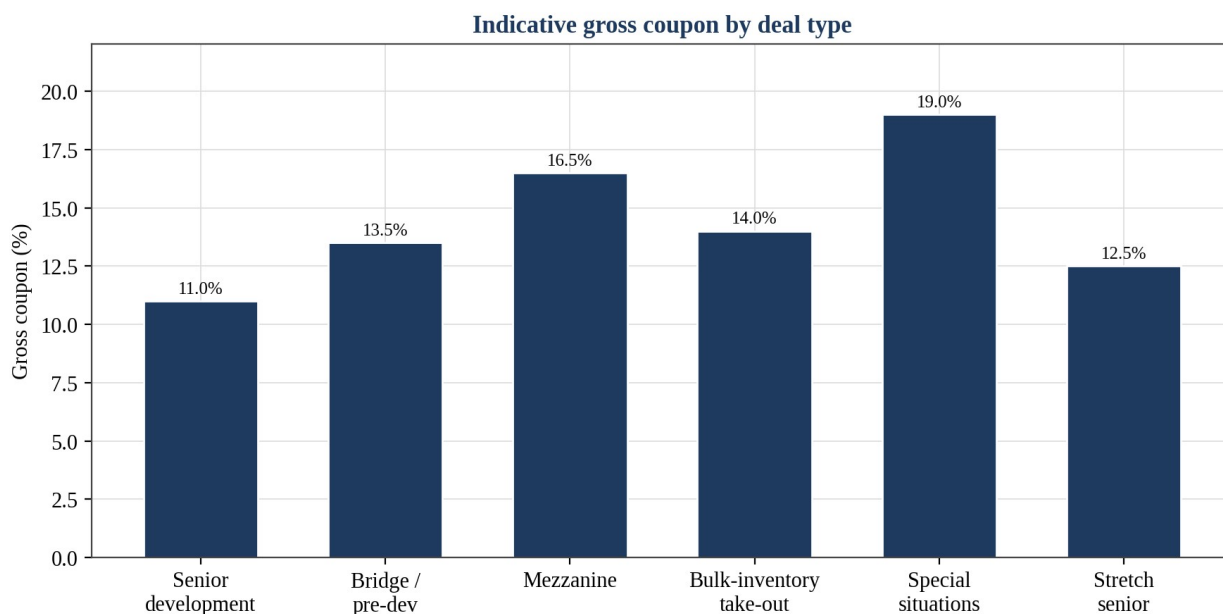
*Illustrative decomposition; the credit-loss block is a minority of the all-in coupon.*

The significance of this decomposition is that it reframes the investor's risk. An investor earning a mid-teens coupon of which perhaps a quarter is credit spread is not, in any meaningful sense, taking mid-teens credit risk. The credit risk borne is the credit-spread block; the rest is compensation for bearing illiquidity and for supplying scarce capability, exposures that are real but quite different in character from default risk and that a patient, capable lender is well placed to absorb. The headline coupon overstates the credit risk by a wide margin, which is precisely why a naive reading of it as implausibly high is wrong.

## 4.2 Coupons by Deal Type

Figure 2 shows indicative gross coupons across the six transaction types. The ordering is informative. Senior development lending, the most secured and least complex, carries the lowest coupon; special situations, where complexity, time-pressure and subordination are greatest, carries the highest. Mezzanine and bulk-inventory take-out sit in between, reflecting their intermediate position in the capital structure and their intermediate complexity. The coupon is not a single number for the market but a function of where in the structure and in the risk spectrum a given transaction sits.

Figure 2. Indicative Gross Coupon by Deal Type



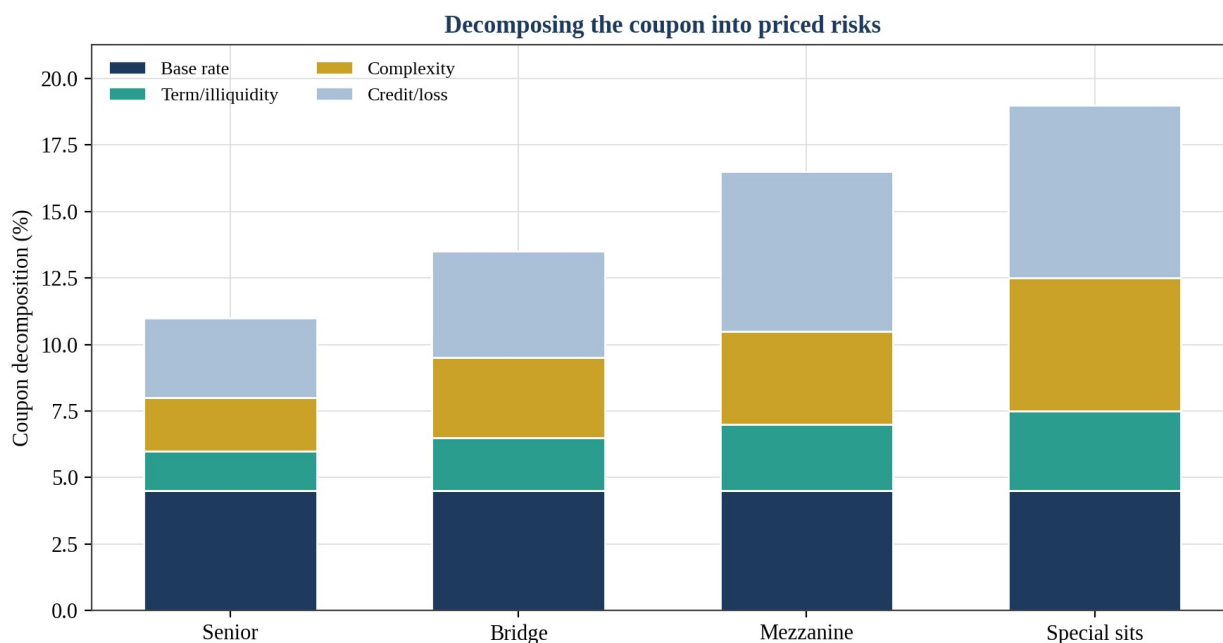
*Coupons rise with subordination, complexity and time-sensitivity, consistent with priced risk.*

That the coupon orders itself so cleanly by complexity and seniority is itself evidence for Proposition 3. If the high coupons were random or were compensation for hidden, uniform risk, one would not expect them to track the economic characteristics of the transactions so closely. The fact that the most subordinated, most complex, most time-sensitive transactions command the highest coupons, and the most senior and straightforward the lowest, is exactly the pattern that priced-risk theory predicts.

### 4.3 Decomposing Across Deal Types

Figure 3 decomposes the coupon for four representative deal types into the four components of the framework. Two features stand out. First, the base rate is common to all, a reminder that part of every coupon is simply the dollar risk-free rate and not a risk premium at all. Second, as one moves from senior to special situations, the complexity and credit blocks grow while the base and illiquidity blocks grow more slowly. The escalation in the coupon is driven by the components that economic theory says should drive it: the difficulty of the transaction and the risk of loss.

Figure 3. Decomposing the Coupon into Priced Risks

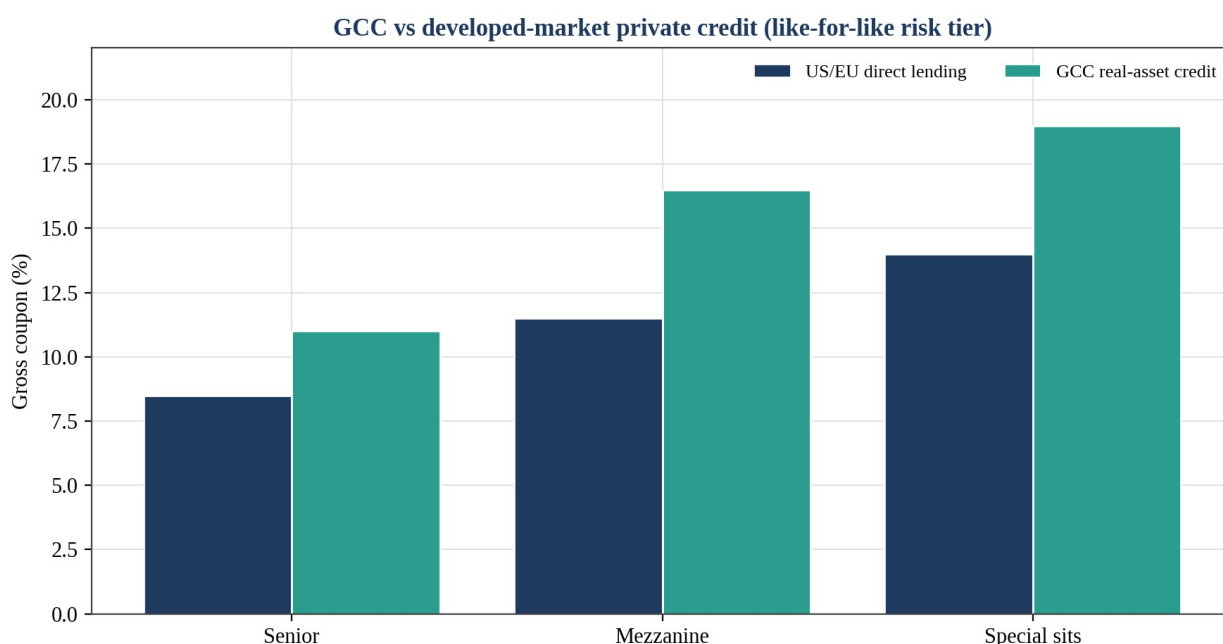


*As subordination rises, the complexity and credit blocks expand; the base rate is common to all.*

#### 4.4 The Gulf Premium Against Developed Markets

Figure 4 compares Gulf real-asset coupons against developed-market direct lending at matched risk tiers. At every tier the Gulf coupon is higher, and the gap is the quantity this paper seeks to explain. The framework attributes the gap principally to the illiquidity and complexity premia: the Gulf market is younger, thinner and less intermediated than the US or European direct-lending markets, so the same risk tier commands a larger premium. The gap is not, on this analysis, evidence that Gulf collateral is weaker; it is evidence that Gulf capital is scarcer relative to the opportunity.

Figure 4. GCC versus Developed-Market Private Credit



*At matched risk tiers the Gulf coupon is higher; the gap is largely an illiquidity and scarcity premium.*

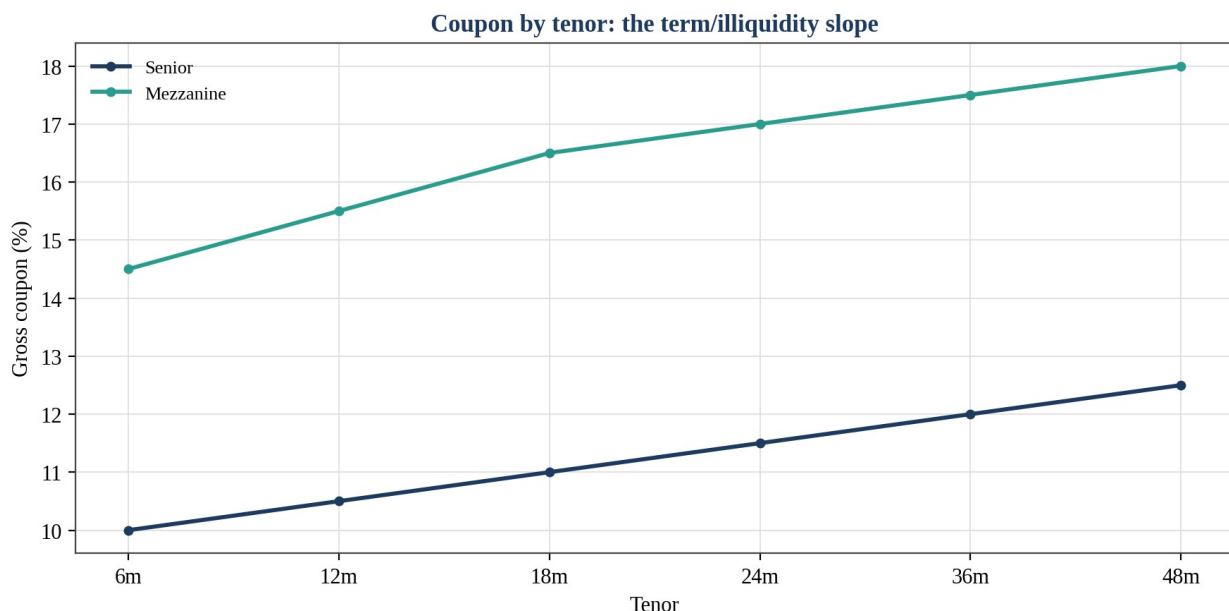
This comparison is where the structural argument earns its keep. In a mature market, competition among lenders compresses the premium for any given risk to its competitive minimum. In the

Gulf, the supply of capable non-bank capital is small relative to the demand from sponsors that banks will not serve, so the premium remains wide. Proposition 5 follows directly: as more capital enters and the market deepens, the gap in Figure 4 should narrow, and the excess return now available to early entrants should compress. The premium is a reward for being early and capable in a market that has not yet matured.

#### 4.5 The Term Structure of the Coupon

Figure 5 shows how the coupon rises with tenor for senior and mezzanine transactions. The upward slope is the term and illiquidity premium made visible: the longer the lender is locked in, the larger the compensation demanded. The slope is steeper for mezzanine than for senior, reflecting the compounding of subordination and illiquidity over time. For an investor, the term structure is a menu: a shorter-tenor book sacrifices some coupon for faster capital recycling and lower lock-up, while a longer-tenor book earns more coupon at the cost of greater illiquidity. Neither is right in the abstract; the choice depends on the investor's funding stability and liquidity needs.

Figure 5. Coupon by Tenor: the Term and Illiquidity Slope

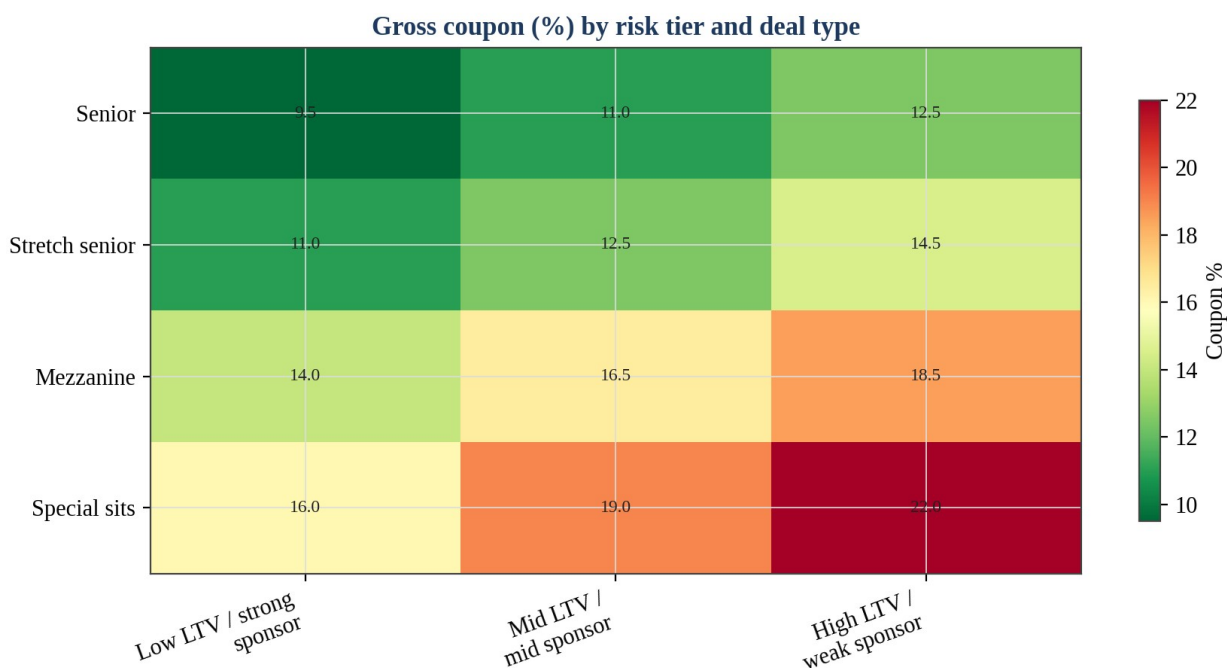


*The coupon rises with tenor; the slope is the illiquidity premium, steeper for subordinated claims.*

#### 4.6 The Coupon Surface: Deal Type by Risk Tier

Figure 6 presents the coupon as a surface over two dimensions: deal type and risk tier. Reading down a column shows how the coupon rises with subordination at a fixed collateral and sponsor quality; reading across a row shows how it rises as collateral and sponsor quality deteriorate at a fixed seniority. The surface is monotonic in both directions, the coupon never falls as risk rises, which is the signature of a market pricing risk coherently rather than randomly. The highest coupons, in the bottom-right corner, attach to the most subordinated claims on the weakest collateral and sponsors; these are the transactions where the headline yield is most likely to be genuine credit compensation rather than illiquidity premium, and where underwriting must be most demanding.

Figure 6. The Coupon Surface: Deal Type by Risk Tier



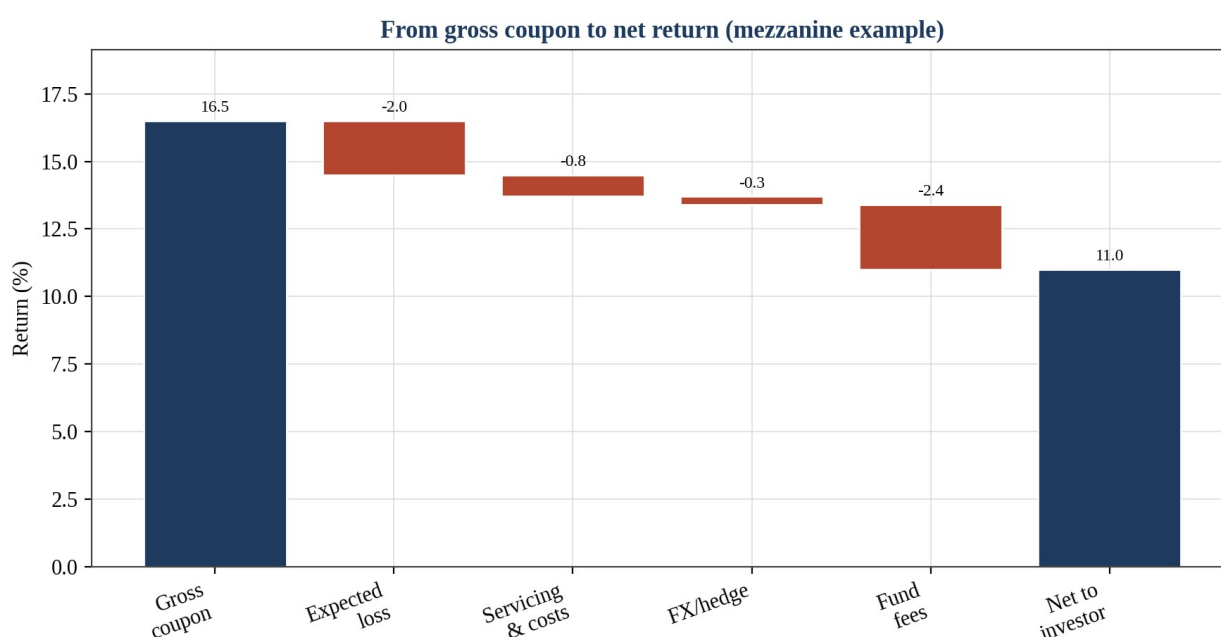
*Coupons rise monotonically with both subordination and collateral/sponsor risk, the signature of coherent pricing.*

The practical lesson of the surface is that an investor chooses a position on it. A conservative lender operates in the upper-left, accepting lower coupons for senior claims on strong collateral; an aggressive lender ventures toward the bottom-right, earning higher coupons for subordinated claims on weaker credits. The surface also warns that two transactions quoting the same coupon can occupy very different positions, one a senior loan on a weak credit, another a mezzanine loan on a strong one, and that the coupon alone does not reveal which. Only decomposition does.

#### 4.7 From Gross Coupon to Net Return

Figure 7 performs the translation that separates serious analysis from naive yield-chasing: it moves from the gross coupon a borrower pays to the net return an investor keeps, using a mezzanine transaction as the example. From a gross coupon in the mid-teens, the framework deducts expected credit loss, servicing and operating costs, currency and hedging costs, and fund-level fees. What remains, the net return to the investor, is several percentage points below the headline, but still firmly in double digits. The largest single deduction is not credit loss but fund fees, a reminder that for investors accessing the market through a fund, the fee structure matters as much as the underwriting.

Figure 7. From Gross Coupon to Net Return (Mezzanine Example)



*The net return is well below the gross coupon but remains double-digit; fees, not losses, are the largest deduction.*

Table 2 generalises this translation across deal types, reporting for each an indicative gross coupon, an expected-loss deduction, a fee deduction and a resulting net return. The table is the quantitative core of the paper's answer to its title question. The coupon is real, the deductions are real, and what survives, the net return, remains attractive relative to developed-market alternatives at every tier. The yield, in other words, is not an illusion; it is a gross figure from which real costs must be subtracted to reach a real and still-attractive net.

Table 2. Gross-to-Net Return by Deal Type (Illustrative)

| Deal type               | Gross coupon | Expected loss | Costs & fees | Net return |
|-------------------------|--------------|---------------|--------------|------------|
| Senior development      | 11.0%        | -0.8%         | -3.0%        | 7.2%       |
| Bridge / pre-dev        | 13.5%        | -1.2%         | -3.2%        | 9.1%       |
| Bulk-inventory take-out | 14.0%        | -1.0%         | -3.1%        | 9.9%       |
| Mezzanine               | 16.5%        | -2.0%         | -3.5%        | 11.0%      |
| Stretch senior          | 12.5%        | -1.1%         | -3.1%        | 8.3%       |
| Special situations      | 19.0%        | -3.5%         | -3.8%        | 11.7%      |

*Illustrative; expected loss is a through-cycle average, costs include servicing, FX and fund fees. Net returns are modelled, not promised.*

## 4.8 Interpreting the Results

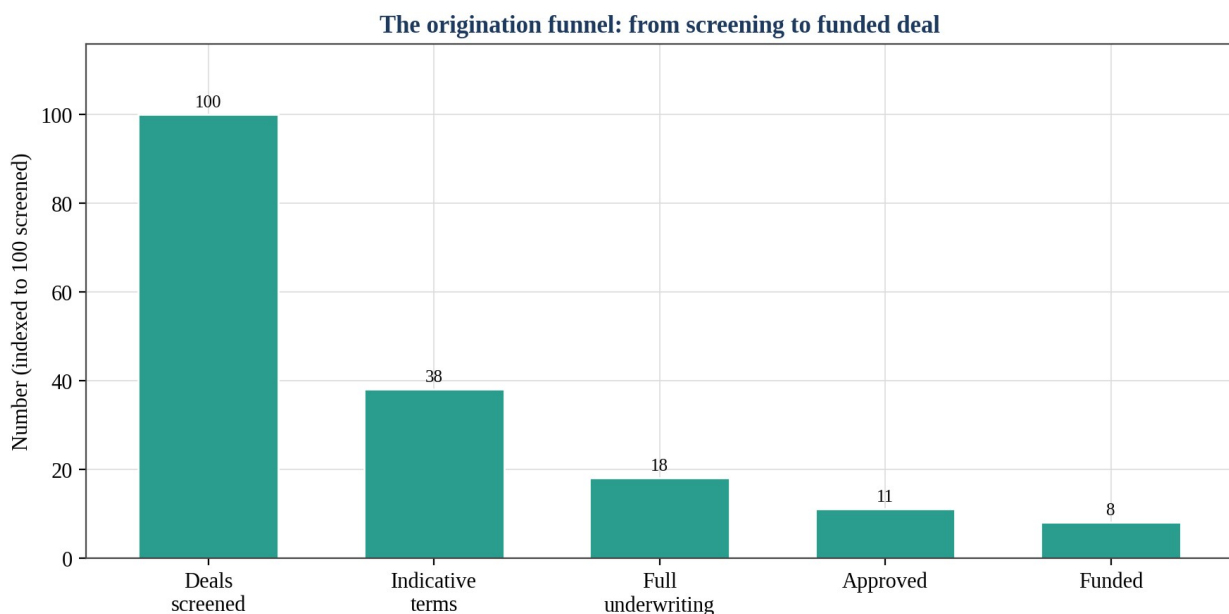
The results support the first four propositions. The coupon decomposes cleanly into identifiable components (Proposition 1); the credit-loss component is a minority of the coupon for well-secured transactions (Proposition 2); the coupon varies across deal types and tiers in the direction priced-risk theory predicts (Proposition 3); and the net return, after realistic losses and fees, remains materially above developed-market direct lending at a comparable tier (Proposition 4). Proposition 5, the prediction that the premium will compress as the market matures, is not

directly testable in a stylised framework but is consistent with the comparison in Figure 4 and with the general history of private-credit markets elsewhere.

#### 4.9 The Origination Funnel and Realised Yield

A coupon earned on a transaction the lender never funds is worth nothing, and a realistic view of the return must account for the origination funnel, the attrition from transactions screened to transactions funded. Figure 9 illustrates a representative funnel. Of every hundred opportunities screened, only a fraction reach indicative terms, fewer still survive full underwriting, and fewer still are approved and funded. The funnel matters for two reasons. First, it means that the capacity to deploy capital at the target coupon depends on the volume and quality of flow at the top of the funnel, which is why origination capability is the binding constraint on the return. Second, it means that the realised yield on deployed capital reflects the discipline of the funnel: a lender that funds a high proportion of what it screens is either exceptionally well-sourced or insufficiently selective, and the latter is far more common than the former.

Figure 8. The Origination Funnel: From Screening to Funded Deal



*Illustrative attrition from screened to funded; selectivity, not deal count, protects realised yield.*

The funnel reframes the relationship between selectivity and return. It is tempting to think that funding more transactions raises the return, because each carries an attractive coupon, but the opposite is usually true. The transactions that survive a disciplined funnel are those whose decomposition shows a coupon comfortably above the risk borne; the transactions rejected are disproportionately those whose coupon, on inspection, was genuine credit compensation for weak collateral. A lender that loosens the funnel to deploy capital faster does not earn more; it simply funds the transactions a disciplined lender declined, and inherits the losses that came with them. Realised yield is protected by selectivity at the top of the funnel, not by deployment volume at the bottom.

#### 4.10 The Investor's Decision Rule

The results can be distilled into a single decision rule that operationalises the paper's argument. For any transaction, estimate the four components of the coupon, then compare the credit-spread component with an independent estimate of the expected loss on that transaction. If the credit spread comfortably exceeds the expected loss, and the investor can bear the illiquidity and

underwrite the complexity that the other components pay for, the transaction is attractive: the lender is being paid for risks it can absorb plus a margin. If the credit spread merely matches or falls short of the expected loss, the coupon is an illusion, the lender is being paid for a loss that will, on average, arrive, and the transaction should be declined however high the headline. The rule reframes the question from is the coupon high enough, which invites yield-chasing, to does the spread exceed the loss, which enforces discipline.

Applying the rule consistently has a portfolio-level consequence: it tilts the book toward transactions where the non-loss components dominate and away from those where the credit spread is doing the heavy lifting. Over time this produces a book whose coupon is high but whose realised losses are low, because the transactions selected are precisely those in which the high coupon was compensation for illiquidity and complexity rather than for credit risk. The rule is simple to state and demanding to apply, because it requires an independent loss estimate for every transaction rather than reliance on the coupon as a summary statistic. That demand is the discipline the rest of the paper has argued for, expressed as a single test.

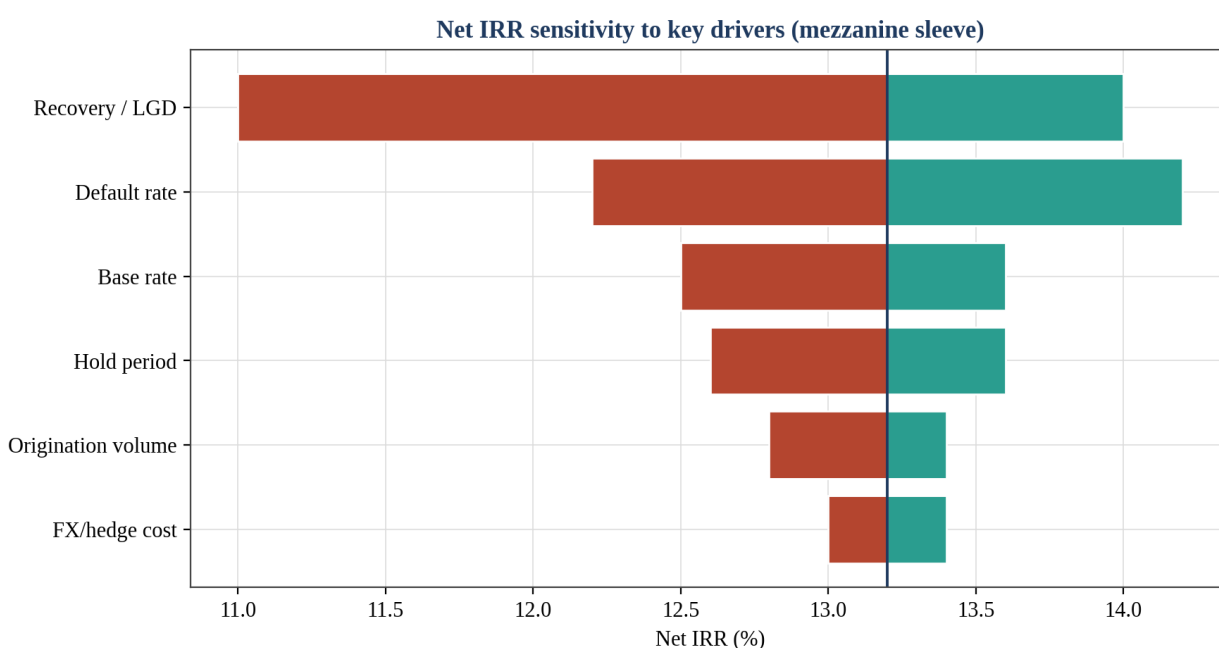
## **5. ROBUSTNESS AND SCENARIO ANALYSIS**

The conclusions of Section 4 rest on assumptions, and their credibility depends on whether they survive plausible variation in those assumptions. This section stresses the key inputs, examines a downside scenario, and considers the conditions under which the investment case would fail.

### **5.1 Sensitivity to Key Drivers**

Figure 8 reports the sensitivity of the net internal rate of return on a mezzanine sleeve to variation in six drivers: the default rate, the recovery rate or loss given default, the base rate, origination volume, the hold period, and currency and hedging costs. Each bar shows the swing in net return as the driver moves across its plausible range with the others held at base case. The default rate and the recovery rate dominate, as expected: the credit-loss component, though a minority of the gross coupon, is the most uncertain part of it, and errors in estimating default and recovery translate most directly into return variation. The base rate matters because it sets the floor under the coupon; origination volume matters because it determines how much capital is actually deployed at the target coupon; the hold period and FX costs matter least.

Figure 9. Net IRR Sensitivity to Key Drivers (Mezzanine Sleeve)



*Each bar shows the net-return swing from varying one driver across its range; default and recovery dominate.*

The tornado carries a clear instruction for the underwriter: spend analytical effort where the sensitivity is greatest. Because default and recovery dominate, the underwriting must concentrate on the probability of loss and, above all, on the value and enforceability of the collateral that determines recovery. A lender who underwrites the collateral conservatively and structures for recovery controls the two drivers that matter most; one who relies on the coupon to compensate for weak collateral is exposed precisely where the model is most sensitive.

## 5.2 The Downside Scenario

The scenario that matters is a simultaneous deterioration in the credit environment: a real-estate downturn that raises defaults, depresses collateral values and lengthens enforcement timelines all at once. In such a scenario the credit-loss block of the coupon, modest in the base case, expands sharply, and for the most subordinated and highest-coupon transactions it can consume the entire spread. Table 3 illustrates the effect on net returns across deal types under a stressed scenario in which default rates roughly double and recoveries fall. The senior, well-secured transactions remain positive because their credit-loss block was small and their collateral cushion large; the most aggressive special-situations transactions can turn negative, because their high coupon was in part genuine credit compensation that the downturn calls in.

Table 3. Net Return Under Base and Stressed Scenarios (Illustrative)

| Deal type               | Base net | Stressed net | Change |
|-------------------------|----------|--------------|--------|
| Senior development      | 7.2%     | 4.8%         | -2.4%  |
| Bridge / pre-dev        | 9.1%     | 5.2%         | -3.9%  |
| Bulk-inventory take-out | 9.9%     | 6.0%         | -3.9%  |
| Mezzanine               | 11.0%    | 4.5%         | -6.5%  |
| Stretch senior          | 8.3%     | 4.4%         | -3.9%  |
| Special situations      | 11.7%    | 1.0%         | -10.7% |

*Illustrative stress: default rates roughly double and recoveries fall. Senior, well-secured positions prove far more resilient.*

The scenario reinforces the central message. The high coupon is not free; in the transactions where it is largest, it is in part compensation for a credit risk that a downturn will realise. The protection against the scenario is not the coupon but the collateral cushion and the seniority of the claim. A book tilted toward senior, well-secured, strongly sponsored transactions sacrifices some coupon in the good times and is rewarded with resilience in the bad; a book that maximises coupon by concentrating in subordinated, weakly secured transactions does the opposite. The decomposition framework tells the investor exactly which kind of book they are building.

### **5.3 When the Case Fails**

It is worth stating plainly the conditions under which the investment case collapses. The case fails if the credit-loss component is systematically larger than assumed, that is, if Gulf real-asset collateral is in truth weaker or less enforceable than the security packages suggest, so that Proposition 2 is false and the coupon is mostly a credit spread. It fails if losses cluster, so that the diversification a portfolio appears to offer is illusory because all the loans are exposed to the same real-estate cycle. And it fails if fees are high enough to consume the net return, so that Proposition 4 is false at the investor level even where it holds at the asset level. Each of these is a real risk, and each is addressable: enforceability by legal and structuring diligence, clustering by deliberate diversification across sponsor, asset type and geography, and fees by negotiating access on terms that leave the investor with the bulk of the spread.

### **5.4 Robustness of the Central Conclusion**

Across the variations considered, the central conclusion, that the Gulf coupon is mostly compensation for illiquidity and complexity rather than for credit loss, and that the net return remains attractive after realistic deductions, survives for senior and well-secured transactions under all but the most severe scenarios. It is more fragile for subordinated, weakly secured transactions, exactly as it should be, because those are the transactions in which the credit-loss component is genuinely large. The framework thus does not claim that all Gulf private credit is safe; it claims that the safety of any given transaction can be read off its decomposition, and that a disciplined investor can construct a book whose net return is both attractive and robust.

### **5.5 Correlation and the Limits of Diversification**

The robustness of a portfolio, as opposed to a single loan, depends on how losses correlate across transactions, and this is where a naive count of loans can mislead. A book of fifty Gulf real-asset loans appears well diversified, but if all fifty are exposed to the same property cycle, the same regional economy and, in some cases, the same small set of large sponsors, the effective number of independent bets is far smaller than fifty. In the base case, idiosyncratic risks, a particular sponsor's difficulty, a particular asset's slow sale, wash out across the book. In the stressed scenario, the systematic factor, a regional property downturn, hits many loans at once, and the diversification that looked ample in good times proves thin in bad. This is the single most important caveat to the portfolio case, and it cannot be diversified away within the asset class.

The practical responses are threefold. First, diversify deliberately across the dimensions that are not perfectly correlated, asset type, sub-region, sponsor and vintage, so that the book is not a single concentrated bet on one corner of the market. Second, size the overall allocation on the assumption that the systematic factor will eventually bind, rather than on the comfortable average of good years. Third, tilt the book toward the senior, well-secured transactions whose collateral

cushion absorbs the systematic shock, accepting a lower coupon in exchange for resilience. None of these eliminates the property-cycle exposure, but together they ensure that the exposure is sized and structured deliberately rather than discovered in a downturn.

## **5.6 Benchmarking the Net Return Against Alternatives**

A final robustness check asks whether the net return, having survived losses and fees, is still attractive relative to the alternatives an investor actually faces. The relevant comparison is not against a risk-free rate but against developed-market direct lending at a similar risk tier, the closest substitute in most allocators portfolios. On the figures developed here, the net return on senior Gulf real-asset credit exceeds that on comparable developed-market senior direct lending by a margin that persists even after the Gulf book is charged a full fee and stressed for higher losses. The margin is widest for the senior, well-secured transactions, precisely because their gross coupon is mostly illiquidity and complexity premium rather than credit spread, so little of it is eroded by the loss stress. For the most subordinated transactions the margin narrows under stress, as it should, because there the gross coupon was in part genuine credit compensation.

The comparison should be made on a like-for-like basis, matching not only the nominal risk tier but the currency and the illiquidity profile. The dollar peg means the Gulf return requires no currency-risk adjustment that a true emerging-market comparison would demand, which strengthens the case relative to unpegged high-yield markets. The illiquidity, by contrast, is real and must be matched: the fair comparison is against equally illiquid developed-market private credit, not against liquid public high yield. Held to that standard, the Gulf net return remains superior at the senior end and competitive at the subordinated end, which is the evidence base for Proposition 4. The investor is not being asked to accept a lower return for the privilege of novelty; the market pays a premium for the illiquidity and capability it requires, and that premium survives a conservative translation into net, stressed, like-for-like terms.

## **6. IMPLEMENTATION CONSIDERATIONS**

Translating the analysis into a live programme requires decisions about sourcing, underwriting, structuring, portfolio construction and access. This section addresses each.

### **6.1 Sourcing and Origination**

Because the premium is in part an origination and complexity premium, it accrues to lenders who can source proprietary transactions rather than compete for intermediated ones. Origination capability, relationships with sponsors, brokers and local advisers, a reputation for closing reliably and quickly, is therefore not a back-office function but the engine of the return. An investor without origination capability of its own must either build it, partner with a local originator, or access the market through a fund whose origination it has diligenced. The worst outcome is to have capital but no proprietary flow, and so to be shown only the transactions that better-connected lenders have declined.

### **6.2 Underwriting Discipline**

The sensitivity analysis instructs the underwriter to concentrate on default probability and, above all, on collateral value and enforceability, the drivers of recovery. In the Gulf context this means valuing collateral conservatively, understanding the saleability of the underlying asset in a downturn, and structuring the security so that the lender can actually realise it. The coupon should be treated as the reward for getting these judgements right, not as a substitute for making

them. A transaction whose coupon is high because its collateral is weak is not an opportunity; it is a credit risk wearing an attractive coupon.

### **6.3 Structuring for Recovery**

Because recovery dominates the downside, structuring matters as much as pricing. The lender should seek the security, controls and covenants that maximise recovery in stress: first-ranking charges where possible, step-in and cure rights, completion guarantees, cash-flow control, and clear enforcement paths. The complexity premium in the coupon is, in part, payment for doing this structuring work well; a lender who collects the premium but neglects the structuring is being paid for work it has not done and is exposed when the work would have mattered. Structuring is examined in greater depth in the companion papers on underwriting and on security and enforcement.

### **6.4 Portfolio Construction and Diversification**

A single Gulf real-asset loan is an undiversified, illiquid, concentrated exposure. A portfolio of such loans, if deliberately diversified across sponsor, asset type, geography within the region and vintage, can offer an attractive return with materially lower idiosyncratic risk. The key word is deliberately: because all real-asset loans share exposure to the property cycle, diversification across that single systematic factor is limited, and the investor must size the overall allocation accordingly rather than assuming that holding many loans removes the risk. Portfolio construction for a Gulf credit book is the subject of a dedicated companion paper.

### **6.5 Accessing the Market**

An investor can access Gulf real-asset credit directly, by lending from its own balance sheet; through a fund managed by a specialist originator; or through a managed account or co-investment alongside such a manager. The direct route captures the full spread but requires origination and underwriting capability the investor may not possess. The fund route supplies that capability but charges for it, and the fee, as Figure 7 showed, is the largest single deduction from the gross coupon. The managed-account and co-investment routes can offer a middle path, access to the manager's origination and underwriting at a lower fee load, for investors large and capable enough to use them. The right choice depends on the investor's scale, capability and fee sensitivity.

### **6.6 Monitoring the Premium**

Because Proposition 5 holds that the premium will compress as the market matures, an investor should monitor the indicators of maturation: the entry of new lenders, the emergence of any secondary market, the willingness of local banks to return to development risk, and the compression of coupons for a given risk tier over time. These indicators tell the investor how much of the structural premium remains and how the opportunity is evolving. The early, capable entrant captures the widest premium; the investor who waits until the opportunity is widely recognised will find much of it gone.

### **6.7 Communicating the Coupon to an Investment Committee**

A final implementation point concerns governance. A committee presented with an eighteen per cent coupon will, rightly, be sceptical. The decomposition framework is the antidote: by showing the committee that the coupon is the sum of a base rate, an illiquidity premium, a complexity premium and a credit spread, and that the credit spread, the part that compensates for loss, is a

minority of the total, the analyst converts an implausible-looking headline into a comprehensible set of priced risks. The committee can then debate each component, what illiquidity the institution can bear, what complexity it can underwrite, what credit loss it can absorb, rather than reacting to the headline. Decomposition is not only an analytical tool but a communication tool, and the quality of the communication often determines whether a sound opportunity is actually funded.

## **6.8 Fee Structures and Net-of-Fee Capture**

Because the largest single deduction from the gross coupon is the fund fee, the structure on which an investor accesses the market is as consequential as the assets it accesses. A standard fund fee load, a management fee on committed or invested capital plus a carry on profits above a hurdle, can convert an attractive gross coupon into a merely adequate net return, particularly for the senior, lower-coupon transactions where the fee is a larger proportion of the spread. The investor's objective is to capture as much of the spread as its capability permits. A large, capable investor may justify the effort of direct or co-investment structures that minimise the fee load; a smaller investor may rationally pay a full fee for access to origination and underwriting it cannot replicate. What no investor should do is pay a full fee without examining what proportion of the gross spread it actually keeps.

The fee discussion also bears on manager selection. A manager that originates proprietary flow, underwrites conservatively and charges a fair fee can deliver a strong net return; a manager that buys intermediated flow, underwrites loosely and charges a full fee delivers a weak one, even if both quote similar gross coupons. The decomposition framework gives the investor the tools to ask the right questions of a manager: what is the gross coupon, what is the expected loss, what is the fee, and what, therefore, is the net return, and how much of the gross spread does the manager keep versus pass through. A manager unwilling or unable to answer these questions in decomposed terms is one to approach with caution.

## **6.9 Building the Capability or Buying It**

The recurring theme of the implementation discussion is that the Gulf coupon rewards capability, origination, underwriting, structuring and monitoring, more than it rewards capital alone. An investor must therefore decide whether to build that capability in-house, buy it through a manager, or rent it through a co-investment or managed-account relationship. Building it is expensive and slow but captures the full spread and creates a durable franchise; it suits large institutions with the scale to amortise the cost and the patience to develop local relationships. Buying it through a fund is fast and turnkey but surrenders a large part of the spread in fees; it suits investors who want exposure without operational commitment. Renting it through co-investment sits in between, offering access to a manager's capability at a lower fee load for investors able to underwrite the individual transactions they are offered.

There is no universally correct choice; there is only a choice consistent with the investor's scale, horizon, fee sensitivity and operational appetite. What the framework provides is the basis for making the choice deliberately. An investor who understands that most of the coupon is a payment for capability can ask, honestly, whether it possesses that capability, can acquire it, or must pay someone who has it; and it can compare the cost of each route against the spread each route captures. The mistake the framework guards against is the unexamined default, deploying capital into the market without deciding how the capability the coupon pays for will actually be

supplied, and then discovering, transaction by transaction, that capital without capability earns the leftovers rather than the premium.

### **6.10 Common Errors in Reading the Coupon**

It is useful to close the implementation discussion by naming the errors the framework is designed to prevent, because each is common and each is costly. The first error is to treat the coupon as a measure of risk, reasoning that an eighteen per cent coupon implies eighteen per cent risk and either rejecting the transaction as too risky or accepting an equivalent return elsewhere. The decomposition shows that the credit risk is the credit-spread block alone, a fraction of the coupon, so the coupon systematically overstates the risk for well-secured transactions and the error leads to good transactions being declined.

The second error is the mirror image: to treat the coupon as a measure of return, reasoning that an eighteen per cent coupon means an eighteen per cent return and chasing the headline without deducting losses, costs and fees. The gross-to-net translation shows that several points separate the coupon from the return, and that the gap is widest exactly where it is most tempting to ignore it. The third error is to treat all transactions quoting the same coupon as equivalent, when the coupon surface shows that the same coupon can attach to a senior claim on a weak credit or a subordinated claim on a strong one, exposures with very different downside. The fourth error is to assume that holding many loans removes the risk, when correlation through the property cycle means the effective diversification is far less than the loan count suggests.

Each error has the same root: using the coupon as a summary statistic in place of the decomposition. The discipline the paper advocates is to refuse that shortcut, to decompose every coupon into its components, to estimate the loss independently, to translate gross into net, and to size the portfolio for the systematic factor that the loan count conceals. None of this is exotic; it is ordinary credit discipline applied to an extraordinary-looking coupon. The coupon looks extraordinary because the market is young and segmented, not because the analysis required to understand it is. An investor who brings ordinary discipline to this extraordinary market is well placed to capture a premium that the market will not offer indefinitely.

## **7. CONCLUDING COMMENTS**

This paper has asked where the fifteen-to-twenty per cent coupons on Gulf real-asset credit come from, and whether they represent compensation for risk or evidence of mispricing. The answer, developed through a transparent decomposition framework, is that the coupon is a sum of priced components, a dollar base rate, a term and illiquidity premium, a complexity and origination premium, and a credit spread, and that for well-secured, well-sponsored transactions the credit-loss component is a minority of the total. The bulk of the coupon is compensation for bearing illiquidity and for supplying scarce, capable capital into a young, segmented, collateral-rich market that the banking system has largely vacated.

The practical implications follow directly. The high coupon is real, not an illusion, but it is a gross figure from which real expected losses, costs and fees must be subtracted to reach a real net return, and that net return, while well below the headline, remains materially above developed-market direct lending at a comparable risk tier. The coupon varies across transactions in the direction priced-risk theory predicts, rising with subordination, complexity and time-sensitivity and falling with collateral and sponsor quality, so that a lender can read the risk of any transaction

off its decomposition. And because the premium is structural, it will compress as the market matures, rewarding early and capable entrants disproportionately.

The argument is properly qualified. The framework is stylised, and the figures are illustrative rather than forecasts; the components of the coupon are not perfectly separable in practice; and the conclusion that the credit-loss component is small holds for well-secured transactions but not for the most subordinated and weakly secured ones, where the coupon is genuine credit compensation and the downside is real. The central contribution is not a number but a discipline: treat the coupon as a sum of priced risks, estimate each, and fund only those transactions where the total payment comfortably exceeds the total risk borne.

The study is subject to limitations that also define its contribution. It relies on stylised assumptions rather than a proprietary loan dataset; a natural extension would calibrate the decomposition to realised loss and recovery data as the market matures and such data accumulate. It treats the property cycle as a single systematic factor; further work could model the correlation structure across Gulf real-asset exposures more explicitly. And it considers the premium at a point in time; tracking its compression as the market deepens would test Proposition 5 directly. Each of these extensions would sharpen the framework without altering its central message.

In sum, the contribution of this paper is to take a feature of the Gulf credit market that is widely observed and often disbelieved, the double-digit coupon, and to render it intelligible by decomposing it into its economic parts. The coupon is neither a mirage nor a free lunch. It is a structured payment for bearing illiquidity, supplying scarce capability and accepting a measured credit risk, and it rewards the investor who can tell those components apart.

## DISCLOSURES

The author is an independent researcher and transaction adviser who advises capital providers and capital seekers on real-asset and private-credit transactions in the Gulf and may have a commercial interest in the matters discussed. This paper is provided for information and education only. It is not investment, legal, tax or accounting advice, and it is not an offer or solicitation in respect of any security, loan or transaction. All figures are modelled and illustrative, calibrated to publicly observable market structure rather than to any individual transaction, and are not forecasts of the return on any investment. Private credit involves the risk of loss, including loss of principal, and past or illustrative performance is not indicative of future results. Readers should obtain independent professional advice before acting.

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APPENDIX A. BASE-CASE ASSUMPTIONS

Table 4. Full Parameter Set for the Coupon Decomposition

| Parameter                             | Base case | Low      | High      |
|---------------------------------------|-----------|----------|-----------|
| US dollar base rate                   | 4.5%      | 3.5%     | 5.5%      |
| Term / illiquidity premium (senior)   | 1.5%      | 1.0%     | 2.5%      |
| Term / illiquidity premium (mezz)     | 2.5%      | 1.5%     | 3.5%      |
| Complexity / origination premium      | 3.0%      | 2.0%     | 5.0%      |
| Probability of default (senior)       | 3.0%      | 1.5%     | 6.0%      |
| Probability of default (mezzanine)    | 6.0%      | 3.0%     | 12.0%     |
| Probability of default (special sits) | 9.0%      | 5.0%     | 18.0%     |
| Loss given default (senior)           | 25%       | 15%      | 40%       |
| Loss given default (mezzanine)        | 40%       | 25%      | 60%       |
| Recovery lag (enforcement)            | 12 months | 6 months | 30 months |
| Servicing & operating cost            | 0.8%      | 0.5%     | 1.2%      |

|                              |           |          |           |
|------------------------------|-----------|----------|-----------|
| <b>FX / hedging cost</b>     | 0.3%      | 0.2%     | 0.5%      |
| <b>Fund management fee</b>   | 1.5%      | 1.0%     | 2.0%      |
| <b>Carry-equivalent drag</b> | 1.5%      | 0.8%     | 2.0%      |
| <b>Representative tenor</b>  | 24 months | 6 months | 48 months |

*Indicative, illustrative parameter set; low and high columns define the ranges used in the robustness analysis. Not forecasts.*

## APPENDIX B. GLOSSARY

The following terms are used in this paper. Definitions are provided for the non-specialist reader and are deliberately plain rather than technical.

**All-in coupon** The total interest rate a borrower pays on a loan, expressed as a single annual percentage, before any deductions to the lender.

**Base rate** The reference interest rate, here the US dollar risk-free rate, on which a coupon is built; the floor beneath the spread.

**Bridge finance** Short-term lending that funds a borrower between two events, such as acquiring land and arranging permanent finance.

**Bulk-inventory take-out** Financing secured against a block of completed but unsold units, releasing capital tied up in inventory.

**Carry** The share of investment profits, typically around twenty per cent, paid to a fund manager above a hurdle; a deduction from investor return.

**Collateral** Assets pledged by a borrower that a lender can seize and sell if the loan is not repaid.

**Complexity premium** The portion of a coupon that compensates a lender for the specialised work of structuring a difficult transaction.

**Coupon** The interest payment on a loan or bond, here used interchangeably with the all-in interest rate.

**Credit spread** The portion of a coupon, above the risk-free rate, that compensates a lender for the risk of default and loss.

**Default** A borrower's failure to meet its obligations, such as missing a payment or breaching a covenant.

**Direct lending** Lending by non-bank institutions, typically funds, directly to borrowers, without a bank intermediary.

**Expected loss** The average loss a lender anticipates over time, equal to the probability of default multiplied by the loss given default.

**Illiquidity premium** The extra return demanded for holding an asset that cannot be sold quickly or cheaply.

**Internal rate of return (IRR)** The annualised return that makes the present value of an investment's cash flows equal to its cost.

**Loan-to-value (LTV)** The ratio of a loan to the value of the collateral securing it; lower ratios mean more protection for the lender.

**Loss given default (LGD)** The fraction of an exposure a lender actually loses when a borrower defaults, after recoveries.

**Mezzanine** Financing that ranks below senior debt but above equity, earning a higher coupon for its subordinated position.

**Net return** The return an investor keeps after deducting expected losses, costs and fees from the gross coupon.

**Origination** The work of sourcing, evaluating and arranging a loan; in this market a key source of the lender's premium.

**Private credit** Lending arranged privately, outside public bond markets, typically illiquid and held to maturity.

**Probability of default (PD)** The likelihood, over a given period, that a borrower will default.

**Recovery rate** The fraction of an exposure a lender recovers after a default; one minus the loss given default.

**Risk-free rate** The return on an asset considered free of default risk, here the US dollar reference rate.

**Seniority** The rank of a claim in the capital structure; senior claims are repaid before subordinated ones.

**Special situations** Complex, often time-sensitive transactions, such as distressed or transitional assets, commanding the highest coupons.

**Stretch senior** A senior loan extended to a higher loan-to-value than a conventional senior lender would accept, at a higher coupon.

**Term premium** The extra coupon demanded for lending over a longer period; here closely linked to the illiquidity premium.

**Through-the-cycle** An average taken over a full economic cycle, including both good and bad years, rather than at a single point.