Sycamore Tree
Capital Partners

Financing the AI Buildout

AI Capex, the Credit Markets, and the Coming Dislocation

The financing of AI infrastructure has migrated from hyperscaler balance sheets into external credit markets at a scale and pace with few precedents. To date, the focus has been largely an equity debate: whether the return justifies the capital. The more consequential issue for credit investors is less examined: **the composition of financing has changed, and the risk increasingly sits where it is less visible, less liquid and less able to reprice. When the cycle turns, repricing will surface first in traded credit, and second in the private secondary market. We believe this sequence will create opportunity.**

Trey Parker, Chief Investment Officer & Co-Founder

AUGUST 2026

EXECUTIVE SUMMARY

1 **The buildout is increasingly credit-financed,** and the pace of that migration deserves as much attention as its size. Morgan Stanley estimates roughly $2.9 trillion of global data center capex through 2028, of which hyperscaler cash flows cover about $1.4 trillion, leaving a financing gap of roughly $1.5 trillion. AI-related fixed income issuance in the first five months of 2026 exceeded all of 2025.

2 **Reported leverage understates the true credit exposure.** Lease commitments across the largest technology companies now approach $932 billion, most of it outside the reported debt line. Leases are only one off-balance-sheet category, alongside contingent project-finance guarantees and, increasingly, multi-year purchase commitments that behave like debt.

3 **Credit enhancement has changed where development risk resides, rather than remove it.** Almost none of this financing is speculative development lending in the traditional sense; nearly all is pre-leased and guaranteed. But the protections are conditional in scope, finite in tenor, concentrated in a handful of counterparties, and, at the frontier, circular. The underlying development risk remains in the credit system in a way that is not transparent.

4 **From the closest historical precedent, we might anticipate the next credit cycle.** The telecom buildout of 1996–2002 was also a debt-financed infrastructure cycle where the demand thesis proved ultimately correct. **The lenders were impaired regardless, because monetization arrived later than the debt matured.** The assets were ultimately repriced, not abandoned, and the repricing was the opportunity.

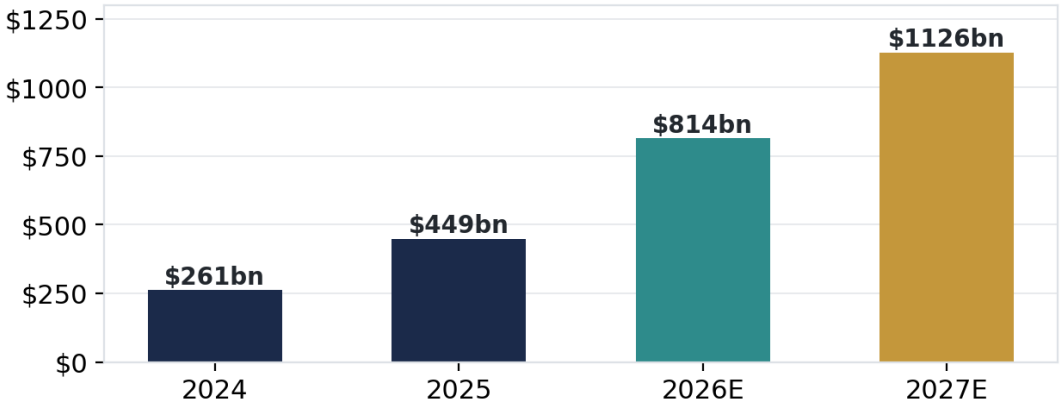
5 **Market structure will determine the sequence of adjustment.** The repricing is likely to arrive in three phases. First, even before any stress, the sheer weight of new supply has already begun to reprice the primary market, offering entry to new issue at wider spreads. Second, when conditions turn, the adjustment will surface in traded credit (loans, high yield, and ABS), the credit venue where stress can clear continuously. Third, private credit's illiquidity will defer rather than diffuse that adjustment, routing the pressure into the secondary market at a discount through both liquidity and spread. For investors, we suspect that the opportunity will present itself in the same sequence: capture primary repricing with new-issue credit selectivity, navigate a traded credit repricing with tactical liquidity and loan-level selectivity, and provide liquidity to a private credit repricing with dedicated secondary capital.

I. FINANCING OF THE BUILDOUT

> Roughly $1.5 trillion of the AI buildout is expected to be financed externally, and the credit markets have embraced it faster than any asset class in recent history.

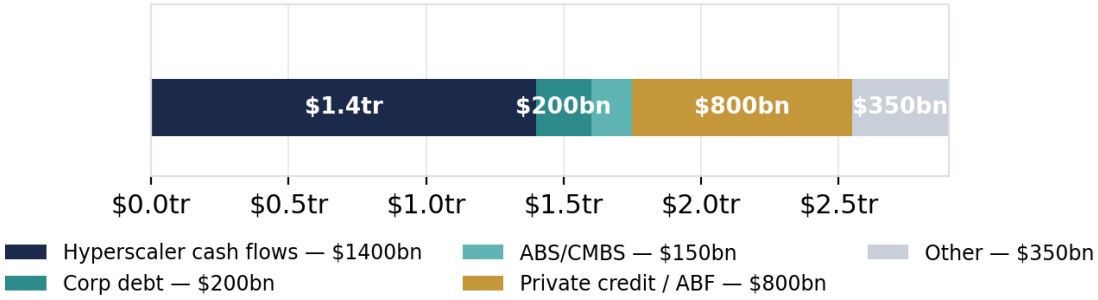
The scale is visible in the exhibits below: capex at the five largest spenders is on track to roughly quadruple between 2024 and 2027, and hyperscaler cash flows cover only about half of the global data center spend through 2028. The rest is external capital, with incremental power investment adding an additional $300 billion or more.

Exhibit 1 · Hyperscaler capital expenditure, 2024–2027E
Combined capital expenditure, five largest spenders ($bn)



Source: Company data, Morgan Stanley Research estimates (May 2026).

Exhibit 2 · Estimated financing sources for global data center capex, 2025–2028
Morgan Stanley Research estimates ($bn)



Source: Morgan Stanley Research (Jul 2025). Private credit components are led by asset-based finance.

More important for credit investors than the size is the pace. AI-related gross issuance approached $250 billion in the first five months of 2026, more than all of 2025, and full-year US supply is forecast near $500 billion across investment grade, leveraged finance, and securitized markets. The high yield market went from essentially no AI-related supply to a functioning project-finance channel within a year. Even the equity market has begun to acknowledge the limits of internal funding: Alphabet's decision to raise up to $80 billion of equity in mid-2026, after $55 billion of debt in the preceding months, suggests the buildout has outgrown self-financing.

Pace matters because financial structures are meant to mature alongside an asset class. Covenant conventions, recovery precedents, secondary depth, and a seasoned investor base develop over cycles. When half a trillion dollars of annual supply arrives before that scaffolding exists, investors are underwriting structures whose behavior under stress is unobserved. That is not an argument that stress is imminent; it is an argument that the market's capacity to absorb it is untested. For context,

it took roughly 25 years to build the ~$1.5tr bank loan asset class and ~15 years to build the ~$2tr direct lending market. AI-related financing markets are emerging virtually overnight.

Morgan Stanley's assessment is that fundamentals, while strong, are no longer the primary driver of price action in this market. Supply expectations and the pace of issuance are. We would draw the conclusion more explicitly than the sell-side tends to: when technicals dominate fundamentals, liquidity and positioning determine outcomes. This is the direct continuation of the argument we made in our prior whitepaper *Why Liquidity Matters Again*, and it frames what follows. The structural asymmetry is worth stating at the outset: the public equity value of this buildout is marked daily and can be exited continuously, while a growing share of the debt is neither marked nor readily exitable. The two parts of the same balance sheet will register stress at very different speeds and outcomes

II. WHERE THE LEVERAGE RESIDES

> Borrowers look pristine on reported leverage. The real obligations are migrating off the balance sheet into leases, guarantees, and purchase commitments, and onto the same five or six names.

By conventional measures, the core borrowers here are among the strongest credits in the world. The investment grade technology sector carries roughly 0.8x net leverage against 1.8x for non-financial investment grade broadly, holds cash equal to more than half its debt, and averages an A2/A3 rating. Morgan Stanley estimates the largest hyperscalers could add more than $500 billion of incremental debt without triggering a single-notch downgrade. Three developments, however, complicate that picture.

LEVERAGE IS MOVING OFF THE REPORTED BALANCE SHEET

Lease obligations — the mechanism through which hyperscalers rent capacity from developers instead of building it themselves -- have reached approximately $675 billion of operating leases, $175 billion of finance leases, and a further $82 billion of committed leases not yet commenced. Microsoft's lease liabilities have more than doubled since 2022. Rating agencies capture these obligations in adjusted debt, so the gap between reported leverage and the leverage the agencies recognize widens each quarter. Capitalizing the operating and committed leases adds roughly 0.8–1.2x of EBITDA, taking sector net leverage from a reported 0.8x to a lease-adjusted 1.8–2.0x. On a fully-loaded basis that also draws the incremental debt capacity these balance sheets are said to carry, pro-forma leverage could approach 2.5–3.0x, more like a capital-intensive industrial issuer.

A third category compounds the same hidden financial obligation dynamic. Beyond leases and guarantees, hyperscalers are now committing to large multi-year purchase obligations that are increasingly disclosed but rarely read as debt. Alphabet reported approximately $707 billion of purchase commitments, up more than $450 billion quarter-over-quarter, with the "significant majority" tied to long-term supply agreements. A growing share are memory contracts: Micron's recently announced strategic customer agreements run five years through 2030, lock in roughly a fifth of its DRAM and a third of its NAND volume, and, through price floors, guarantee the supplier gross margins well above any prior cyclical peak, with SK Hynix and Samsung reported to be negotiating similar terms. These are, in substance, fixed- and floating-rate obligations tied to DRAM pricing, maturing inside the same five-to-seven-year window as the notes financing the buildout. Their effect is to commit the hyperscaler cash flows that implicitly underpin the entire credit stack to the most cyclical industry in the economy, absorbing memory-cycle risk onto the balance sheets that back everything else. The reported debt line captures none of it.

THE UPSIDE AND THE RISK SIT WITH DIFFERENT INVESTORS

If generative AI monetizes as its proponents expect, the benefit accrues to shareholders. Credit investors hold capped-upside instruments and bear the refinancing, ratings-migration, and supply-absorption risk in full. Financing a technology transition through instruments that cannot participate in its success is reasonable only if the excess spread compensates for the asymmetry. At current levels, in our opinion, it does not.

> The early evidence suggests credit markets have begun to register the asymmetry. Buyside research notes that hyperscaler capex now consumes roughly 80% of operating cash flow, without precedent for companies of this quality, and that forward free cash flow estimates are being revised down ahead of consensus, and that hyperscaler credit spreads (expressed synthetically via credit default swaps ("CDS")) have begun to trade apart from the investment grade index. The repricing, to the extent it has started, has started in credit.

CONCENTRATION IS APPROACHING STRUCTURAL LIMITS

Oracle is now the largest non-financial issuer in the US investment grade index, and hyperscaler-linked paper is arriving simultaneously through unsecured bonds, secured project deals, ABS and leveraged loans. Portfolio managers report approaching single-name and sector limits across several channels at once. This matters for pricing: concentration limits convert incremental supply directly into spread pressure irrespective of fundamentals, because the marginal buyer is already at capacity.

III. DEVELOPMENT RISK AND THE LIMITS OF CREDIT ENHANCEMENT

> Credit enhancement has not removed the development risk in these deals – it has relocated it. The protections are conditional, finite, concentrated, and at the frontier, circular; the risk remains in the system, just harder to see.

Set aside the AI vocabulary and the transaction is familiar: a capital-intensive build against projected demand, with uncertain unit economics, executed quickly. In every prior form (speculative commercial real estate, merchant power, first-wave shale, telecom), this has been difficult for credit to finance well. The difficulty is structural. A lender to a development-stage asset collects a coupon if everything goes right; that is the whole of the upside. Against it, the lender bears construction, lease-up, technology, and refinancing risk, hedged only by recovery. In equity-funded development, the investor bearing the risk owns the outcome that justifies it. In credit-funded development, the two are separated, which places substantial weight on the recovery assumption, here for assets with no credit-cycle precedent.

THE MARKET'S ANSWER: CREDIT ENHANCEMENT

A sophisticated investor will object that almost none of the current financing is speculative development lending, and the objection is correct. Data center ABS carries no construction risk and is already cash-flowing, priced off its investment grade tenancy. The high yield project deals often carry construction risk, but they are pre-leased on ten- to fifteen-year terms against roughly five-year notes, largely amortizing, and supported by hyperscaler lease and construction guarantees, plus a place in the capital structure that is defensive compared to an equity play, whether or not it is secured by hard assets. Even the earliest-stage structures in private credit and asset-based finance are substantially pre-leased. The market has not financed speculative data centers; it has financed pre-leased, guaranteed development, on the basis that enhancement converts development risk into tenant credit risk.

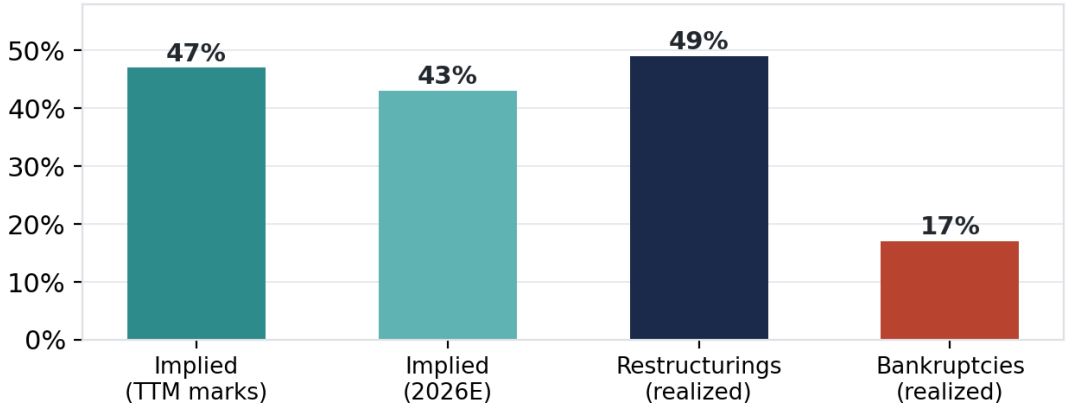
Enhancement changes the location and timing of the risk rather than removing it. Four characteristics of these structures, each visible in the deal documentation, show how. Enhancement is **conditional**: a construction guarantee covers completion, not demand, and several structures grant tenants lease-out or rent-credit options if construction slips beyond roughly 180 days. Those options go unexercised in a supply-constrained market but would be exercised in a softer one, at precisely the moment the structures could least absorb it. It is **finite in tenor**: the guarantee supports the lease, the lease supports the note, and nothing supports the refinancing. A tenant can perform for the full life of a non-amortizing bond, decline to renew, and leave the refinancing exposed to long-run demand for that facility's capacity. It is **concentrated**: five or six companies stand behind most of the guarantees, leases, and backstops across every channel simultaneously, and the scenario in which those commitments are tested is the same one in which those companies would be reducing them, which converts asset-level risk largely into single-name concentration risk. And at the frontier it is **circular**: the support behind a neocloud borrower

is often a contract from a model laboratory that is not itself investment grade, or a BBB-rated intermediary carrying rapidly compounding lease obligations of its own, funded in part by vendor support from the chipmaker whose hardware the borrower is buying. This is vendor-financed demand standing behind vendor-financed supply, a configuration with a specific and disappointing history we discuss in Section 5.

WHAT RECOVERY DATA ACTUALLY SHOWS

The adjacent private credit market offers a useful check on how much weight recovery assumptions can bear. KBRA DLD reports a trailing twelve-month implied recovery of 47% for direct lending. But these figures derive from BDC fair-value marks around the default event, not realized workout outcomes; they are the lenders' own estimates. Where the data isolates something closer to realized experience, the picture is weaker: direct lending bankruptcies have recovered roughly 17%, against 49% for consensual restructurings, and the forecast implied recovery for 2026 declines to 43% as marks deteriorate. If this is the recovery reality in mature, cash-flowing corporate lending, the assumptions embedded in development-stage data center structures, which have no workout precedent at all, warrant caution.

Exhibit 3 · Direct lending recovery rates: implied vs. realized
Percent



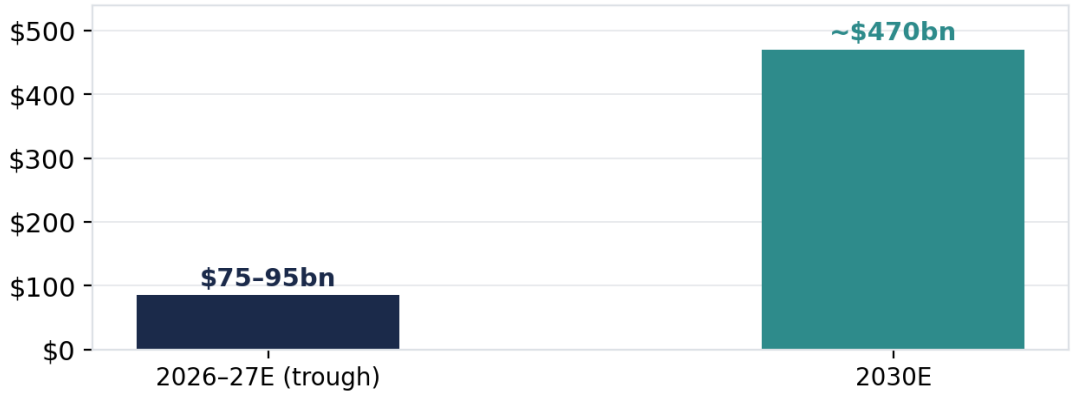
Source: KBRA DLD Direct Lending Default Research (Apr 2026). Implied figures derive from BDC fair-value marks; bankruptcy and restructuring figures approximate realized outcomes.

There is also a structural reason to expect data center recoveries at the weaker end of that range: **the collateral has limited alternative use**. Most prior credit-funded development produced assets that could be repurposed under stress: an office becomes residential, a warehouse finds another tenant. A purpose-built data center is a powered shell filled with tenant-specific fit-out configured to a single operator's specification. If the anchor tenant does not renew, we believe the improvements that account for most of the construction cost have materially less value to anyone else. The land and interconnection retain value; the capital that went in on top of them may not.

Obsolescence compounds the problem. A powered shell may serve for twenty years; the chips inside it have an economic life closer to four to eight, and each hardware generation resets the cost curve. A non-amortizing structure secured by a data center lease therefore exposes the investor not to the tenant's credit but to long-run demand for that facility's compute at the point of refinancing. In substance this is a technology forecast that debt investors are not compensated to make and, in these structures, are making regardless. The asset is at once rapidly obsolescing and difficult to redeploy, leaving little between a tenant's departure and a distressed recovery.

The underwriting case ultimately rests on the consensus free cash flow trajectory shown below: hyperscaler FCF compresses hard in the 2026–27 trough as capex peaks, then recovers only late in the decade. The financing is being committed now, in the trough years, against cash flows that are back-loaded and forecast-dependent.

Exhibit 4 · Consensus hyperscaler free cash flow estimates
Largest hyperscalers, consensus estimates ($bn)



Source: Consensus estimates per Apollo Global Management (Jul 2026).

The pricing assumptions beneath that trajectory are also being tested: Chinese open-weight models rose from roughly 5 of the 50 most-used models in January 2025 to about 20 by May 2026. Two caveats sharpen the point: OpenRouter traffic skews toward price-sensitive developer usage and overstates the Chinese share, and token volume is not revenue. The right interpretation is not that US laboratories have lost material market-share, but that incremental AI capacity is getting commoditized at the margin. The debt has been sized against a consensus FCF recovery that margin compression directly threatens.

Setting the enhancement aside, the standalone borrowers here (neoclouds, miners converting to hosting, developer joint ventures) are sub-investment-grade, development-stage credits, and the least-enhanced exposure sits in private credit and asset-based finance. If the enhancement web is tested (renewals declined, delay options exercised, guarantees called), this cohort is the most likely source of forced selling. It is also, for investors with capital and liquidity at that point, the most likely source of opportunity.

IV. SECOND-ORDER EXPOSURES: ENABLERS AND INCUMBENTS

> While data center debt may be limited in traded credit markets, the buildout is reshaping credits already sitting in loan and bond portfolios – the enablers levering up to supply it, and the software incumbent it disrupts.

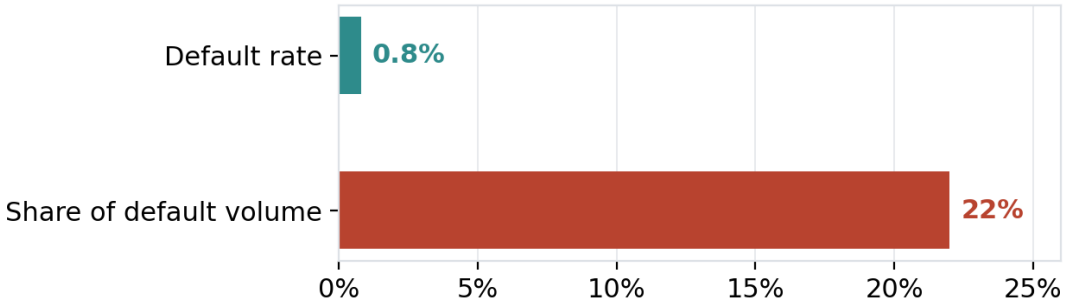
THE ENABLERS

Electricity is a primary bottleneck. Morgan Stanley sizes the US power shortfall at roughly 38 to 45 gigawatts through 2028, up to a 16% deficit even after available remedies, and more than nine in ten surveyed developers cite grid constraints as their principal obstacle.

THE INCUMBENTS

Software represents roughly 13% of the leveraged loan index and nearly one-fifth of direct lending portfolios, up from a negligible share a decade ago. Morgan Stanley is direct on the implication: loan investors are more exposed to AI-related disruption risk than to AI infrastructure upside. The early default data is consistent with concern without confirming distress. The rate is reassuring, but the dollar amounts, on a large base, are less so.

Exhibit 5 · Software in direct lending: default rate vs. share of default volume
KBRA direct lending index



Source: KBRA DLD (Apr 2026). Software base in KBRA DL index approximately $99bn.

As managers of CLO portfolios with real software exposure, we do not observe this risk from a distance. Our assessment is not that it is overstated, but that AI operates as a dispersion catalyst: it strengthens some businesses while accelerating obsolescence and raising reinvestment requirements for others. Potential secular disruption concentrates in commoditized functionality with low switching costs and per-seat pricing exposed to headcount reduction; it proceeds far more slowly, where at all, in mission-critical systems of record with high switching costs and accumulated data. The analytical task is separating the two at the loan level, a task we would argue the market is not currently performing.

> Our own positioning reflects this framework. CLO software exposure across our portfolio runs at approximately 13%, in line with the loan market rather than overweight, and consists entirely of higher quality, first lien positions. Where price volatility has been sentiment-driven rather than fundamental, we have generally held rather than crystallize par losses. We pay particular attention to software loans maturing in 2027 and 2028, where weaker borrowers will face a refinancing market that may be less forgiving than the one they last faced.

We note our positioning because it illustrates the broader point: instrument-level selection is the appropriate response to a dispersion event, and it is available only to investors whose exposure is liquid, marked, and actively managed. The market has, in fact, begun to price the dispersion: software loan yields have moved to roughly 12–13% and the leveraged loan technology sub-index has widened against the broader market. Spreads that widen before defaults arrive are a potential entry point for active managers, but for locked or passive holders, they are simply information that arrive too late to use.

V. THE TELECOM PRECEDENT

> Telecoms in 1996-2002 is the closest analogy: the demand thesis was right, yet the lenders were impaired because monetization came after the debt matured, and the repricing, not the collapse, was where the money was made.

Capital expenditure cycles invite historical comparison, and the telecom buildout of 1996–2002 is not merely a period analogy for the current cycle but also a structural one.

Exhibit 6 · Telecom 1996–2002 and AI 2023–present: structural comparison
STCP framework

	Telecom 1996–2002	AI 2023–present
The asset	Fiber, long-haul capacity	Data centers, GPUs
The demand thesis	Traffic growth assumed unbounded	Compute demand assumed unbounded
The marginal borrower	CLECs, fiber overbuilders	Neoclouds, miners-turned-hosts
The financing pattern	Debt against projected demand	Debt against projected demand

	Telecom 1996–2002	AI 2023–present
The circularity	Equipment vendors financing customers	Chipmakers supporting customers
The technology curve	Wave-division multiplexing	Successive GPU generations
The mismatch	Capacity grew faster than debt amortized	Hardware value decays faster than debt amortizes

The outcome of that cycle is well documented: several of the largest bankruptcies of the era, the effective elimination of a borrower class, and transport capacity changing hands at deep discounts to invested capital. The concentration was extreme: at the 2002 peak, telecommunications issuers accounted for roughly 56% of all corporate default volume, and recovery rates on defaulted telecom paper fell to about 23% before mean-reverting toward 45% as the default wave subsided. The instructive part of this precedent is not simply the scale of the losses but their cause. The demand thesis was vindicated. Internet traffic grew roughly as optimists projected, and the assets carried global traffic for decades. What failed was the capital structure: adequate economics on this capital arrived on a schedule the debt could not accommodate, and eventual underlying product demand did not protect lenders whose maturities came first. For a credit investor, the relevant question about a technology buildout is rarely whether the technology is real. It's whether monetization arrives before the maturity wall, at unit economics that survive the technology curve. The "aging effect" of credit has historically created default risk that peaks three to four years after issuance. Record late-1990s telecom issuance produced its default wave in 2001–02; the 2025–26 surge in AI-related issuance suggests a comparable window in 2028–2030, coinciding with the tail end of the free-cash-flow trough shown earlier.

Two historical features deserve attention. The warning indicators were visible in real time: the FDIC's 2001 regional outlook work, using KMV expected-default-frequency measures, ranked telecom among the most stressed industries in the syndicated loan market well before defaults crested. The information existed; the constraint was positioning. The worst losses concentrated not among unsupported speculators but in circular structures, where equipment manufacturers financed their own customers' buildouts to sustain demand for their products. Today, chipmakers supporting customers' hardware purchases today reproduce that same configuration; this is the historical basis for our concern with circular enhancement discussed in Section 3.

The key takeaway is equally relevant. The fiber was not abandoned; it was repriced, and investors who acquired distressed telecom credit in 2002–04 realized some of the strongest returns of that era. One important difference is worth noting. Stranded fiber was durable and inexpensive to reactivate, so capacity was bought cheaply and lit as demand caught up. Data center collateral may be less forgiving: the powered site and interconnection retain value (in a power-constrained market the site may be the most valuable component), but the hardware that represents much of the invested capital does not survive idleness the way glass in the ground did, and purpose-built improvements do not repurpose cleanly. The repricing opportunity we expect is therefore likely to concentrate in the land, the power, and the debt claims on them, rather than in the facilities as configured.

VI. MARKET STRUCTURE WHEN THE CYCLE TURNS

> The reassurance that this cycle's risk is "distributed" is too optimistic. Moving credit into vehicles that cannot mark them or exit does not diffuse risk; it defers when the risk gets recognized.

The most common rebuttal to the telecom comparison is that this cycle's credit risk is distributed rather than concentrated, spread across insurance accounts, private credit funds, and asset-based finance vehicles, with roughly $800 billion of the gap expected to be met by private credit, a sum the sell-side benchmarks against the $9 trillion investment grade market rather than the $1.4 trillion high yield market. Distribution, in this account, is the mitigant.

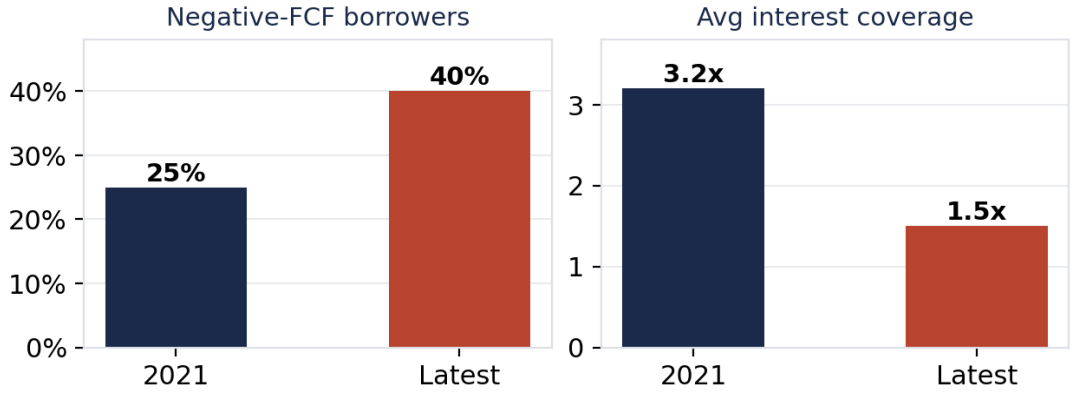
We read the same facts differently. Risk that has moved into vehicles that are neither marked to market nor from which one can readily exit has not been mitigated; it has been moved away from the mechanisms of price discovery. Public markets surface stress continuously through daily repricing; private markets defer it. Each dollar that migrates from marked, liquid

markets into unmarked, locked vehicles removes one channel through which adjustment can occur readily, and it adds a potential forced seller to an eventual adjustment. On this reading, the growth of private credit and asset-based finance does not diffuse this cycle's risk. It concentrates the timing of its recognition.

BORROWER FUNDAMENTALS ARE ALREADY DETERIORATING

This is not hypothetical. The April 2025 IMF Global Financial Stability Report estimated that roughly 40% of private credit borrowers now generate negative free cash flow, up from 25% in 2021, while average interest coverage has declined from 3.2x toward 1.5x. KBRA's direct lending data showed the pressure surfacing in the mechanics: non-accruals rose from 1.5% to 2.4% of index volume in a single month, the watchlist has grown 20% year over year, and payment-in-kind features appear in roughly 60% of the most troubled names against 13% across the index. Rising deferral, widening disagreement among lenders' marks, and a rising default forecast characterize a market in which adjustment is being postponed rather than avoided.

Exhibit 7 · Private credit borrower fundamentals, 2021 vs. latest
Negative free cash flow share and average interest coverage



Source: IMF Global Financial Stability Report (Apr 2025); FSB (May 2026); KBRA DLD (Apr 2026).

THE SEQUENCE

If conditions turn, whether due to disappointing economics on the capital, a hardware generation that strands a vintage of capacity, or simple supply indigestion, the sequence follows from the structure rather than the underperformance. First, cash flows fall short at the sub-investment-grade developer cohort, and the enhancement web is tested: renewal options declined, delay options exercised, guarantees called, refinancings failing at anticipated repayment dates. Second, private credit holders, unable to exit deteriorating positions and pressed by their own redemption and funding dynamics, sell what can be sold, their liquid holdings, into the traded market. Third, the adjustment concentrates in the liquid market. This is not because it held the worst risk, but because it is the venue where stress can clear. For investors with stable capital at that point, the dislocation is investable: CLO vehicles reinvesting at wider spreads with term, non-mark-to-market liabilities; opportunistic strategies purchasing from forced sellers; and secondaries capital providing the exits that private structures cannot.

VII. IMPLICATIONS FOR INVESTORS

> Understand where your AI credit exposure sits – most of it does not carry an "AI label." Liquidity in credit has optionality, despite relatively tight current spreads. Term-funded CLOs, opportunistic credit, and secondaries are built to be on the offensive side of a dislocation.

This argument does not depend on a forecast. Whether the adjustment arrives in 2027 or later, the structural facts are in place today: a development-stage buildout financed through capped-upside credit instruments; enhancement that is conditional, finite, concentrated, and at the margin circular; leverage migrating into vehicles that cannot mark or exit; and a

funding base likely to contract when it is most needed. These facts carry implications for portfolio construction now.

The first is risk awareness: investors should establish where their AI-related credit exposure actually resides. For most institutional portfolios, the honest answer includes places that do not carry the label: investment grade indices whose largest non-financial issuer is now an AI capex borrower; private credit sleeves whose recent vintages are increasingly data-center adjacent; direct lending portfolios in which software has become a fifth of holdings; insurance general accounts holding the same enhanced structures. The exposure visible on a screen under an AI heading is the minority of the total, and the most liquid minority. Exposure that is not marked cannot be measured, and exposure that cannot be measured cannot be managed.

The second is the value of liquidity: In a market where technicals dominate fundamentals, liquidity is not a return concession; it is optionality whose use will not be a luxury but a difference maker. The premium available for surrendering it has compressed (the central finding of our prior white paper, in *Why Liquidity Matters Again)*, while the intrinsic value of retaining it, measured by the ability to reprice, reposition, and act when others cannot, has risen. We believe that compression persists for reasons worth highlighting: 1) spreads are historically tight from genuine euphoria around AI's potential, 2) well-founded confidence in "current" hyperscaler balance sheets, and 3) strong demand for new credit in a supply-starved market. The most serious challenge amongst these to our view is that if AI proves as transformational as its proponents believe, the hyperscalers may simply grow into these debt obligations and the repricing never arrives. But credit investors, in our opinion, are not currently paid enough to for this risk. When stress in private structures ultimately clears through the public market, investors holding liquid credit are on the receiving side of that flow instead of being forced sellers.

The opportunity is not only in discounted secondary paper. This supply technical will cause new-issue spreads to widen across investment grade issues, and because investment grade anchors credit spreads, this widening will pull other spread product with it. In that environment, spread widening driven by supply rather than fundamentals rewards good underwriting: the manager who can separate a mispriced new issue from a fundamentally riskier one creates alpha opportunities.

Sycamore Tree Capital Partners' strategies are constructed around this view. CLO vehicles that secure term, non-mark-to-market liabilities in benign markets convert dislocation into reinvestment rather than forced sales. Opportunistic credit strategies selectively purchase what forced sellers must sell. And credit secondaries, the newest of the three and in our judgment the one whose opportunity is most asymmetric, provide the exits that locked private structures cannot provide themselves, into a market where deal flow exceeds dedicated capital. The common element among these strategies is the one this white paper and its predecessor share: in credit, the durable advantage lies with investors who can act when the market requires action. The coming phase of this cycle, whenever it arrives, will be a significant opportunty for alpha creation.

CONCLUSION

The AI buildout may well earn attractive returns; that is a question for the equity market. Our focus is narrower and, for a credit investor, more actionable: the spend is being financed in a way that concentrates risk where it is least visible and least liquid, at a pace that outruns the market's capacity. Enhancement has relocated development risk instead of removing it, and the venues now holding much of that risk cannot mark or exit it. When the adjustment comes, it will surface first in traded credit (loans, high yield, and ABS) because that is the place stress can clear continuously. Private credit's inability to participate in that clearing is precisely what routes the pressure, as a second stage, into the secondary market, where it arrives priced at a discount to both liquidity and spread.

This is the same conclusion we reached in *Why Liquidity Matters Again*, arrived at from a different perspective. Liquidity is not a concession to be minimized. In a market whose outcomes are set by technicals rather than fundamentals, it is the edge.

SOURCES & NOTES

I. THE FINANCING OF THE BUILDOUT

$2.9tr global data center capex through 2028 (ex-power); ~$1.4tr covered by hyperscaler cash flows; ~$1.5tr external financing gap; +$300bn power — Morgan Stanley Research, Bridging a $1.5tr Data Center Financing Gap (Jul 2025). Capex >$800bn (2026), ~$1.1tr (2027) — Morgan Stanley Research, Data Center Financing: Faster, Broader, Deeper (May 2026). S&P 500 capex ~$950bn (2024) — S&P/Compustat aggregate. AI-related gross issuance ~$250bn in first five months of 2026; full-year 2026 US supply ~$500bn — Morgan Stanley Research (May 2026). Alphabet up to $80bn equity raise following $55bn debt (mid-2026) — public reporting.

II. WHERE THE LEVERAGE RESIDES

IG tech 0.8x net leverage vs. 1.8x non-financial IG; cash >50% of debt; A2/A3 average; >$500bn debt capacity pre-downgrade — Morgan Stanley Research (May 2026). Lease commitments: ~$675bn operating, $175bn finance, $82bn not-yet-commenced (~$932bn total); MSFT liabilities >2x since 2022 — Morgan Stanley Research (May 2026); company filings. Oracle largest non-financial issuer in US IG index — Morgan Stanley Research (May 2026). Leverage estimates: Operating and committed lease obligations (~$675bn + ~$82bn) expressed against estimated aggregate hyperscaler EBITDA of ~$650–700bn (Microsoft, Alphabet, Amazon, Meta, Oracle, per company filings); the 2.5–3.0x figure is pro-forma and assumes drawdown of incremental debt capacity not currently reflected on the balance sheet; it is not a current leverage measure. Hyperscaler capex ~80% of operating cash flow; forward FCF revised down; hyperscaler CDS decoupling from IG index — Apollo Global Management / Daily Spark (Jul 2026). Alphabet purchase commitments ~$707bn, +$450bn QoQ, "significant majority" long-term supply agreements (2Q26 disclosure) — company filings. Micron strategic customer agreements (5-yr terms through 2030, ~20% DRAM / ~33% NAND volume, price floors above prior-peak margins); SK Hynix / Samsung reported LTAs — Micron company disclosure; TrendForce (Apr 2026).

III. DEVELOPMENT RISK AND THE LIMITS OF CREDIT ENHANCEMENT

Deal structure (pre-lease terms, construction/lease guarantees, ~180-day delay options, non-amortizing refinancing exposure, ABS no-construction-risk) — Morgan Stanley Research (May 2026). Direct lending recovery: 47% TTM implied (BDC fair-value marks); ~17% realized bankruptcy; 49% restructuring; 43% 2026E — KBRA DLD US Direct Lending Default Research (Apr 2026). Chip economic life 4–8 yrs vs. 20+ yr shell; GPU ABS amortization — Morgan Stanley Research (May 2026). Consensus hyperscaler FCF ~$75–95bn trough 2026–27, ~$470bn 2030E — Apollo Global Management (Jul 2026). Chinese open-weight models ~5→~20 of top-50 (Jan 2025–May 2026) — Apollo Global Management (Jul 2026); OpenRouter.

IV. SECOND-ORDER EXPOSURES

US power shortfall 38–45GW through 2028; up to 16% deficit; 92% cite grid constraints — Morgan Stanley Research (May 2026). HVDC architecture, wide-bandgap semiconductors, grid-modernization capex; EU pipeline grid-gated — JPMorgan, AI Capex 2.0 and First Principles (Jun 2026); Goldman Sachs, Powering Up Europe (2026). Software ~13% of leveraged loan index, ~19% of direct lending; default rate 0.8% but 22% of default volume on ~$99bn base — KBRA DLD (Apr 2026); Morgan Stanley Research (May 2026). Software loan yields ~12–13%; tech loan sub-index widening — LCD/BofA. STCP CLO software exposure ~13%, first lien; semi-annual re-underwriting — STCP internal, latest trustee reports.

V. THE TELECOM PRECEDENT

Telecom default concentration (telecom = 56.4% of 2002 default volume), recovery trough/recovery (~23% in 2001 rising to ~45% in 2003; long-run all-issuer mean ~40%), and the "aging effect" (peak default risk years 3–4 post-issuance) — Moody's Investors Service, Default & Recovery Rates of Corporate Bond Issuers, 1920–2003 (Jan. 2004). FDIC 2001 KMV EDF telecom stress ranking — FDIC, Atlanta Regional Outlook (2001). Equipment-vendor financing history — Lucent/Nortel.

VI. MARKET STRUCTURE WHEN THE CYCLE TURNS

~$800bn gap met by private credit; benchmarked to $9tr IG vs. $1.4tr HY — Morgan Stanley Research (Jul 2025 / May 2026). ~40% private credit borrowers negative FCF (from 25% in 2021); ICR 3.2x→1.5x — IMF Global Financial Stability Report (Apr 2025); Financial Stability Board (2026). Non-accruals 1.5%→2.4% in one month; watchlist +20% YoY; PIK ~60% of troubled names vs. 13% index — KBRA DLD (Apr 2026). Annuity inflow rate-sensitivity (~3% threshold); ~$400bn retail structures with 5–25% quarterly redemption caps — Morgan Stanley Research (May 2026).

Important Disclosures

This white paper provides general information regarding the markets it describes as well as the business and certain related information of Sycamore Tree Capital Partners, L.P. ("Sycamore") and the funds managed and to be managed by Sycamore Tree.

Disclaimer. This white paper is intended for institutional investors and qualified purchasers only. Sycamore does not make any representation or warranty, express or implied, as to the accuracy or completeness of the information (financial, legal or otherwise) contained in this presentation. In addition, Sycamore shall not have any liability to any recipient of this presentation as a result of receiving or evaluating any information concerning this presentation. This material is not intended to provide, and should not be relied upon for accounting, legal or tax advice or investment recommendations. Readers are urged to speak with their own tax or legal advisors before entering into transactions. This material is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to local law or regulation. The views expressed are those of the authors as of the date of this publication and are subject to change without notice.

Risk. An investment in any strategy, including the general strategies described herein, involves a high degree of risk. There is no guarantee that the investment objective will be achieved. Past performance of these strategies is not necessarily indicative of future results. There is the possibility of the loss of principal.

Opinions, Market & Industry Data; Third Party Data Limitations. The opinions, estimates, market and industry data contained in this presentation are based on Sycamore's own estimates, internal research, surveys and studies conducted by third parties and industry and general publications and are believed by Sycamore to be reasonable estimates as of the date of this report. This data is subject to change and cannot always be verified with certainty due to limits on the availability and reliability of raw data, the voluntary nature of the data gathering process and other limitations and uncertainties inherent in any statistical survey of market or industry data. As a result, you should be aware that market and industry data set forth herein, and estimates and beliefs based on such data may not be reliable. Sycamore has no obligation to update, modify or amend this report or otherwise notify a reader hereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate. **[**All third-party data referenced herein is sourced from publicly available information, including:

Forward Looking Statements. The information in this white paper contains forward-looking statements within the meaning of U.S. federal securities laws. Forward-looking statements are statements regarding our future and are not of historical facts, which may be stated or may be implied. These forward-looking statements are based on our current expectations and assumptions regarding how the markets and credits we describe perform and how our business, our prospects, the economy and how our funds perform and other factors. As with any forecast, they are inherently susceptible to uncertainty, changes in circumstances and are subject to a variety of risks. These risks include how the credit markets described herein will perform (in general and with respect to the specific trends and risks contemplated hereby), risks to the credit quality and pricing of the debt described herein, the risks of credit downgrades, market price volatility, liquidity risks, interest rate and duration risks, leverage of the borrowers, default rate assumptions, the several structural features of the investors and how the debt described herein is held and the many factors that are involved in how the companies and their loans and debt perform, among other things. Risks relating to Sycamore products are set forth in greater detail in applicable private placement memoranda. How we as a firm and how Sycamore's products perform may vary materially from those expressed or implied in these forward-looking statements.

Securities Law Matters. This paper does not constitute an offer, nor a solicitation of an offer, of the sale or purchase of securities, nor shall any securities of any fund or of Sycamore be offered or sold, in any jurisdiction in which such an offer, solicitation or sale would be unlawful. Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the transactions contemplated hereby or determined if this presentation is truthful or complete. If, in the future, Sycamore offers you an opportunity to invest in a fund, Sycamore itself or its products, it will at that time do so by making an offer expressly and by distributing to you a Private Placement Memorandum and related documents.