PitchBook

H1 2022

GLOBAL

Private Debt Report

Contents

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Published on September 28, 2022

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Key takeaways

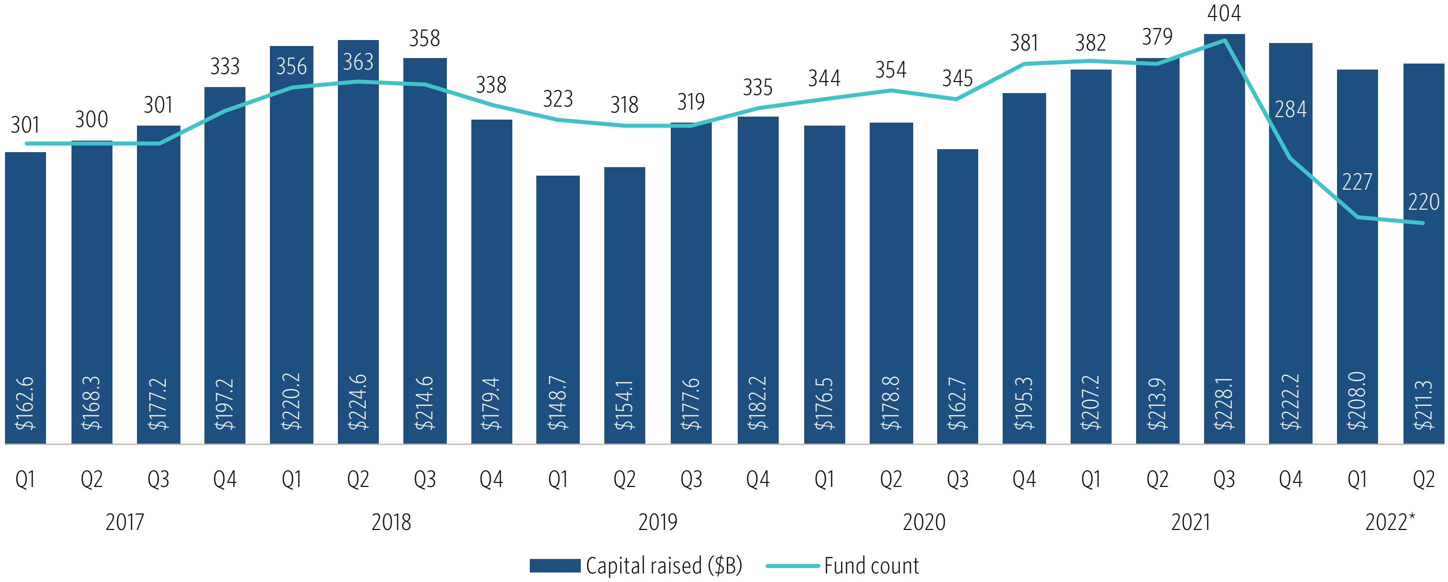
- Private debt fundraising stagnated in H1 2022 but is still on par with last year's record-setting pace. Direct lending continues to be the standout strategy, accounting for more than a third of capital raised in the first half of the year. We expect the continued growth in PE dealmaking, combined with direct lenders' taking of market share from banks, to fuel private debt's dealmaking capacity in the coming years.

- The current macroeconomic backdrop presents a double-edged sword for private debt funds. On the one hand, the floating-rate nature of many of these instruments makes existing loans more lucrative, as coupon rates will rise in step with central bank rate hikes. On the other, rising rates could make more-traditional fixed-income investments relatively more attractive to allocators.

- It has been a tough year for the leveraged loan and high-yield bond markets in both the US and Europe, according to data from LCD. Concern over inflation, rising rates, the potential for recession, supply chain issues, and the ongoing war in Ukraine weighed heavily on sentiment, sparking downturns in the secondary market not seen since the onset of the COVID-19 pandemic. The Morningstar LSTA US Leveraged Loan Index was down 4.6% YTD, the second-worst reading for any comparable period since the global financial crisis.

Fundraising and overview

Rolling 12-month private debt fundraising activity



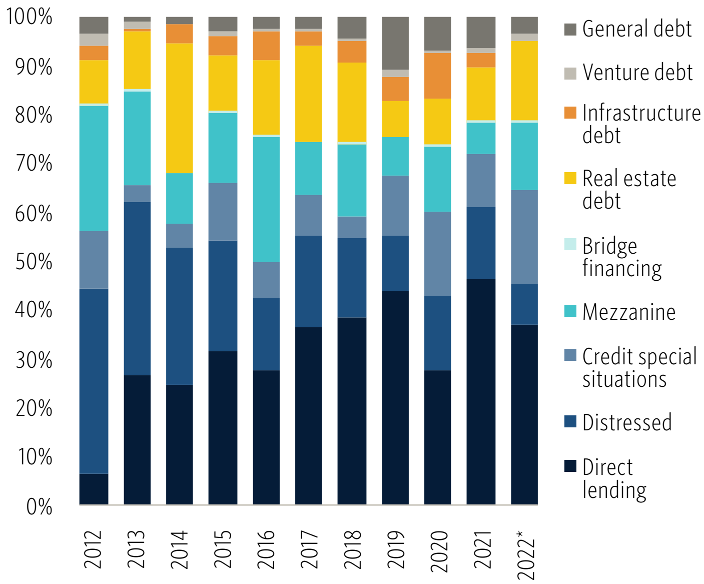
Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Dylan Cox, CFA
Head of Private Markets Research

Following a record-setting 2021, private debt fundraising decelerated slightly in the first half of 2022. Managers raised $82.0 billion across 66 funds globally in the first six months of the year. Looking at the trailing 12-month period, however, fundraising is on par with its 2021 peak, totaling $211.3 billion in commitments in the year ended Q2 2022. Direct lending continues to be the standout strategy, accounting for more than a third of capital raised in the first half of the year, but other substrategies, such as special situations funds and real estate debt funds, also garnered plenty of attention.

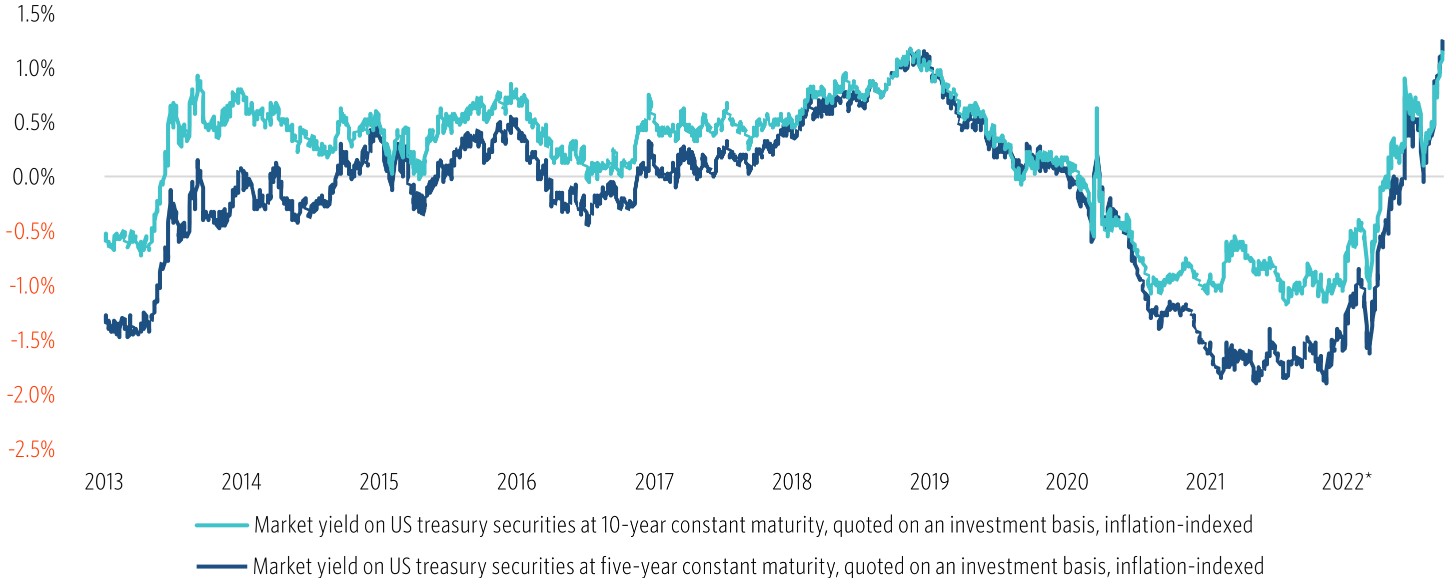
The macroeconomic backdrop—characterized by rising rates, slowing economic growth, and surging inflation in most developed economies—presents a double-edged sword for private debt funds. On the one hand, the floating-rate nature of many of these instruments makes existing loans more lucrative, as coupon rates will rise in step with central bank rate hikes. On the other, rising rates could make new fixed-income investments (such as corporate bonds, government bonds, and real-estate-related debt) relatively more attractive to allocators. One of the main reasons LPs have shifted allocations away from traditional fixed income and toward private debt in recent years is that interest income in a near-zero interest rate environment became nearly negligible for many institutions. If real yields rise back to long-term averages, LPs will be more incentivized to maintain allocations to more-liquid credit investments.

Share of private debt capital raised by type



Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Real Treasury yields

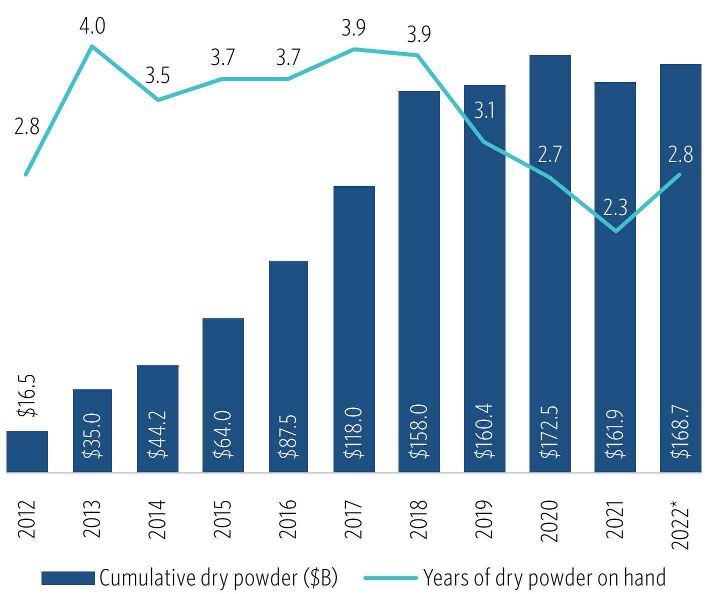


Source: Federal Reserve Bank of St. Louis | **Geography:** United States
*As of June 30, 2022

Another challenge for managers raising new capital is the equity market sell-off in H1 2022. This makes LPs' portfolios less valuable overall and increases their effective allocations to alternative assets, including private debt (a phenomenon known as the "denominator effect"). That said, we expect private market fundraising to remain robust in the years to come. Many LPs are simply pausing or delaying contributions to new funds as they assess their current portfolios, which could cause pent-up demand to positively influence fundraising figures in H2 2022 and early 2023. Private debt funds still provide higher expected returns than many other asset classes, presenting an attractive proposition particularly for pension funds, which in the US have an average funding ratio of just 75%, totaling a $1.3 trillion shortfall.[1]

The growing size of the private equity (PE) market is another factor likely to drive fundraising for private debt funds. PE deal flow reached a record $2.0 trillion across the US and Europe in 2021 before tapering amid the macroeconomic uncertainty in the first half of 2022. PE deals are growing larger due to both larger fund sizes and higher purchase price multiples. A record 40.2% of US PE deals were completed at an EV/EBITDA of 15x or more in 2021. While deal flow has lulled and purchase price multiples have receded in 2022, PE funds are likely to keep supplying direct lenders with plenty of capital deployment opportunities. In fact, capital deployment has been so rapid that cumulative dry powder of direct lending funds has remained relatively flat since 2018, even amid record fundraising. As of Q2 2022, direct lending dry powder totaled $168.7 billion globally, just 6.8% above the $158.0 billion recorded in 2018.

Direct lending dry powder and years of dry powder on hand



Source: PitchBook | **Geography:** Global
*As of June 30, 2022
Note: The current year's contributions are annualized for the cash on hand calculation. Cash on hand is the end-of-year dry powder divided by the contributions during the past three years.

1: "Global SWF Update - In-depth Analysis of US Pension Funding Gap," *Portfolio for the Future*, CAIA Association, August 10, 2022.

Direct lenders are also gaining share from the high-yield bond and syndicated loan market. Larger fund sizes mean that PE increasingly looks to the direct lending space to finance its deals. Earlier this year, we saw multiple billion-dollar-plus unitranche financings (referred to as “jumbo” or “mega” unitranche) from direct lending funds, sometimes in the form of club deals. For example, Hellman & Friedman’s majority stake purchase of Information Resources, Inc. was financed by a $4.5 billion unitranche loan that was split among Blackstone, Ares, Blue Owl, and Oak Hill advisors.[2] This type of loan, which was reportedly priced at 5.75% over SOFR, would have been nonexistent in the market just a few years ago and exemplifies the growing influence of these asset managers when it comes to both credit and equity. For PE investors, unitranche deals in the private market are generally more expensive but offer a higher certainty of closing and can be arranged more quickly. In times of market volatility—as seen in the first half of this year—the high-yield bond and syndicated loan markets can dry up without much notice, whereas private debt managers are more likely to continue making loans due to the longer-term nature of private fund commitments.

In terms of geographical focus, private debt funds continue to be concentrated in North America, though their European and Asian counterparts have made steady gains in recent years. European-headquartered funds raised a record $69.8 billion in 2021—representing 31.4% of capital raised globally—though have started more slowly this year. Asian-headquartered funds raised more than $6 billion in each of the last three years but still account for less than 5% of capital raised over that time. There is growing demand for non-bank lending in Asia given the uptick in sponsored deal activity in recent years, but the creditor-debtor regimes vary greatly and can make it difficult for direct lending funds to establish a foothold. It is therefore more common for managers to view Asian credit deployment with a more opportunistic lens, as opposed to the senior-secured or unitranche, sponsored deals that have become commonplace in North America and Europe. North American-headquartered funds have accounted for 88.4% of capital raised thus far in 2022, though some of this capital is earmarked for deployment elsewhere, as many of the largest US-based managers raise capital with a global mandate.

Top private debt funds closing in H1 2022*

Fund name	Fund size ($M)	Fund type	Fund location
Blackstone Capital Opportunities Fund IV	$8,750	Mezzanine	New York City, US
Crescent Direct Lending Fund III	$6,000	Direct lending	Los Angeles, US
Monroe Capital Private Credit Fund IV	$4,800	Direct lending	Chicago, US
Carlyle Credit Opportunities Fund II	$4,600	Direct lending	Washington DC, US
Apollo Hybrid Value Fund II	$4,600	Distressed debt	New York City, US
Thoma Bravo Credit Fund II	$3,300	Direct lending	Chicago, US
AG Credit Solutions Fund II	$3,100	Credit special situations	New York City, US
Oaktree Real Estate Debt Fund III	$3,000	Real estate debt	Los Angeles, US
Bridge Debt Strategies Fund IV	$2,900	Real estate debt	Salt Lake City, US
17Capital Credit Fund	$2,844	Direct lending	London, UK

Source: PitchBook | **Geography:** Global
*As of June 30, 2022

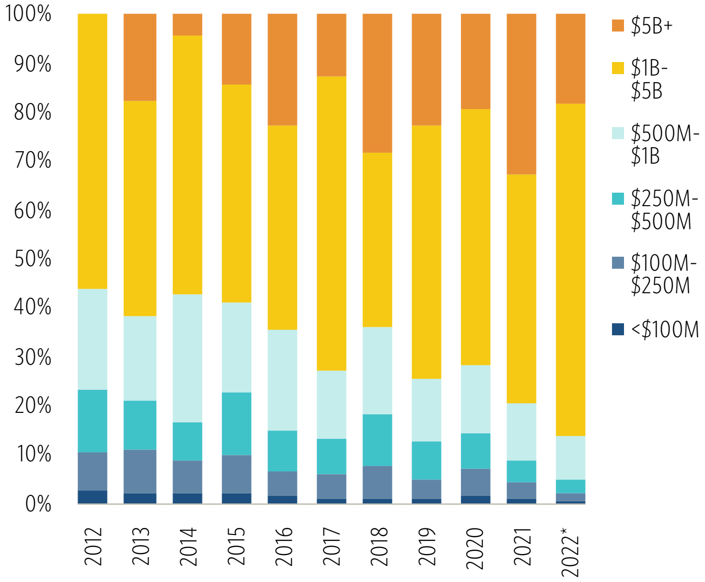
2: “Blackstone Leads $4.5 Billion Unitranche Loan for H&F Buyout,” Bloomberg, Davide Scigliuzzo, May 4, 2022.

European direct lending market statistics*

Period	Average deal size (€M)	Average EBITDA (€M)	Average leverage
Q1 2020	90.0	21.4	4.0x
Q2 2020	132.4	28.4	4.6x
Q3 2020	110.8	20.2	4.5x
Q4 2020	118.2	21.8	5.8x
Q1 2021	151.9	24.9	5.2x
Q2 2021	140.5	30.0	5.4x
Q3 2021	172.7	29.7	6.2x
Q4 2021	284.7	42.5	5.9x
Q1 2022	281.4	32.7	5.7x
Q2 2022	721.0	50.3	6.0x
Average	**220.4**	**30.2**	**5.3x**

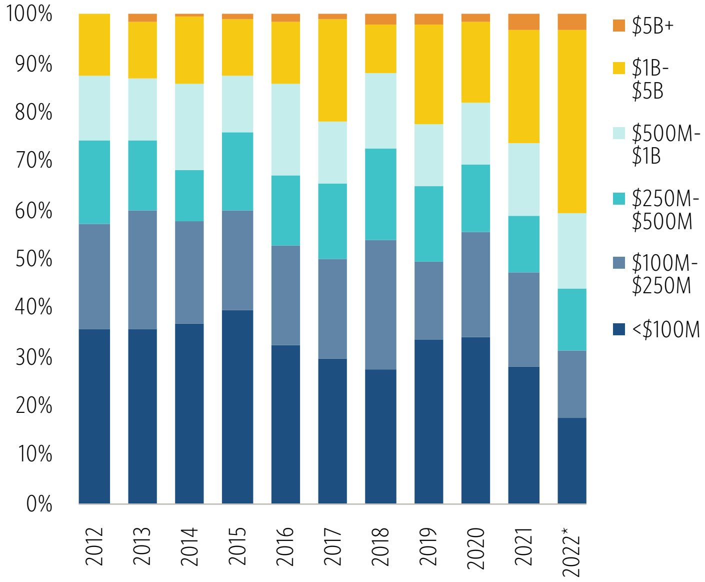
Source: LCD | **Geography:** Europe
*As of June 30, 2022
Note: As per LCD news reporting. Includes derived figures where available.

Share of private debt capital raised by size bucket



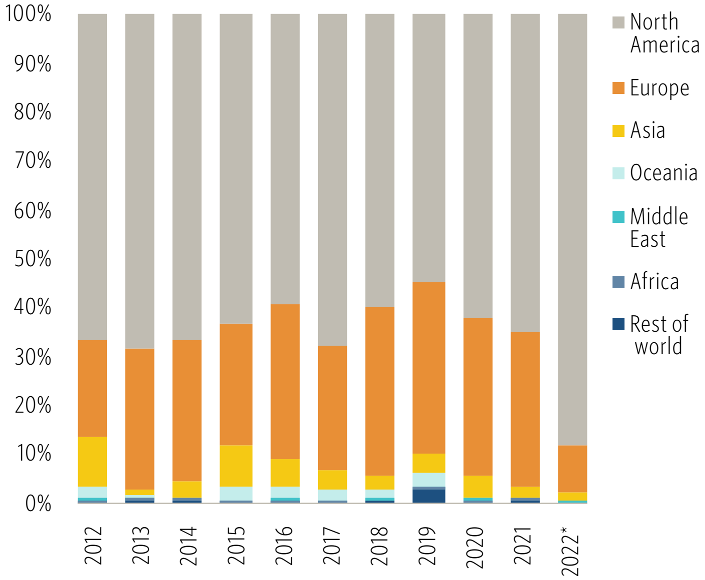
Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Share of private debt fund count by size bucket



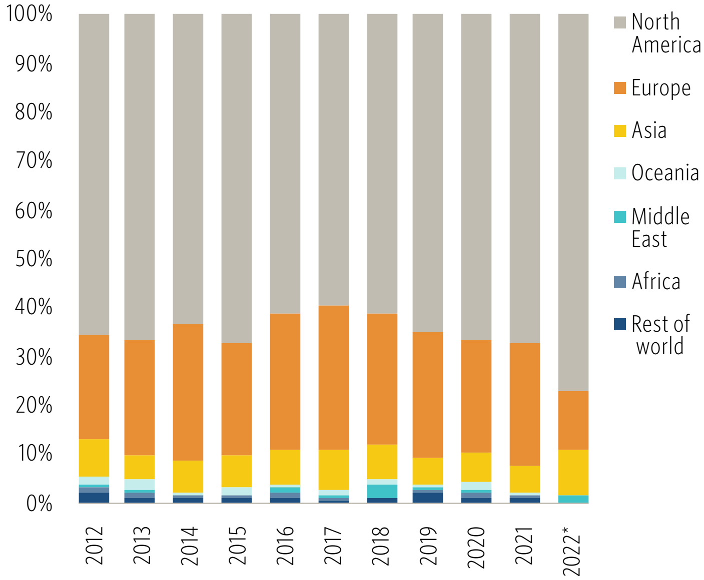
Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Share of private debt capital raised by region



Source: PitchBook | **Geography:** Global
*As of June 30, 2022

Share of private debt fund count by region



Source: PitchBook | **Geography:** Global
*As of June 30, 2022

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SPOTLIGHT

Leveraged loans and high-yield bonds

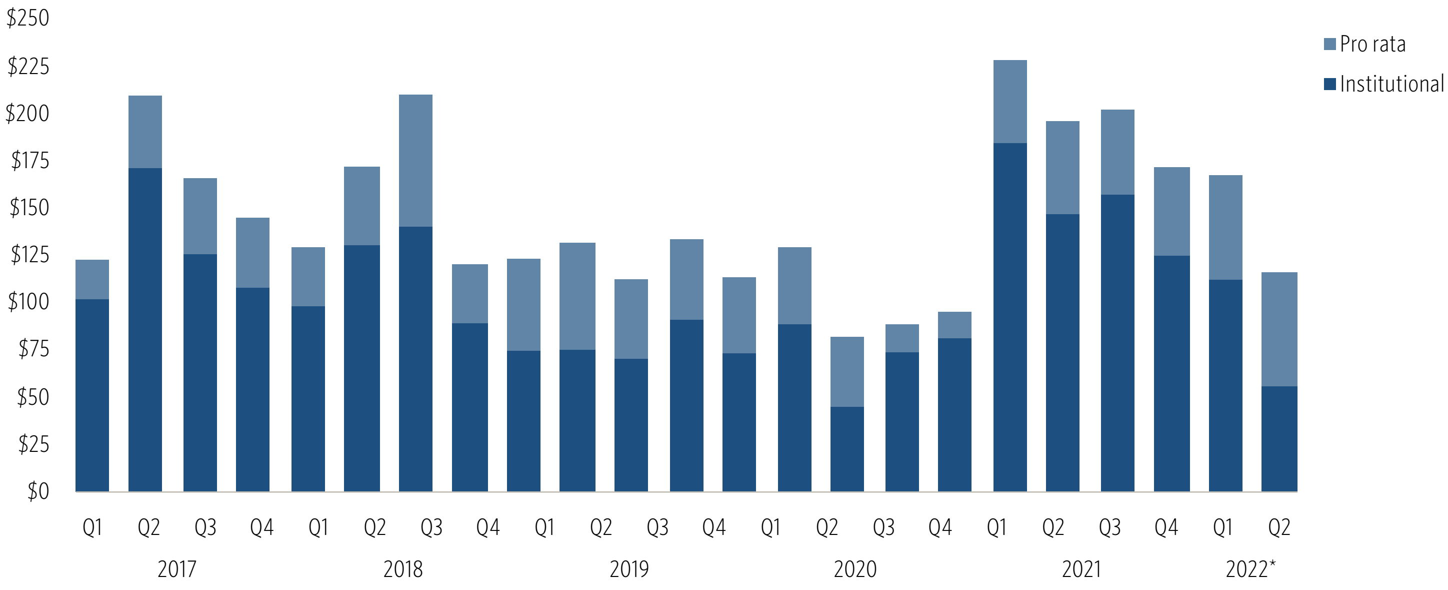
Taron Wade
Director, LCD

It has been a tough year for the leveraged loan and high-yield bond markets in both the US and Europe, according to data from LCD. Concern over inflation, rising rates, the potential for recession, supply chain issues, and the ongoing war in Ukraine weighed heavily on sentiment, sparking downturns in the secondary market not seen since the onset of the COVID-19 pandemic. Direct lenders stepped up to the plate in both regions to provide some liquidity for borrowers, even for larger buyout transactions.

Since that time, secondary loan prices have rallied in both markets and sentiment has improved somewhat. In the US, refinancings started up again in August as primary pricing showed signs of improvement. In Europe, although collateralized loan obligation volume has returned, there is less optimism about primary issuance resuming as usual in the autumn months.

In the US, institutional loan volume in the second quarter to the end of June was $56.0 billion, the lowest output since Q2 2020, when the market was overcome by the onset of the pandemic. The second-quarter figure was a 49.8% drop from the first quarter, which itself was largely driven by a white-hot January market. Volume in the second quarter was down 61.9% from Q2 2021. Total US leveraged loan volume in the second quarter, including pro rata issuance, was $115.7 billion, a six-quarter low.

US leveraged loan volume ($B)



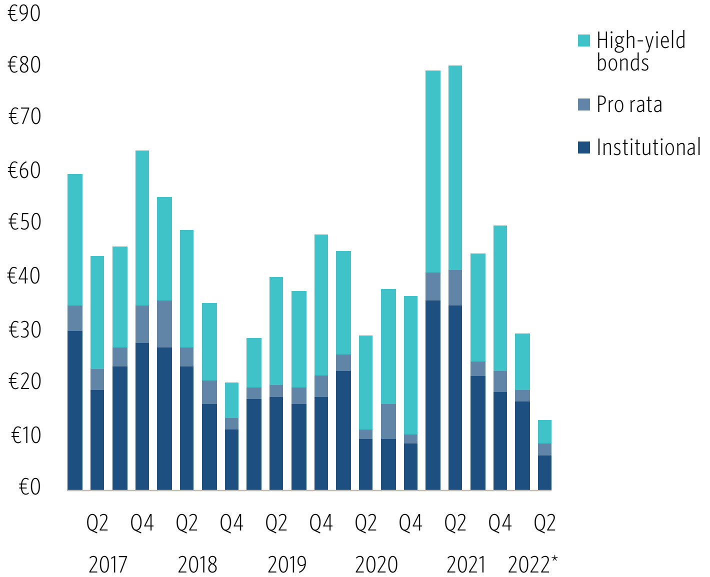
Source: LCD | **Geography:** United States
*As of June 30, 2022

In Europe, the leveraged loan volume in H1 2022 was just €28.1 billion, down sharply from €82.8 billion in the first half of last year (institutional volume totaled €23.4 billion in H1 2022 and €71.2 billion in H1 2021). The second quarter of this year was particularly slow, producing a volume of just €9.0 billion (with an institutional volume of €6.6 billion), versus a €19.1 billion effort in the first quarter and €41.5 billion in Q2 2021. Moreover, the second-quarter tally is the lowest quarterly volume counted since 2012, when the market was mired in the eurozone debt crisis.

The high-yield bond markets were also hit. The European high-yield bond market generated the lowest first-half issuance total since the global financial crisis, while in the US, high-yield issuance continued to spiral lower in the second quarter, showing the lowest total for second-quarter issuance since 2005.

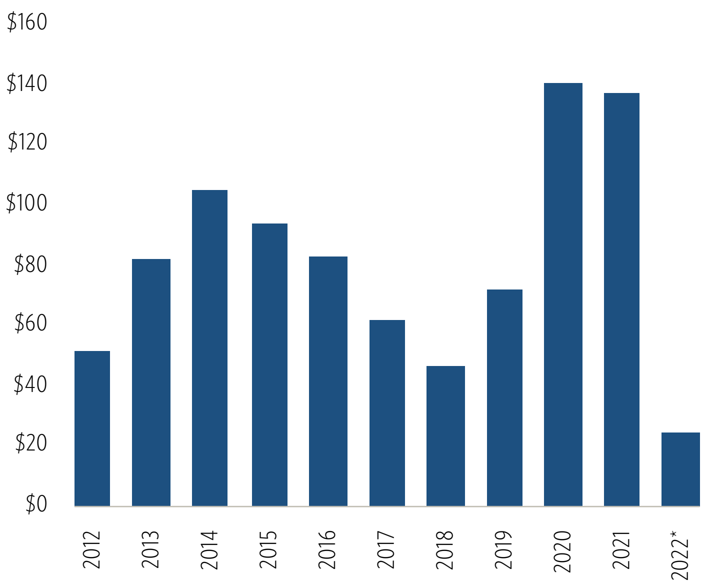
As primary issuance nearly ground to a halt, secondary loan prices were also severely impacted, resulting in plummeting loan returns. The Morningstar LSTA US Leveraged Loan Index was down 4.6% YTD, the second-worst reading for any comparable period since the global financial crisis (loans lost 4.6% in the first half of 2020). The index was up 3.3% in the first half of 2021. On average, loans have gained 2.1% during comparable periods over the last 13 years.

Quarterly European leveraged finance volume (€B)



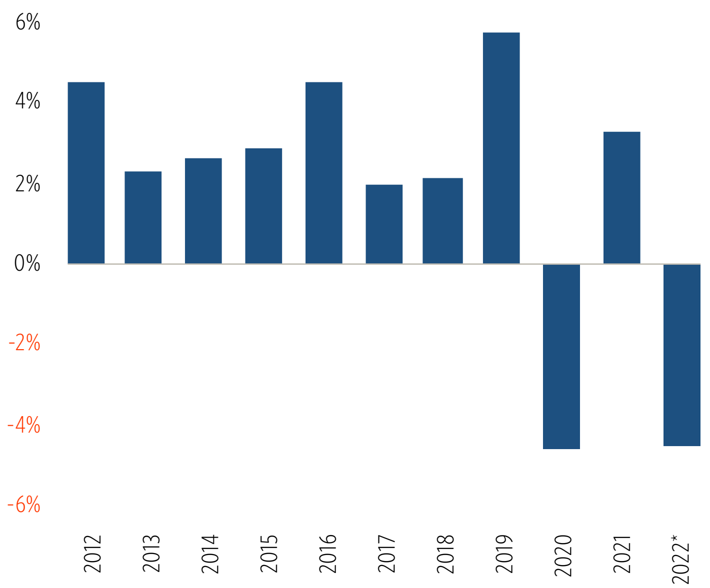
Source: LCD | **Geography:** Europe
*As of June 30, 2022

US high-yield bond issuance in Q2 ($B)



Source: LCD | **Geography:** United States
*As of June 30, 2022

US leveraged loan returns in H1

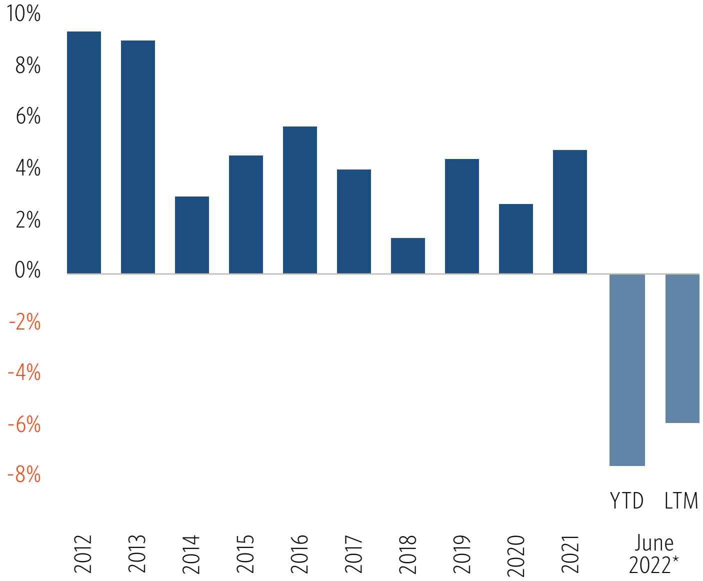


Source: LCD, Morningstar LSTA US Leveraged Loan Index (TR USD) | **Geography:** United States
*As of June 30, 2022

By the end of June, the Morningstar European Leveraged Loan Index (ELLI) was down by 7.5% (excluding currency), in stark contrast to the healthy 2021 year-end reading on this measure of 4.8%. Meanwhile, returns for the last 12 months were negative for the second consecutive month at -5.8%, having been -1.2% at the end of May and 1.8% in April. To put this performance into context, the ELLI has not ended a full year with a negative return since 2008, when the index posted a loss of 27.6% (excluding currency).

But is the tide shifting? Both regions had a strong secondary rally throughout the summer. The Morningstar LSTA US Leveraged Loan Index gained an impressive 2.1% from August 1 through August 16, on top of July's 2.1% advance. US leveraged loans have returned 3.7% in the last two months combined, the strongest performance over any comparable period since May and June 2020, when the market bounced back from the sharp pandemic-induced sell-off. With the recent gains, US loans recouped a significant portion of the 4.7% loss in May and June of this year, inching closer to positive territory for the year overall. Through August 31, the index was down 1.0%, far improved from the 4.9% loss through July 6.

European leveraged loans annual returns



Source: LCD | **Geography:** Europe
*As of June 30, 2022

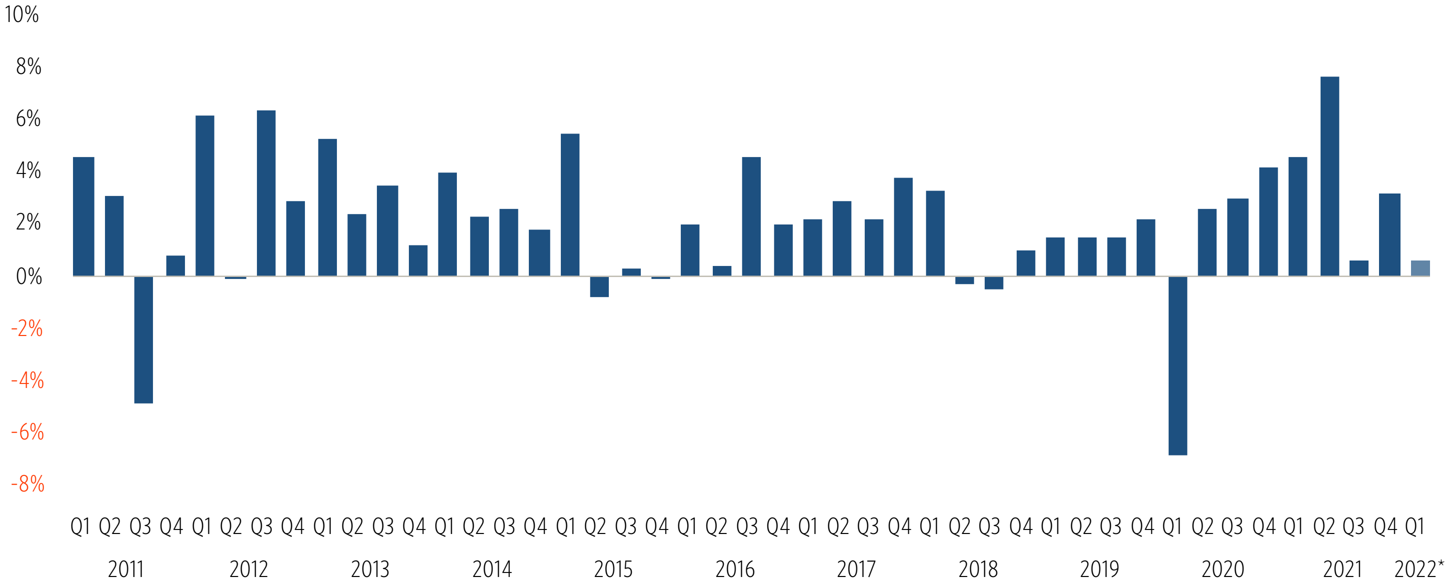
European loans continued to rally in August, as the Morningstar ELLI posted a hefty 2.3% return (excluding currency) for the month. Combined with July's 2.6% reading, the market had its strongest consecutive months since May and June 2020. The performance scratched back some losses from May and June, bringing the ELLI's year-to-date return to -3.0% (excluding currency) to the end of August, from -5.1% at the end of July. The rolling 12-month return has also improved, though it remains in the red at -1.9%.

There seems to be optimism as autumn begins in the United States, with issuers slowly re-entering the market to address refinancing needs in August as new-issue spreads narrowed from their recent highs and, in several transactions, were adjusted in favor of borrowers ahead of pricing. However, conditions remain challenging.

While primary volume in Europe is expected to pick up somewhat in the autumn, the tone is more sober, with few market participants predicting a significant shift in activity any time soon. There are only two deals out to syndication so far in September, and the market in Europe is on pace for its slowest year of issuance since 2012. "Everyone across the market is cautious, and I don't expect this situation to change in the foreseeable future," one banker told LCD News.

Private debt performance

Private debt funds quarterly IRR



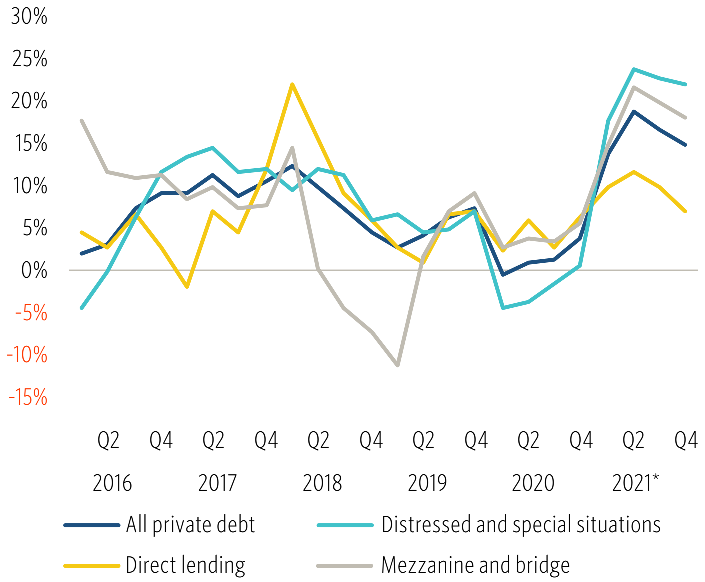
Source: PitchBook | **Geography:** Global
*As of March 31, 2022
Note: Q1 2022 data is preliminary.

This section was originally published in the [2022 Annual Global Fund Performance Report](), which also includes analysis on private equity, venture capital, real assets, secondaries, and other private market strategies.

Kyle Walters
Associate Analyst, Private Equity

Q4 2021 private debt performance came in at 3.2%, an improvement over Q3's 0.6%, but our preliminary Q1 2022 figure shows another pullback down to 0.6%, as rising interest rates begin to take a toll on income assets. Given the limited upside—and hopefully limited downside—of private debt due to the return of capital plus interest characteristics that provide few opportunities for outsize returns, private debt will generally lag when equities are rising dramatically. The 14.9% one-year IRR is well below the 37.6% posted for all private capital funds. Distressed and special situations, which posted negative one-year results in each of the first three quarters of 2020 as the uncertainties around the pandemic led to write-downs, led the way in Q4, posting a 21.8% one-year horizon IRR. Mezzanine and bridge funds ended the year up 18.1%, while direct lending vehicles, the largest private debt category, returned only 7.0%.

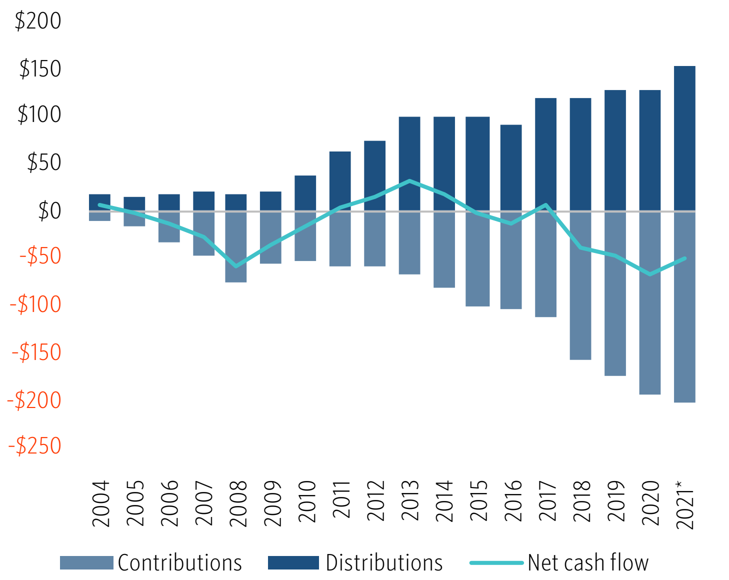
Private debt rolling one-year horizon IRR by type



Source: PitchBook | **Geography:** Global
*As of December 31, 2021

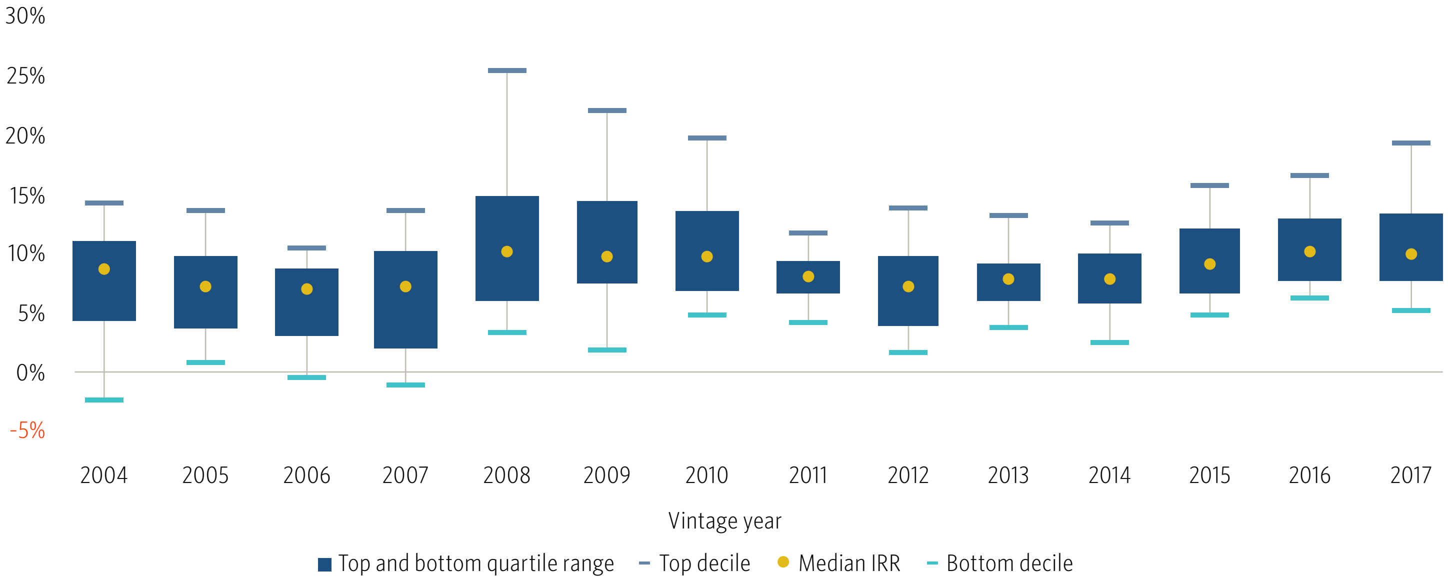
To some extent, horizon IRRs for private debt are less interesting than for other private fund strategies, as for the most part, these funds provide loans and expect to receive their money back plus interest, so interim valuations are meaningless to the end result of a fund. That said, the economic landscape does heavily influence the demand for debt and the rates that can be charged. 2022 has already seen multiple rate hikes globally, with more expected to come in the remainder of the year. With the cost of debt rising, PE firms using the services of private debt funds may lower their use of leverage, potentially reducing the deal flow for these funds. That said, the funds will be able to collect higher rates of interest on what they do lend. Direct lending tends to benefit from rate hikes, as they often use floating-rate instruments. However, with inflation at 40-year highs, real returns from interest payments will be reduced.

Private debt cash flows ($B)



Source: PitchBook | **Geography:** Global
*As of December 31, 2021

Private debt dispersion by vintage year*



Source: PitchBook | **Geography:** Global
*As of December 31, 2021

Additional research

Private markets

Q2 2022 US PE Middle Market Report

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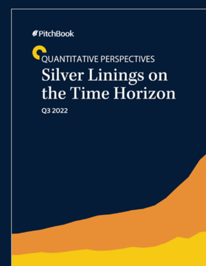

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