Private markets turn down the volume

McKinsey Global Private Markets Review 2023

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## Acknowledgments
Welcome to the 2023 edition of McKinsey’s annual review of private markets investing. Our ongoing research on the industry’s dynamics and performance has revealed several insights, including the following trends:

**The music didn’t stop, but someone turned it way down.** Private markets have enjoyed strong tailwinds since the depths of the Global Financial Crisis (GFC). Interest rates stayed low, credit availability was high, and valuations rose consistently. Each year since its inception, this annual publication has discussed new records in fundraising and deal flow while celebrating strong performance across asset classes. Even in 2020, when activity stalled briefly during the early months of the COVID-19 pandemic, private markets hummed again in the second half. In almost every regard, 2021 was an exceptional year, but it was not a trend breaker. Markets climbed higher still, awash with central-bank-induced liquidity. In the first half of 2022, central banks fought roaring inflation with sharply rising interest rates, and public market valuations cratered. In the private markets, first-half deal activity softened but subtly so, nearly matching the record-setting pace set in 2021.

The mood changed in early summer. Banks began to pull back, unwilling or unable to lend. Private markets deal volume plummeted, performance declined, and valuations fell—sharply in certain sectors. Still, private markets outperformed public markets on the way down, whether due to truly more resilient portfolios, a lag in timing, or manager discretion over their marks (private markets tend to mark up less quickly during ascending markets and mark down less quickly in falling markets). The discrepancy this year drove private market allocations higher on a percentage basis across institutional portfolios—closer to preexisting targets for most, and above targets for many limited partners (LPs)—triggering the so-called denominator effect. Though few LPs thus far have abandoned commitment plans entirely or sold portfolios as they did 15 years ago, many have pulled back, particularly from smaller and newer funds, causing fundraising to decline.

**Deal making slowed in the second half.** After a frenzied 2021, private equity (PE) deal volume decreased 26 percent to $2.4 trillion, while deal count fell 15 percent to just under 60,000. The deal-making momentum of 2021 continued through the first half of 2022, and despite the striking slowdown in second-half deal activity, 2022 remained the second most active year on record. The number of buyout and growth deals greater than $500 million decreased by 33 percent. Add-on deals, which tend to be smaller, continued to gain share as a percentage of total deals. New platforms comprised 28 percent of total transactions in 2022, 14 percentage points lower than five years ago.

Real estate deal volume declined 20 percent to $1.1 trillion, also the second-highest year on record. Like PE deal making, first-half real estate deal making continued close to the record-setting pace of the second half of 2021, but second-half volumes declined precipitously. After more than doubling year over year in 2021, multifamily deal volume fell 29 percent in 2022, accounting for nearly half of the asset class’s overall decline in deal activity.

**The denominator effect took hold.** Global private markets fundraising declined by 11 percent to $1.2 trillion. Real estate (−23 percent) and private equity (−15 percent) declined most precipitously from 2021’s record highs, while private credit (+2 percent) proved more resilient. Macroeconomic headwinds, including rising inflation and interest rates, coupled with sharply negative public market
performance (~17.7 percent) triggered the aforementioned denominator effect, and LPs scaled down new commitments. Despite these challenges, 2022 is likely to be the second-best fundraising year on record (after all data is reported), demonstrating—thus far—discipline and longer-term thinking by LPs.

**North American fundraising was resilient; Europe and Asia faced challenges.** Fundraising results differed notably across geographies, more so than in previous years. Private markets fundraising in North America increased by a modest 2 percent year over year but declined in Asia and Europe by 39 percent and 28 percent, respectively. Since 2017, fundraising in Asia has declined 16 percent per year, driven primarily by reduced investment in China. In 2017, for example, China represented 83 percent of fundraising in Asia, a share that dropped to 34 percent in 2022. In Europe, an 11-year run of fundraising growth ended, largely due to geopolitical instability and broader macroeconomic challenges, including volatility in foreign currency exchange rates. A strengthening dollar accounted for a material portion of the dollar-based decline in fundraising in non-US markets.

**Investors fled to known names and larger funds.** Amid a pullback in commitments, an outsized share of capital flowed to the largest funds, as investors re-upped with their existing managers but reduced backing smaller and new funds. Funds over $5 billion collected a record $445 billion in aggregate, a 51 percent increase over funds of a similar size in 2021. Conversely, dollars raised by sub-$5 billion funds decreased by 28 percent. Just 2,141 funds were closed during the year, 1,600 fewer than in 2021 and the fewest of any year since 2013. First-time fund launches also decreased by 40 percent.

**Dry powder inventory spiked.** Total private markets assets under management (AUM) reached $11.7 trillion as of June 30, 2022. AUM has now grown at an annual rate of nearly 20 percent since 2017. As of the second quarter of 2022, dry powder exceeded $3 trillion, reflecting an 8.4 percent year-over-year increase and marking the eighth consecutive year of growth. Dry powder inventory—the amount of capital available to GPs expressed as a multiple of annual deployment—spiked. In PE, inventory jumped from a historically low 0.9 times at the end of 2021, following a year of record deal flow that outpaced fundraising, to 1.4 times. That number is likely to
have grown even higher in the second half of 2022, as deal flow dried up more abruptly than fundraising slowed.

**PE multiples contracted.** PE buyout entry multiples declined slightly in 2022, falling to 12.9 times EBITDA from a record 13.2 times a year ago, while public market multiples compressed dramatically, declining to 12.0 from 14.6 times EBITDA. Financial services (~2.5 times) and information technology (~2.2 times) recorded the largest multiple declines among PE subsectors, while rising commodity prices drove multiple expansion in raw materials and resources (+2.6 times).

**PE posted negative performance for the first time since 2008.** Global PE performance turned negative for the first time since 2008, posting a −9 percent return through September1 and ending a five-year run as the highest-performing private asset class. Tech-focused buyout funds performed worse than other buyout funds for the second consecutive year, and venture capital (VC) underperformed buyout strategies for the first time since 2017. Counterintuitively, manager selection mattered less in 2022 than in years past; the interquartile spread of returns of PE funds narrowed in 2022 to 21.6 percent from the prior ten-year average of 33.8 percent. As the industry narrative turned from beta to alpha, there was less alpha to be had in 2022.

**Real estate served as an inflation hedge.** One of real estate’s biggest draws for institutional investors is the long-held belief in the asset class’s ability to protect real value during periods of higher inflation. Indeed, real estate performance has exceeded inflation in six of the last seven inflationary periods, in part due to cap rate compression even during a rising interest rate environment. The pattern in 2021 and 2022 was no different: despite rising US Treasury (UST) rates, cap rates decreased, and values rose. However, cap rates started expanding toward the end of 2022, signaling heightened uncertainty across real estate markets.

**Private debt had its moment (again).** Private debt fundraising continued to grow last year (+2 percent), once again bucking the trend of other private asset classes. Institutional investors sought out the asset class for various features that are attractive in times of market volatility: current yield, floating rates, and relative insulation (via its senior position in the capital stack) from declining valuations. The prevailing market uncertainty also served as a shot in the arm for private credit deployment opportunities. As bank financing dried up in the second half of the year, private lenders stepped into the void, providing financing for more than 80 percent of PE transactions in the middle market.

**More mega-funds and a broader mandate for infrastructure.** Infrastructure and natural resources fundraising rose to an all-time high of $158 billion, benefiting from the closing of a record five funds of more than $10 billion. The definition of infrastructure and natural resources continues to expand, with today’s funds now taking more equity risk than yesteryear’s did. Macroeconomic events had mixed impact across sectors: rising oil and gas prices drove a resurgence in demand for traditional energy investments, while growth in renewables fundraising continued amid the multiyear push toward decarbonization.

**Sustainable investing gained scale.** 2022 will prove to be the best year yet for ESG-focused fundraising, with $24 billion raised through the first half of the year. Sustainability-related deals (the “E”) increased by 7 percent to nearly $200 billion, proving resistant to the deal-making headwinds that affected other asset classes. Venture capital accounted for 40 percent of this total, while on

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1 As measured by year-to-date IRR as of September 30, 2022, for global funds vintages between 2000 and 2019.
a sectoral basis, power and transportation targets led the pack for the third year running. But ESG’s growing impact on private markets goes beyond just dedicated funds and deals: most funds (of any strategy) now consider ESG risk factors in due diligence, and some explicitly include ESG concepts in their value creation plans.

**Private markets firms still have work to do on diversity.** Considerations for diversity, equity, and inclusion (DEI) have become an important part of the fundraising, hiring, and investing landscape in private markets. LP willingness to allocate more capital to diverse deal teams is prompting more GPs (52 percent in 2021–22) to share DEI data during fundraising. On some diversity metrics, private markets firms compare favorably with corporate America, although ethnic diversity is not yet broad based. Ethnic, racial, and gender representation also remains imbalanced in senior positions and investing roles, suggesting that firms broadly continue to miss talent opportunities. Increasing representation across all levels will require managers to take fresh approaches to hiring, retention, and promotion.
Compared with a heady prior decade of robust growth, 2022 was a subdued year in the private markets. Following the record highs achieved in 2021, which were buoyed by pent-up demand from the earlier stages of the pandemic, several exogenous macroeconomic events stymied growth. High inflation persisted throughout most of 2022, prompting central banks around the world to increase interest rates at a historic pace. Quantitative tightening and dislocation in asset prices raised fears of an economic slowdown. And the ongoing war and humanitarian crisis in Ukraine further exacerbated risks to the global economy, including higher commodity prices and disrupted supply chains. Amid the challenges, public markets sold off substantially, and though private markets remained relatively buoyant in the first half of 2022, they followed in the latter half.

These disruptions had substantial and varied impacts on private markets fundraising, performance, and AUM growth, with steep declines in certain regions and strategies, and pockets of resilience in others.

Private markets fundraising fell 11 percent to $1.2 trillion, as the denominator effect affected some LPs’ ability to allocate capital. The decline was most evident in Europe and Asia, while, fundraising in North America increased slightly. Capital deployments into larger vehicles increased as investors re-upped with existing managers while forgoing commitments to smaller and newer managers.

Performance of every private markets asset class declined relative to 2021 but continued to outperform public market equivalents at current marks, though private market valuation changes often lag those in public markets. In a break from years past, PE performed worse than other private asset classes, producing negative returns (through September 30, 2022) for the first time since 2008. Natural resources strategies, meanwhile, generated relatively strong performance for a second consecutive year, buoyed by elevated commodity prices.

While fundraising and investment performance declined, the industry’s growth held reasonably steady, with assets under management increasing to $11.7 trillion as of June 30, 2022.
Fundraising

Global private markets fundraising totaled $1.2 trillion in 2022, matching the prepandemic high achieved in 2019. However, fundraising fell 11.4 percent from its $1.4 trillion record haul in 2021 (Exhibit 1). Still, 2022’s total is the third highest on record (and will likely climb to second when full-year data is finalized).

The so-called denominator effect may have played a role in the fundraising slowdown. As the value of institutional investors’ public investments depreciated faster than their private holdings, private allocations increased as a percentage of overall portfolios. For some LPs, this dynamic merely reduced the allocation “gap” that had existed between their actual and target private market allocations, but for others, it resulted in over-allocations to one or more private asset classes. Because some LPs are obligated to maintain private markets allocations below said targets, these valuation-driven allocation changes contributed to lower new commitments—and, in select cases, the sale of private market holdings in the secondary market—last year. Still, most LPs appear to be staying the course, intent on avoiding the sins of the GFC, during which many LPs sold positions at a discount and reduced allocations.

Exhibit 1

Private markets fundraising fell 11.4 percent in 2022.

Private markets fundraising, 2022

<table>
<thead>
<tr>
<th>Asset class</th>
<th>North America</th>
<th>Europe</th>
<th>Asia</th>
<th>Rest of world</th>
<th>Global</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total, $ billion</td>
<td>2021–22, $ billion</td>
<td>YoY change, %</td>
<td>Total, $ billion</td>
<td>2021–22, $ billion</td>
</tr>
<tr>
<td>Private equity</td>
<td>799</td>
<td>19</td>
<td>2.4</td>
<td>57</td>
<td>57</td>
</tr>
<tr>
<td>Real estate</td>
<td>444</td>
<td>-7</td>
<td>-1.5</td>
<td>43</td>
<td>93</td>
</tr>
<tr>
<td>Private debt</td>
<td>113</td>
<td>-31</td>
<td>-21.7</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>Infrastructure and natural resources</td>
<td>147</td>
<td>14</td>
<td>10.6</td>
<td>58</td>
<td>58</td>
</tr>
</tbody>
</table>

Note: Figures may not sum precisely, because of rounding.

1 Excludes secondaries, funds of funds, and co-investment vehicles to avoid double counting of capital fundraised. Reported figures only include funds that held final closes in FY 2022.

Source: Preqin
commitments for multiple years, permanently impairing their portfolios.

North America, which accounted for two-thirds of private markets fundraising, was the only region in which fundraising climbed higher in 2022, increasing 2.4 percent to $799 billion (Exhibit 2). Across asset classes in North America, fundraising for natural resources and infrastructure grew 82 percent, and private credit grew 11 percent. Closed-end real estate fundraising declined 22 percent.

Fundraising in Europe fell 28 percent to $230 billion (measured in US dollars), the lowest total since 2018, ending the continent’s 11-year growth streak. The decline was driven partially by foreign-exchange effects, as the dollar strengthened relative to most European currencies in 2022. Lower commitments may have been driven by record highs in dry powder at the end of 2021 and a more sober economic outlook relative to North America. The fundraising decline was broad based, with totals in closed-end real estate, PE, and infrastructure and natural resources all falling more than 30 percent year over year.

In Asia, fundraising declined for the fourth time in five years, falling 39 percent to $118 billion, 59 percent below 2017’s $288 billion peak. The multiyear decline for Asia-focused funds—and a particularly notable drop in China-focused fundraising—resulted from a confluence of factors, including excess dry powder and changing governmental regulations. Across Asia, fundraising fell substantially in PE (−49.2 percent) and private debt (−24.6 percent), while infrastructure and natural resources fundraising grew by a modest 1 percent.

Exhibit 2
North America was the only region to record positive fundraising growth in 2022.

Global private markets fundraising by region, $ billion

<table>
<thead>
<tr>
<th>Region</th>
<th>2017–22 CAGR, %</th>
<th>2021–22 growth, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>2.9</td>
<td>−11.4</td>
</tr>
<tr>
<td>Rest of world</td>
<td>2.9</td>
<td>−9.3</td>
</tr>
<tr>
<td>Asia</td>
<td>−16.4</td>
<td>−39.0</td>
</tr>
<tr>
<td>Europe</td>
<td>1.6</td>
<td>−28.2</td>
</tr>
<tr>
<td>North America</td>
<td>10.1</td>
<td>2.4</td>
</tr>
</tbody>
</table>

1 Private markets refers to private equity, real estate private equity (ie, closed-end funds), private debt closed-end funds, natural resources closed-end funds, and infrastructure closed-end funds. Secondaries and funds of funds are excluded to avoid double counting of capital fundraised.

Source: Preqin

McKinsey & Company
2022’s fundraising headwinds did not affect all managers equally. In a turbulent market, investors shifted new commitments to larger funds. Funds greater than $5 billion raised a record $445 billion, 51 percent more than in 2021. Conversely, funds smaller than $1 billion raised just $349 billion, a decrease of 31 percent. Last year’s move toward larger funds accelerated a long-running trend. Funds smaller than $1 billion decreased as a percentage of total fundraising from 47 percent in 2017 to 29 percent in 2022, while the share of funds greater than $5 billion grew from 21 percent to 37 percent over the same period (Exhibit 3).

A similar trend played out in fund count. The total number of funds of less than $1 billion fell by 45 percent to around 1,900. By contrast, the number of funds of greater than $5 billion increased by nearly 40 percent to 39 funds.

Despite a more challenging fundraising year, established GPs managing larger funds succeeded in attracting significant investor commitments. Indeed, the top 20 fundraisers raised 32 percent of the total fundraising volume in 2022, which is the highest share since 2009 and a 9 percent year-over-year increase.

Exhibit 3

**Funds greater than $5 billion raised 37 percent of total fundraising.**

<table>
<thead>
<tr>
<th>Global private markets fundraising by fund size and close year, % of total in-year fundraising amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; $250 million</td>
</tr>
<tr>
<td>$250–500 million</td>
</tr>
<tr>
<td>$500 million–1 billion</td>
</tr>
<tr>
<td>$1–5 billion</td>
</tr>
<tr>
<td>$5–10 billion</td>
</tr>
<tr>
<td>&gt; $10 billion</td>
</tr>
</tbody>
</table>

1 Secondary and funds of funds are excluded to avoid double counting of capital fundraised.
2 Source: Preqin

McKinsey & Company
AUM

Private markets AUM totaled $11.7 trillion as of June 30, 2022 (Exhibit 4). AUM has grown at an annual rate of nearly 18 percent since 2017. In 2022, a deteriorating macro environment coupled with lower availability and higher cost of debt slowed exit activity, driving growth in net asset value (NAV). Dry powder totaled more than $3 trillion, increasing 8.3 percent from the first half of 2021 through the first half of 2022 and marking the eighth consecutive year of growth. Due to a lag in reported data, market dynamics in the second half of last year are not reflected in reported AUM figures.

Exhibit 4

Private markets AUM totaled $11.7 trillion.

Private markets assets under management, H1 2022, $ billion

<table>
<thead>
<tr>
<th>Region</th>
<th>Buyout</th>
<th>Venture capital</th>
<th>Growth</th>
<th>Other</th>
<th>Private debt</th>
<th>Real estate</th>
<th>Infrastructure and natural resources</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>2,016</td>
<td>1,068</td>
<td>494</td>
<td>388</td>
<td>829</td>
<td>854</td>
<td>640</td>
</tr>
<tr>
<td>Europe</td>
<td>849</td>
<td>1,201</td>
<td>525</td>
<td>57</td>
<td>362</td>
<td>368</td>
<td>394</td>
</tr>
<tr>
<td>Asia</td>
<td>344</td>
<td>109</td>
<td>91</td>
<td>19</td>
<td>51</td>
<td>62</td>
<td>122</td>
</tr>
<tr>
<td>Rest of world</td>
<td>80</td>
<td>109</td>
<td>91</td>
<td>19</td>
<td>51</td>
<td>62</td>
<td>122</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>6,288</td>
<td>2,578</td>
<td>1,218</td>
<td>535</td>
<td>1,333</td>
<td>1,461</td>
<td>1,273</td>
</tr>
</tbody>
</table>

100% = $11.7 trillion

Note: Figures may not sum precisely, because of rounding.

*a* Includes turnaround PE funds and PE funds with unspecified strategy.

Source: Preqin

McKinsey & Company
Performance

All private markets asset classes posted lower returns in 2022 than in 2021. After five consecutive years as the highest-returning private markets asset class, PE was the only asset class to generate negative performance, turning in a net IRR of −9.2 percent year to date as of September 30. Meanwhile, natural resources had its second straight year of strong performance, returning 15.6 percent and leading all private markets asset classes (Exhibit 5).

Private markets asset classes outperformed their corresponding public markets indexes, a consistent trend over the past two decades. In a turbulent year for public markets, that result is unsurprising; private marks often lag public valuations and benefit from a degree of valuation discretion. PE outperformed public markets indexes, with the MSCI World Index posting −25.1 percent returns through the first three quarters of 2022. Within PE, buyouts returned −6.0 percent through September 30, while venture capital returned −14.9 percent. Closed-end real estate, which generated a 2.5 percent net IRR through September, also outperformed public indexes, such as the FTSE Nareit Equity REITs Index, which lost 27.9 percent over the same period.

PE has been not only the best-performing private markets asset class over the long run but also the asset class for which manager selection matters most. The median net IRR to date for PE funds

Exhibit 5

All private market asset classes posted lower returns yet outperformed public equities.

Performance by asset class, 1-year pooled IRR for 2000–19 vintage funds,¹ %


Source: Bloomberg; Burgis

McKinsey & Company
raised between 2009 and 2019 was 20.1 percent as of September 30, which exceeds the top-quartile return of all other private asset classes. However, the spread between top- and bottom-quartile PE funds was 18 percentage points, which is 400 basis points greater than for any other asset class (Exhibit 6). So, while dollars put to work in PE broadly have been more productive than in other asset classes, the dispersion of fund performance in PE also presents the greatest opportunity for LPs to outperform (or underperform) through optimal fund selection. Performance relative to the median is often the key measuring stick for teams managing private asset portfolios.

**Non-institutional capital comes in to focus**

Institutional investors remain the dominant providers of capital into private markets, but non-institutional capital has grown in importance. Private markets are slowly becoming more accessible as regulatory changes and novel investment vehicle structures open private investment opportunities to high-net-worth and retail-capital pools. GPs have eagerly responded to the opportunity.

Investing in the private markets appeals to non-institutional investors for the same reasons that it does to institutional ones: the potential for higher returns, lower correlation with public equity markets, and access to otherwise inaccessible markets and strategies. Fund managers, meanwhile, see non-institutional investors as a $45 trillion global capital pool and a relatively untapped source of funds. At present, retail investor allocations to private markets range from 5–6 percent. As more institutional investors achieve asset-allocation maturity and slow the growth of their new commitments to private markets, non-institutional capital will be the next growth frontier for GPs.

Recent regulatory changes in the United States and Europe have facilitated this so-called democratization of private markets.

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**Exhibit 6**

**The performance gap between top- and bottom-quartile PE funds is wider than for the other asset classes.**

*Performance by asset class, median IRR and percentile spreads for 2009–19 vintage funds,*

<table>
<thead>
<tr>
<th>Private equity</th>
<th>Private debt</th>
<th>Real estate</th>
<th>Natural resources</th>
<th>Infrastructure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top 25%</td>
<td>Median</td>
<td>Bottom 25%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>29.8</td>
<td>20.1</td>
<td>11.4</td>
<td>12.6</td>
<td>14.5</td>
</tr>
<tr>
<td>20.1</td>
<td>11.4</td>
<td>12.6</td>
<td>9.3</td>
<td>14.5</td>
</tr>
<tr>
<td>18.4</td>
<td>11.4</td>
<td>7.0</td>
<td>11.5</td>
<td>10.3</td>
</tr>
<tr>
<td>11.4</td>
<td>7.0</td>
<td>6.5</td>
<td>6.5</td>
<td>4.3</td>
</tr>
<tr>
<td>17.8</td>
<td>6.5</td>
<td>6.5</td>
<td>6.5</td>
<td>9.3</td>
</tr>
<tr>
<td>13.4</td>
<td>6.5</td>
<td>6.5</td>
<td>13.9</td>
<td>6.5</td>
</tr>
<tr>
<td>14.5</td>
<td>9.3</td>
<td>9.3</td>
<td>10.3</td>
<td>4.3</td>
</tr>
</tbody>
</table>

*IRR spreads calculated for funds for separate vintage years for 2009–19, and then averaged out. Median IRR was calculated by taking the average of the median IRR for funds within each vintage year; net IRR to date through Sept 30, 2022.

Source: Burgiss

McKinsey & Company
of private markets. Two salient examples: In 2020, the US Department of Labor issued a statement allowing select 401(k) plans to incorporate PE as a component of their investment plans. And in February 2023, the European Parliament voted to approve revisions to the European Long-Term Investment Funds that will relax rules restricting individual investment in private asset classes, including minimum investment and diversification requirements.

With relaxing regulatory barriers and growing demand for alternatives among non-institutional investors, GPs have utilized enhanced distribution teams and structured vehicles. One common structure is the feeder fund, a vehicle that aggregates commitments from several individual investors into a common pool that is then invested in a private partnership (such as a PE fund). While this is hardly a new structure (private banks have been assembling feeders for their wealthiest clients for years), these vehicles have grown more common and their utilization more widespread, driven by a handful of start-ups that have entered the space and grown quickly, easing the operational burden for GPs.

Beyond feeder funds, several other vehicles enable private markets investing for non-institutional clients, including interval funds, tender funds, private real estate investment companies (REITs), and business development companies (BDC). None are new, but most have grown in relevance. In real estate, private REIT contributions has grown dramatically over the last several years, driven by the market entry of a few well-known players that built large sales teams to facilitate distribution. Two such vehicles faced liquidity challenges in recent months, when non-institutional investors sought exits. And in private debt, though non-institutional investors have long had access to BDCs, a new breed of BDC, known as the nontraded perpetual life BDC, has grown in popularity. These nontraded BDCs generated more than 80 percent of BDC asset growth last year through September.3

New technology plays a role in promoting access for and distribution to non-institutional investors. Tokenized funds have grown in number, utilizing blockchain technology to fractionalize fund stakes into smaller tokens, lowering the minimum investment required for qualified US-based investors. In 2022, two large asset management companies announced plans to tokenize funds that span private equity, private credit, secondaries, and other asset classes.

While addressing the non-institutional market is an enormous opportunity for private markets players, there are numerous operating challenges. A move in this direction will require substantial investments in distribution and reporting infrastructure, coming from either GPs themselves or the range of technology-oriented start-ups jumping into the space. Regulators are likely to watch closely as the market develops. Regardless, with mountains of potential capital up for grabs, GP interest in the non-institutional opportunity is only going to grow.

3 Refinitiv.
On the heels of a banner 2021, which set records for fundraising and deal making and produced exceptionally strong returns, PE fell back to earth in 2022. Aforementioned challenges—the higher cost and lower availability of debt, rapidly declining public market valuations, and macroeconomic uncertainty—stifled growth, activity, and performance in what had been the best-performing private markets asset class for many years running.

Globally, fundraising fell 15 percent from the all-time high achieved in 2021. LPs concentrated commitments among large funds as many investors chose to re-up with known, tested names while forgoing commitments to smaller, newer managers. In particular, megafunds gained prominence: 11 funds of more than $10 billion each were raised, totaling $170 billion collectively. VC and growth equity both had their second-largest fundraising year on record, cumulatively accounting for more than 50 percent of PE fundraising for the first time.

AUM ascended higher, as it has in every year since the global financial crisis, to $7.6 trillion. Additionally, the deal-making momentum of 2021 continued through the first half of the year before falling dramatically in the second, weighed down by reduced credit availability and valuation uncertainty. Exit volume fell sharply, as sponsors chose to hold assets rather than sell into a declining-valuation environment.

PE returns disappointed, recording the worst year (through September 30) since 2008, and PE ended a five-year run as the top-performing asset class. Because of the deterioration in technology valuations, VC and growth equity returns led the fall, in stark contrast to the last several years. The median VC and growth funds lost 6.3 and 7.3 percent, respectively, through the first three quarters of 2022, while the median buyout fund earned 0.9 percent.
Fundraising

Globally, PE fundraising fell 15 percent to $655 billion (Exhibit 7), the lowest sum collected by the asset class since 2017 (except during the pandemic-driven slowdown in 2020). Each major PE strategy experienced fundraising declines greater than 10 percent. Buyout, the largest PE strategy, recorded an 18 percent decline. Growth equity and VC, which each hit record fundraising levels in 2021, dropped by 17 percent and 11 percent, respectively. The fundraising drop was broad-based across regions.

For North America–focused funds, a relative bright spot, fundraising declined just 2 percent from the record set in 2021. Despite the year-over-year decline, 2022 was the second-highest year on record for North American PE fundraising.

Fundraising by VC and growth equity funds grew 6 percent in the region, while buyout fell 15 percent. A key driver of the region’s relative fundraising resilience: dollars shifted in favor of larger funds in 2022, and North America is home to more large funds than any other region. Indeed, seven PE funds in the region raised a record $10 billion or more, while only four such funds were raised in all other regions combined.

Fundraising for Europe- and Asia-focused funds fell precipitously. European PE funds raised $93 billion, a 32 percent year-over-year decline and the lowest total since 2017, reversing the consistent, modest growth seen over the last four years. The fundraising decrease was most evident in midsize vehicles ($1 billion to $5 billion), which declined 61 percent.

Exhibit 7

Global PE fundraising fell to $655 billion.

Global private equity fundraising by region, $ billion

<table>
<thead>
<tr>
<th>Region</th>
<th>2017–22 CAGR, %</th>
<th>2021–22 growth, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>All regions</td>
<td>0.9</td>
<td>−15.2</td>
</tr>
<tr>
<td>North America</td>
<td>10.3</td>
<td>−1.5</td>
</tr>
<tr>
<td>Europe</td>
<td>1.0</td>
<td>−31.9</td>
</tr>
<tr>
<td>Asia</td>
<td>−21.2</td>
<td>−49.2</td>
</tr>
<tr>
<td>Rest of world</td>
<td>16.4</td>
<td>12.5</td>
</tr>
</tbody>
</table>

1Secondaries and funds of funds are excluded to avoid double counting of capital fundraised. Source: Preqin

McKinsey & Company

4 Excludes other PE.
Each major PE strategy experienced fundraising declines greater than 10 percent.

Difficult macroeconomic conditions—which were perhaps most acute in Europe—and the strengthening US dollar are likely to have had an impact on fundraising momentum.

In Asia, fundraising fell 49 percent to $74 billion, the lowest total since 2013 and the fourth annual decline in five years. China-focused fundraising is responsible for much of the region’s steep decline. For example, in 2017, a peak year for capital raising in the country, China-focused funds raised $208 billion. In 2022, that total dropped to $34 billion. China represented more than 85 percent of PE fundraising in Asia in 2017 and only 46 percent in 2022.

Several reasons explain the drop in China-focused fundraising. First, fundraising increased at a rapid pace through 2017 in Asia, particularly China, leading to a large amount of dry powder. From 2014 through 2019, Asia’s dry powder, much of which is located in China-focused vehicles, grew to $312 billion, a nearly 200 percent increase. As a result, GPs eased further fundraising to focus on deploying stockpiles of committed capital. Second, new regulatory policy in China, installed in 2018, has limited nonfinancial entities’ ability to borrow capital to invest in PE funds. Third, the ramifications of COVID-19 and extended lockdowns have made it harder for GPs to organize fundraising roadshows and raise new capital for funds in the country.

Across the rest of the world, which encompassed just 7 percent of the global total, fundraising grew 12 percent year over year. The increase was substantially driven by several large Australia and Australia-Pacific funds.

Drivers of fundraising
Various factors contributed to the drop in fundraising momentum. First, heightened macroeconomic uncertainty had an impact on global financial markets in general and slowed fundraising across most private markets, including PE. In this uncertain environment, private markets investors showed a preference for lower-risk strategies. Consequently, the largest funds, which have exhibited lower return dispersion over time (Exhibit 8), managed to raise relatively greater capital. Second, fundraising regressed from the record-high volume of 2021, which was partially inflated by the backlog of funds unable to reach a final close in 2020 due to the pandemic. Third, the denominator effect closed the gap between current and target allocations for most LPs, driving some institutions into an over-weight position. As of September 2022, PE (as marked) outperformed public markets by a considerable margin: PE’s year-to-date returns totaled –9.2 percent, compared with –25.1 percent for the MSCI World Index. As a result, the current portfolio value for 33 percent of PE LPs outstretched their respective targets in 2022, versus 27 percent in the prior year and just 17 percent in 2019. Within
the LP universe, nearly 50 percent of endowments, government agencies, and public pension funds were overallocated to PE as of the beginning of 2023.

LPs have reacted to their overweight positions in myriad ways. Some LPs obligated to stay below their target allocation limit slowed or stopped allocating new capital. Others sold portfolios, although less so than last year, and a few continued to hold course, sticking to their long-term commitment plans. There were also some investors who simply raised their targets to accommodate the overweight allocations, indicative of their belief in the strategy’s long-term performance potential.

Yet, across the board, a majority of LPs seemed intent to avoid what happened during the last downturn, when commitments ramped up rapidly prior to the GFC, peaking allocations into what turned out to be poorly performing vintages. It took some time before investors reduced new commitments substantially or stopped altogether, so they sat on the sidelines in vintages that ultimately performed fairly well. Investors who faced liquidity concerns and pressure from board members also sold positions in the secondary market at substantial discounts, permanently impairing value. While secondary pricing has once again fallen sharply in the current environment, relatively few LPs have sold into that market thus far. (See later in this chapter for further discussion of secondaries.)

**Concentration into larger funds**

Fundraising challenges in 2022 were not borne equally by all managers. In last year’s report, we discussed the remarkably consistent industry structure in PE. The idiosyncratic timing of funds coming to market does drive annual volatility in fundraising, but a longer-term view reveals consistency. For example, the top 25 managers have accounted for 36 percent of the total fundraising on average over the last decade, with little variation.

**Exhibit 8**

**Median returns were similar across fund sizes; spreads were larger for small-cap buyout funds.**

**Global buyout fund performance by percentile, IRR for 2000–19 vintage funds, %**

![Graph showing median returns and performance by fund size.](image)


Source: Burgiss

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in that number when considering a multiyear view (Exhibit 9). But 2022 was different: the largest 25 managers raised 42 percent of the global total, the highest annual share since 2013. Meanwhile, everyone outside the top 250 managers raised just 19 percent, the lowest share since 2014.

In a year when investors concentrated their allocations amid a broader pullback in commitments, re-ups to existing managers sustained, and larger funds and their sponsors persevered. Dollars allocated to funds exceeding $5 billion grew 25 percent year over year, while fundraising for vehicles of less than $1 billion fell by more than 34 percent.

Consistent with this shift to larger funds, the average fund size across PE strategies increased to approximately $410 million, up from $210 million in 2016, while the number of funds fell 46 percent from a year prior, reigniting a multiyear trend after a temporary stay in 2021 (Exhibit 3). Megafunds played a key role in driving up fund size: a record 11 funds of at least $10 billion closed in 2022,

Exhibit 9

Top managers captured a greater share of PE fundraising in 2022.

Share of PE fundraising by year, %

Note: Figures may not sum precisely, because of rounding.

1 Secondaries, funds of funds, and co-investment vehicles are excluded to avoid double counting of capital fundraised.

Source: Preqin

McKinsey & Company
compared with nine such funds in 2021 and just four in 2020. Within buyouts, the average fund raised $1.25 billion, the second-largest size in the strategy’s history. Meanwhile, the count of funds smaller than $250 million fell by more than 51 percent (Exhibit 10).

Increased concentration among larger funds may reflect investors’ move to limit risk in a volatile equity market. Typically, the median performance of larger funds is similar to that of smaller funds, but the dispersion of returns is narrower for larger funds.

The environment was particularly challenging for first-time funds, whose fundraising fell to $32 billion, the lowest total since 2013 and the lowest share of total fundraising in at least 20 years (Exhibit 11). A single-year shift in fundraising can appear to be driven as much by supply as by demand, based on the timing of large fund families returning to market every three to five years. However, of the 22 funds that raised more than $10 billion from 2017 to 2019, just three such fund families raised a successor vehicle with a final close in 2022, indicating that first-time funds comprised the vast majority of the 11 megafunds closed in 2022.

AUM

Global PE AUM increased to $7.6 trillion in the first half of 2022. This continues a growth trend in which AUM has risen at an annual rate of more than 22 percent since 2017. Within PE, the AUM mix has shifted considerably over time. Buyout accounted for 43 percent of the global total as of the first half, down from 55 percent in 2017. VC’s share was 34 percent, up from 21 percent five years prior.

In Asia, VC accounts for 56 percent of PE AUM, while growth’s share was 25 percent. In contrast, buyout was the largest strategy in Europe and North America, accounting for 70 percent and 51 percent of each region’s overall AUM, respectively. The rest of the world’s AUM was more evenly split, with 36 percent in VC, 30 percent in growth, and 27 percent in buyout as of June 30.

PE dry powder reached an all-time high of nearly $1.9 trillion (Exhibit 12). Dry powder inventory on hand was 1.4, up from 0.9 years in 2021 (which was a historical low driven by heightened deal activity that year). When year-end figures become available,
Exhibit 11

PE fundraising by first-time managers decreased.

Fundraising by first-time managers, \(^1\) $ billion

![Bar chart showing PE fundraising by first-time managers from 2006 to 2022.]

- 2006: 24.5 billion
- 2007: 33.9 billion
- 2008: 24.4 billion
- 2009: 19.6 billion
- 2010: 17.4 billion
- 2011: 31.5 billion
- 2012: 24.6 billion
- 2013: 20.9 billion
- 2014: 50.8 billion
- 2015: 52.9 billion
- 2016: 59.8 billion
- 2017: 93.2 billion
- 2018: 70.6 billion
- 2019: 42.8 billion
- 2020: 39.9 billion
- 2021: 42.8 billion
- 2022: 32.1 billion

\(^1\)Secondaries, funds of funds, and co-investment vehicles are excluded to avoid double counting of capital fundraised. Source: Preqin.

McKinsey & Company

Exhibit 12

Global inventories of PE dry powder rebounded.

Years of private equity inventory on hand, \(^1\) turns

![Line chart showing years of private equity inventory on hand from 2008 to 2022.]

- 2008: 3.0 turns
- 2009: 2.0 turns
- 2010: 1.0 turns
- 2011: 0 turns
- 2012: 0 turns
- 2013: 0 turns
- 2014: 0 turns
- 2015: 0 turns
- 2016: 0 turns
- 2017: 0 turns
- 2018: 0 turns
- 2019: 0 turns
- 2020: 0 turns
- 2021: 0 turns
- 2022: 0 turns

\(^1\)Capital committed but not deployed, divided by equity deal volume. Equity deal volume estimated using transaction volume and leverage figures. Source: PitchBook; Preqin.

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inventory totals are likely to have increased even more, given that deal volume declined more rapidly than the slowdown in fundraising.

Performance

PE was not immune to broader valuation declines, and performance suffered in 2022, albeit less than that of public markets. As stated previously, this result is unsurprising, given a lag in reporting and manager discretion in valuation. For the first time in six years, PE was not the highest-performing private markets asset class. Instead, it was the only asset class to lose money as of September, recording a nine-month trailing pooled net IRR of −9.2 percent. Equity performance is relatively volatile, and the year’s performance followed a full-year return of 39.5 percent in 2021 (Exhibit 13).

In 2022, negative returns were widespread across strategies, though sector focus played a considerable role in relative performance. By strategy, buyout had the strongest performance, returning −6.0 percent on a pooled basis for the three

Exhibit 13

**VC underperformed buyout for the first time since 2017.**

**Performance by strategy, 1-year pooled IRR for 2000–19 vintage funds, %**


Source: Burgiss

McKinsey & Company
quarters ending September 30. Growth and VC, both heavily exposed to tech, underperformed buyout by recording pooled net IRRs of −14.9 and −14.7 percent, respectively. This trend differs from VC’s strong outperformance over the last decade. Tech-oriented strategies dragged down buyout returns as well, posting returns of −11 percent after exceeding 35 percent in the previous two years. Tech performance in public markets mirrored the trend: the NASDAQ lost 32 percent in 2022, trailing the more balanced S&P 500 by eight percentage points. Meanwhile, the best-performing buyout sector year to date was energy, which gained more than 17 percent, driven by rising commodity prices. Consumer staples (6.5 percent) and industrials (6.0 percent) also performed relatively well.

Counterintuitively, manager selection mattered less in 2022 than in years past. The interquartile spread of returns of PE funds—the gap between the bottom and top quartile—narrowed to 21.6 percent from the prior ten years’ annual average of 33.8 percent, largely driven by the drop in top-quartile returns. As the industry narrative turned from beta to alpha, there was less alpha to be had in 2022.

Despite last year’s performance challenges, long-term PE returns remained robust and resilient. PE has outperformed other private markets asset classes over all long-term increments across the last 15 years. The median net IRR of 2009–19 PE fund vintages was 20.1 percent as of September 30, exceeding the top-quartile return of all other private asset classes by more than 200 basis points (Exhibit 14). At the top end, PE’s performance has been exceptional, with top-quartile funds producing net IRRs of 29.8 percent or better.

PE also continued to outperform its public markets equivalents, though valuation discretion in the current environment may play a role in that conclusion. A Kaplan Schoar PME analysis,

Exhibit 14

VC returns outpaced all other PE substrategies across every quartile.

Performance by PE strategy, median IRR and percentile spreads for 2009–19 vintage funds, %

<table>
<thead>
<tr>
<th>Private equity</th>
<th>Venture capital</th>
<th>Buyout</th>
<th>Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top 25%</td>
<td>Median</td>
<td>Bottom 25%</td>
<td></td>
</tr>
<tr>
<td>29.8</td>
<td>33.8</td>
<td>26.9</td>
<td>19.9</td>
</tr>
<tr>
<td>20.1</td>
<td>23.1</td>
<td>19.4</td>
<td>12.8</td>
</tr>
<tr>
<td>11.4</td>
<td>12.2</td>
<td>11.9</td>
<td>7.3</td>
</tr>
</tbody>
</table>

1IRR spreads were calculated for funds for separate vintage years from 2009–19 and then averaged out. Median IRR was calculated by taking the average of the median IRR for funds within each vintage year; net IRR to date through Sept 30, 2022.

Source: Burgiss

McKinsey & Company
which benchmarks PE performance against a public markets index by accounting for the timing of cash flows, indicates that the median PE fund from the 2009–19 vintages outperformed the public markets equivalent by an average of 1.3 times. In fact, the median PE fund in every vintage in the measured decade outperformed public markets equivalents.  

Deal activity

Globally, PE firms executed notably fewer deals than they did during 2021’s enormously busy transaction market. Deal volume fell 26 percent to $2.4 trillion, and deal count fell 16 percent to just under 60,000. Even so, 2022 was the second most active year for deal activity on record, with a particularly robust first half (Exhibit 15).

Exhibit 15

**Private equity deal volume declined 26 percent.**

<table>
<thead>
<tr>
<th>Global private equity deal volume, $ billion</th>
<th>Global private equity deal count, Number of deals, thousands</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>North America</td>
</tr>
<tr>
<td>3,500</td>
<td>3,000</td>
</tr>
<tr>
<td>3,281</td>
<td>–861 (-26%)</td>
</tr>
<tr>
<td>2,420</td>
<td></td>
</tr>
</tbody>
</table>

1 Includes PE buyout/LBO (add-on, asset acquisition, carve-out, corporate divestiture, debt conversion, distressed acquisition, management buyout, management buy-in, privatization, recapitalization, public-to-private, secondary buyout); PE growth/expansion (recapitalization, dividend recapitalization, and leveraged recapitalization); platform creation, angel, seed round early-stage VC, later-stage VC, restart—angel, restart—early-stage VC, restart—later-stage VC.

Source: PitchBook

McKinsey & Company

8 Burgiss.
Global deal activity slowed rapidly in the second half of the year as debt availability declined and economic uncertainty intensified. Indeed, volume in the first six months of 2022 fell just 5 percent from the same period in 2021, while second-half deal volume fell 45 percent. By historical standards, the fourth quarter was particularly slow—in fact, the least active quarter since 2017 (excluding the depths of the pandemic in early 2020). Market activity through early 2023 suggests sustained sluggishness in the first quarter.

Across regions, deal volume in North America declined 27 percent to just under $1.2 trillion, while volume in Europe fell 18 percent to $826 billion. The biggest impact was in Asia, where deal volume decreased by 43 percent to $228 billion (Exhibit 16).

In terms of strategies, global buyout activity fell 25 percent to less than $1.7 trillion, and growth activity fell 18 percent to $254 billion. VC deal volume declined even further, falling 33 percent to $498 billion. The decline in VC deal volume was more dramatic in the second half of 2022, falling 55 percent from the second half of 2021.

Among sectors, energy was the only one in which deal volume grew, buoyed by rising commodity prices. Energy deal volume grew by 6 percent year over year, following a 102 percent increase in 2021. Volumes in the two most negatively affected sectors, consumer and materials and resources, fell 47 percent and 52 percent, respectively (Exhibit 17).

Exhibit 16

Deal volume decreased across all regions in the second half of 2022.

Global private equity deal volume, $ billion

<table>
<thead>
<tr>
<th>Region</th>
<th>2017–22 CAGR, %</th>
<th>2021–22 growth, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>7.8</td>
<td>-26.2</td>
</tr>
<tr>
<td>North America</td>
<td>9.7</td>
<td>-26.7</td>
</tr>
<tr>
<td>Europe</td>
<td>9.3</td>
<td>-17.8</td>
</tr>
<tr>
<td>Asia</td>
<td>-4.1</td>
<td>-43.2</td>
</tr>
<tr>
<td>Rest of world</td>
<td>12.7</td>
<td>-30.9</td>
</tr>
</tbody>
</table>

Source: PitchBook
Deal activity declined across almost every sector.

Global PE deal volume by sector, $ billion

<table>
<thead>
<tr>
<th>Sector</th>
<th>2017–22 CAGR, %</th>
<th>2021–22 growth, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total (all sectors)</td>
<td>7.8</td>
<td>–26.2</td>
</tr>
<tr>
<td>Business products and services (B2B)</td>
<td>9.7</td>
<td>–15.5</td>
</tr>
<tr>
<td>Consumer products and services (B2C)</td>
<td>–3.7</td>
<td>–46.6</td>
</tr>
<tr>
<td>Energy</td>
<td>4.2</td>
<td>5.6</td>
</tr>
<tr>
<td>Financial services</td>
<td>9.1</td>
<td>–21.5</td>
</tr>
<tr>
<td>Healthcare</td>
<td>7.7</td>
<td>–36.6</td>
</tr>
<tr>
<td>Information technology</td>
<td>17.4</td>
<td>–21.1</td>
</tr>
<tr>
<td>Materials and resources</td>
<td>2.3</td>
<td>–52.0</td>
</tr>
</tbody>
</table>

Note: Figures may not sum precisely, because of rounding. Source: PitchBook

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Add-on deals
Add-on deals have consistently grown in popularity. Add-ons represented 49 percent of the total buyout deal count in 2009, increasing to 68 percent in 2021. In 2022, they accounted for 72 percent of all buyouts globally, with the largest concentration in North America (Exhibit 18).

Mergers and acquisitions (M&A) has long been a core PE strategy, even more so today than in years past. Industry roll-ups, among other M&A-backed strategies, allow GPs to invest in smaller targets that often trade at lower multiples, benefiting from the resulting multiples arbitrage (for example, the combined business trading at the larger acquiring company’s multiple upon exit if the merger is successful). Today, PE firms also use M&A to enable cost-oriented synergies, accelerated product development, faster expansion into new markets, and new talent acquisition.

Exits
Among PE deal categories, exits declined by the greatest degree in 2022, as GPs either struggled to find buyers in a liquidity-constrained environment or chose to hold assets rather than sell into an uncertain market. The decline in exits outpaced the decline in total deals such that the ratio of exits to investments as of the third quarter fell to 0.38, the lowest level since 2008. The decline in exits was most pronounced in North America, where PE exits (excluding VC) fell 65 percent year over year. In Europe and Asia, exits declined 37 percent and 32 percent, respectively.

Exhibit 18
Non-platform deals accounted for an increased share of PE buyout activity.

PE buyout deal volume, %

Non-platform deals, % of deal count

Source: PitchBook
McKinsey & Company
GPs that did exit holdings often ended up selling to other sponsors. These so-called sponsor-to-sponsor transactions represented 62 percent of all PE-backed exits through September, nine percentage points above the average of the prior decade. Meanwhile, IPO volumes dropped 70 percent in 2022 year over year, and corporate M&A activity fell 37 percent. As a share of total deal volume, neither carve-outs (−1 percent) nor take-privates (4 percent) saw significant fluctuations.

**Deal multiples and leverage**

From 2010 to 2020, PE and public markets multiples expanded steadily, with valuation growth in the private markets slightly outpacing that in public markets. The average median entry multiple in buyout, for example, increased from 8.8 times to 12.7 times earnings before interest, taxes, depreciation, and amortization (EBITDA) during the period (Exhibit 19). In other words, an investor in 2020 paid 44 percent more to acquire the same EBITDA than it would have paid a decade prior.

In 2022, median global buyout multiples declined to 12.9 times EBITDA from a record 13.2 a year earlier. In contrast, global public equity multiples declined more dramatically, falling from 14.6 to 12.0 times EBITDA.

Among sectors, the largest year-over-year declines in purchase price multiples were seen in information technology (which fell from 17.3 to 15.0) and financial services (14.0 to 11.5), while raw materials and natural resources saw an expansion (9.3 to 11.8). Changes in observed multiples across most

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**Exhibit 19**

**Global buyout entry multiples declined slightly.**

*Median buyout entry multiples and public equity multiples, turns of EBITDA*

Source: Bloomberg; Preqin

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private markets sectors were generally consistent with changes in the corresponding public markets sectors.

Despite the rising cost of debt, ingoing leverage remained roughly the same as in the prior year, at just under 7 times EBITDA. Debt-to-capitalization ratios—and conversely, equity-check percentages—also held roughly in line with 2021’s levels (Exhibit 20).

**Spotlight on secondaries**

In the last few years, the PE secondaries market has gained prominence as a liquidity tool, transitioning from an option of last resort to a more standard exiting- or reallocation-capital approach for LPs and a means by which GPs can continue managing high-quality assets. Theoretically, growth in the depth of the secondaries market should help when a wave of LPs are looking to change their holdings, such as in an environment influenced by the denominator effect, which means that there ought to have been an uptick in secondaries activity. Yet secondaries deal volume fell 18 percent in 2022 from the record high of $132 billion in the prior year, perhaps reflecting the decreases in secondaries pricing and the tendency of LPs to stay the course.

While LP-led secondaries deal volume declined 13 percent to $56 billion, it still accounted for more than 50 percent of the total secondaries deal volume. Notably, first-time sellers made nearly half of these LP-led secondaries deals, doubling their

Exhibit 20

**US buyout leverage remained at nearly seven times EBITDA.**

**US buyout leverage metrics, 2010–22**

![US buyout leverage metrics chart](chart)

Source: Re/initiv

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share from 2021. Should the denominator effect persist, deal volume in this space may accelerate.

Deal volume for GP-led secondaries—often a means for GPs to continue owning their well-performing assets on a new basis, lock in unrealized gains on assets, and return money to LPs—fell 24 percent, reversing a multiyear trend. Consistent with the broader trend in PE, GPs, which sell assets to themselves through continuation funds, elected to hold assets within existing vehicles rather than sell into a declining price environment. Meanwhile, single-asset continuation vehicles continued
to grow in relative prominence, accounting for 50 percent of all GP-led secondaries in 2022.

**Fundraising**

PE secondaries fundraising also declined for the second consecutive year, falling to $31 billion (Exhibit 21). After a record haul in 2020, the decline in the last two years can be mostly explained by the concentration in secondaries fundraising. Over the past decade, the ten most prolific fundraisers have raised 45 percent of the total secondaries fundraising over the last five years. Of these managers, five achieved a final close of their

### Exhibit 21

**A decline in the number of large fund closings reduced PE secondaries fundraising.**

**Global private equity secondaries fundraising, $ billion**

<table>
<thead>
<tr>
<th>Total fundraising, $ billion</th>
<th>3-year average</th>
<th>Prior 10-year average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top 10 secondaries managers</td>
<td>25.8</td>
<td>14.0</td>
</tr>
<tr>
<td>Remaining secondaries managers</td>
<td>28.6</td>
<td>11.4</td>
</tr>
</tbody>
</table>

Source: Preqin

McKinsey & Company

7 Most prolific is defined as highest aggregate fundraising in PE secondaries since 2010.
secondaries fund in 2020, two in 2021, and just one in 2022. With fewer of the largest players in the market in the last two years, fundraising totals have not approached the 2020 peak.

Even then, signs of a deepening secondaries market continue, given the growth in fundraising by managers outside the top ten. Though total PE secondaries fundraising halved year over year in 2021 and fell another 20 percent in 2022, funds raised by GPs outside of the top ten reached a new high of $33 billion in 2021—a total that was nearly matched again in 2022.

Similar to traditional PE fundraising, North American secondaries funds outpaced the broader market, posting a 37 percent year-over-year increase.

**Pricing**

Secondaries pricing on LP portfolios declined 11 percentage points across PE strategies. Buyout secondaries pricing decreased by 10 percent to an average of 87 percent of NAV, while VC pricing fell by 20 percentage points to trade at 68 percent of NAV.

In any given year, secondaries pricing is influenced by the composition of vintage year, uncalled capital, asset class, quality of assets, and seller rationale. In 2022, other factors exacerbated the downward pressure on prices, including the performance lag between private and public markets performance (for example, the “discount” to NAV reflects perceived valuation rather than stated asset prices) and supply dynamics (such as more potential sellers in the market given the denominator effect). The fact that first-time sellers were 50 percent of LP secondaries sellers, up from 25 percent in 2021, suggests that a new set of investors utilized the market to offload positions to rebalance their portfolios in the current market context.
For real estate, 2022 was a year of relative highlights and challenges, with previously-struggling sectors finding stability, and top-performing sectors slowed by tailwinds.

In closed-end funds, AUM reached a new peak, as it has every year since 2016, and managers raised the second-highest total on record, led by commitments to opportunistic vehicles. Open-end funds in the US grew NAV by 24 percent, with contributions exceeding distributions for the first time in two years. Office, retail, and hospitality—the sectors most affected by pandemic-driven changes in working, shopping, and traveling—showed signs of emerging stability. In office, for example, net absorption turned positive as attendance rates seemingly reached a new equilibrium.

Yet, like most private market segments, real estate experienced a downturn in 2022 compared with the record year it followed. Closed-end fundraising declined 23 percent year over year. Deal volume fell 20 percent, declining in each consecutive quarter throughout the year. Expanding capitalization (cap) rates across sectors, which represent the multiple investors are willing to pay for net operating income (NOI), drove performance lower. And multifamily and industrial—sectors benefiting from changes in living and shopping behavior—softened after rapidly rising rents and occupancy of the past two years boosted performance.

Signs of a flight to quality, or at least to better-known managers, emerged. The largest five managers accounted for 29 percent of all fundraising, the highest share of the last decade, and tenants favored class A real estate as they fought to attract and retain employees.

Finally, amid the broader slowdown in technology-oriented PE deal making, investments in property technology companies fell to the lowest total in five years. While the industry continues to digitize rapidly, companies leading that effort found fundraising more difficult than in years past.
Closed-end funds

Closed-end fundraising totaled $166 billion, a 23 percent decline from the record sum achieved in 2021. Year-over-year fundraising declines were most pronounced in debt strategies, and in Europe.

Fundraising results differed across regions more than in most years. Asia-focused funds raised $25 billion, nearly matching the prior year, while fundraising in North America fell 22 percent to $113 billion. European fundraising fared even worse, falling 39 percent to $25 billion in dollar terms, the lowest total since 2012 and the fifth consecutive annual decline.

Among risk strategies, fundraising declines were widespread with some variation (Exhibit 22). Opportunistic and value-add fundraising were relatively resilient, declining by roughly 15 percentage points each to $59 billion and $55 billion, respectively. The size of the average opportunistic fund grew 28 percent year over year to $768 million, a new record; that total was bolstered by two funds that collectively raised $30 billion. Lower-risk strategies encountered fundraising challenges. After three consecutive years of growth, debt fundraising declined by 47 percent year over year to $22 billion, perhaps due to rising yields in traditional fixed income. Closed-end core and core-plus fundraising declined by nearly a quarter.

Returns

Returns in global closed-end real estate funds decreased following a historically strong 2021. Pooled-net IRR for real estate funds in the first three quarters stood at 2.5 percent, a full 23.3 percentage points below the 25.8 percent return achieved in 2021 (but still an improvement over 2020). Though closed-end performance for the fourth quarter is not yet available, open-end marks suggest that

Exhibit 22

Closed-end real estate fundraising fell across strategies to $166 billion.

Global closed-end real estate fundraising by strategy, $ billion

<table>
<thead>
<tr>
<th>Strategy</th>
<th>2017–22 CAGR, %</th>
<th>2021–22 growth, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>−0.8</td>
<td>−23.0</td>
</tr>
<tr>
<td>Value added</td>
<td>4.3</td>
<td>−15.5</td>
</tr>
<tr>
<td>Opportunistic</td>
<td>4.4</td>
<td>−14.8</td>
</tr>
<tr>
<td>Debt</td>
<td>−14.2</td>
<td>−47.2</td>
</tr>
<tr>
<td>Core and core-plus</td>
<td>−2.3</td>
<td>−24.4</td>
</tr>
</tbody>
</table>

Note: Figures may not sum precisely, because of rounding.

1Secondaries, funds of funds, and co-investment vehicles are excluded to avoid double counting of capital fundraised.

2Includes distressed real estate.

Source: Preqin

McKinsey & Company
The largest five managers accounted for 29 percent of all fundraising, the highest share of the last decade.

performance for the full year will end below the 2.5 percent achieved through September 30.

Despite recent volatility, long-term returns for closed-end real estate funds have been relatively consistent. Every vintage from 2009 to 2019 has produced a pooled-net IRR of between 8.8 percent and 18.5 percent as of September 30. The median net IRR to date for funds in that vintage set stands at 11.5 percent, higher than all other private asset classes except PE.

AUM
Total global real estate AUM in closed-end funds grew to a record high of $1.5 trillion in 2022. The 17 percent year-over-year increase was primarily driven by higher-risk strategies, though with some regional variation.

AUM grew fastest in Asia, at 34 percent, outpacing the annualized average since 2017 by 18 percentage points. In North America, AUM rose 18 percent, while AUM in Europe increased just 10 percent, driven by a 16 percent annualized decline in fundraising since 2017.

Real estate dry powder reached an all-time high of $469 billion. Dry powder as a percentage of AUM increased two percentage points from last year’s five-year low to 32 percent; over the long term, dry powder has averaged 14 percent growth annually. Despite larger annual increases, dry powder inventory has remained consistent over the past five years, ranging from 30 to 35 percent of AUM.

Flight to quality
Two shifts in real estate provide evidence of a so-called flight to quality. One shift was in fundraising: amid a more challenging environment, LPs concentrated investments among larger managers. The other shift occurred in the demand for office space. As companies’ space needs became clearer, tenants favored higher-quality spaces, even at higher prices.

Last year’s annual review of private markets commented on the surprising lack of consolidation in fundraising over the previous several years. As of a year ago, the industry looked as fragmented as ever, with the top five managers capturing just 18 percent of commitments. Fundraising in 2022,
by contrast, was the most concentrated it has been since 2012, with the top five managers collecting 29 percent of all dollars raised (Exhibit 23). However, in the long term, fundraising consolidation has been less prevalent. Over the last ten years, the top five managers consistently raised between 15 and 18 percent of capital on a trailing five-year basis.

Collectively, managers raised fewer but larger closed-end funds in 2022 relative to years past. The average closed-end fund raised a record $510 million, up 17 percent from the prior year. Meanwhile, the number of funds totaled just 325, down from 492 in 2021 and the decade’s peak of 548 in 2018. In total, the share of fundraising achieved by funds greater than $500 million increased from 64 percent in 2017 to 77 percent in 2022.

The shift to larger funds is perhaps unsurprising. In real estate, larger funds have traditionally outperformed. Furthermore, the gap between first- and fourth-quartile performance among large funds is relatively narrow, suggesting lower risk in manager selection (Exhibit 24). As stated in last year’s annual review, the advantages of scale are evident and may grow. Large real estate players use their scale to attract talent, acquire complex portfolios, engage operators in systematic joint ventures (or buy operating companies wholesale), and invest in digital infrastructure for efficiency and insight. Scale may be among the most sustainable advantages in the asset class.

While capital accrued to scaled players in 2022, a second type of flight to quality was evident in shifting tenant preferences—a trend most

Exhibit 23

Fundraising concentration in the top five closed-end funds reached a ten-year high.

Closed-end real-estate fundraising by year, %

Note: Figures may not sum precisely, because of rounding.
Source: Preqin

McKinsey & Company
Larger real estate funds have outperformed, with less dispersion.

**Median IRR and percentile spread by fund size**, net IRR to date through Sept 30, 2022, %

<table>
<thead>
<tr>
<th>Fund Size</th>
<th>Top 25%</th>
<th>Median</th>
<th>Bottom 25%</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt;$5 billion</td>
<td>20.8</td>
<td>15.8</td>
<td>12.8</td>
</tr>
<tr>
<td>$1–5 billion</td>
<td>30.3</td>
<td>11.5</td>
<td>7.0</td>
</tr>
<tr>
<td>&lt;$1 billion</td>
<td>-23.3</td>
<td>11.4</td>
<td>5.6</td>
</tr>
</tbody>
</table>

**2009–19 vintage year**

<table>
<thead>
<tr>
<th>Fund Size</th>
<th>Top 25%</th>
<th>Median</th>
<th>Bottom 25%</th>
</tr>
</thead>
<tbody>
<tr>
<td>&gt;$5 billion</td>
<td>-8.0</td>
<td>17.7</td>
<td>-12.1</td>
</tr>
<tr>
<td>$1–5 billion</td>
<td>-23.3</td>
<td>13.2</td>
<td>-12.6</td>
</tr>
<tr>
<td>&lt;$1 billion</td>
<td>-12.0</td>
<td>11.3</td>
<td>6.0</td>
</tr>
</tbody>
</table>

**2015–19 vintage year**

1 IRR spreads were calculated for funds within vintage years separately and then averaged out. Median IRR was calculated by taking the average of the median IRR for funds within each vintage year. Source: Burgiss

pronounced in office. Demand for office space has fallen as hybrid-work models have become the norm, with office attendance hovering at around 40 to 65 percent of prepandemic levels. In that context, class A office properties have outperformed class B and C properties, whether through higher rent, higher occupancy, or both (Exhibit 25). Class A office outperformed on one or both metrics in all of the 20 largest US cities except Phoenix and Chicago. As companies navigate what is important to employees in a postpandemic world, firms are willing to pay a premium to attract employees and entice them back into the office. The McKinsey Global Institute is analyzing the COVID-19 pandemic’s lasting impact on real estate and plans to release a report in the spring of 2023, in which more insights about the future of work, cities, and offices will be featured.

**Open-end funds**

Within open-end funds in the US, as represented by the National Council of Real Estate Investment Fiduciaries Open-End Equity (NFI-OE) Index, contributions exceeded distributions and redemptions, reversing the 2020 and 2021 pattern and seemingly resuming a long-term trend: US core and core-plus vehicles received net inflows every year from 2010 through 2019. Gross contributions to open-end funds increased 11 percent in 2022 to $31 billion. Distributions and redemptions declined by less than 1 percent, resulting in a net inflow of $2.7 billion (or 1 percent of starting NAV). Growth in gross and net contributions may signal a rotation in risk preferences from riskier opportunistic vehicles, where fundraising grew rapidly in 2021, to less risky strategies.
Exhibit 25

Class A outperformed class B in price and demand across a majority of large US cities.

Relative change in demand and price for class A vs class B, percentage points (pp), 2020–22

Relative change in price,\(^1\) %

\[^1\] Defined as % price change in class A minus % price change in class B (based on Q4 2020 and Q3 2022). Price defined as net effective rents for past 12 months by state-MSA.

Relative change in demand,\(^2\) %

\[^2\] Defined as % demand change in class A minus % demand change in class B. % demand change is calculated as 2021–22 net absorption divided by 2020 average occupied inventory by market.

Source: Compstak (price); CoStar (demand); McKinsey Global Institute

McKinsey & Company
While cash flow to institutional open-end vehicles turned positive following net outflows in 2021, private real estate investment trusts (REITs), which target high-net-worth investors, experienced substantial net outflows. Some of the industry’s largest private REITs, which had previously grown rapidly and performed well, gated redeeming investors in December when redemption requests exceeded the ability of funds to responsibly fulfill those requests. One of the key benefits for open-end products, whether retail or institutional, is enhanced liquidity relative to closed-end funds. A turbulent market in 2022 reminded the industry of the downside of offering investors liquidity from a pool of illiquid investments.

**Returns**

Open-end fund performance declined considerably but fared better than that of closed-end funds. NFI-OE funds returned 8.2 percent on a net basis, compared with 22 percent in 2021. It bears noting that there is limited manager discretion in open-end valuation, because third-party valuation firms perform assessments on a quarterly basis. Performance varied across sectors, with office producing the lowest annual returns (−3.4 percent) and industrial producing the highest (14.6 percent).

Reversing a long-term trend, the expansion of cap rates was a headwind for performance in 2022. Across sectors, cap rates increased 70 basis points to 5.2 percent from 2021’s ten-year low of 4.5 percent, representing the largest one-year expansion over the last decade. Still, cap rate expansion was more than offset by rent growth. Rents grew across all sectors, including in office, despite demand concerns driven by lower rates of office attendance.

Across all private real estate, including closed-end and open-end funds, returns stand in stark contrast to the performance of public markets. Public REITs in the United States returned −25 percent through September 30, 2022, as measured by the FTSE Nareit, after gaining 41.3 percent in 2021. The disconnect between private and public real estate

**Reversing a long-term trend, the expansion of cap rates was a headwind for performance in 2022.**
returns is not uncommon. Analysis by CEM Benchmarking, a leading institutional investor benchmarking firm, suggests that private real estate returns lag public markets by as much as 12 months.

Net asset value
Total NAV of the funds included in the NFI-OE Index reached $376 billion at year-end, up 24 percent from $303 billion the year prior—the highest year-over-year growth in the past decade. Over the long term, NAV has grown more modestly, increasing 12 percent per year since 2017.

Deal activity
Global real estate deal volume totaled $1.1 trillion, a 20 percent decline from a frenzied 2021 but still the second most active year on record. (Exhibit 26). Deal making in the first half remained robust, up 25 percent over the first half of 2021, before faltering in the second half as interest rates increased, debt availability declined, and economic uncertainty grew. Second-half deal volume fell 45 percent from the record second half of 2021. Deal volume was highest in the Americas at $698 billion, a 17 percent decline from the year before. Deal activity declined 19 percent to $118 billion in Asia-Pacific and 27 percent to $324 billion in Europe.

Globally, deal activity declined across asset classes except hospitality, which remained flat (Exhibit 27). Along with hospitality, retail deal volume was relatively resilient, declining just 3 percent. Despite the year-over-year decline, retail deal volume in 2022, at $145 billion, was 4 percent higher than in 2019. After record deal volume in multifamily and industrial in 2021, volumes fell 29 and

Exhibit 26

Global deal volume fell 20 percent.

<table>
<thead>
<tr>
<th>Global real estate deal volume, $ billion</th>
<th>2017–22 CAGR, %</th>
<th>2021–22 growth, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>2.4</td>
<td>−20.2</td>
</tr>
<tr>
<td>Americas</td>
<td>7.0</td>
<td>−16.9</td>
</tr>
<tr>
<td>EMEA</td>
<td>−2.5</td>
<td>−26.6</td>
</tr>
<tr>
<td>APAC</td>
<td>−3.9</td>
<td>−19.2</td>
</tr>
</tbody>
</table>

*Excludes residential.
Source: CBRE; Real Capital Analytics

McKinsey & Company
19 percent year over year, respectively. The decline in multifamily deal activity was the sharpest among sectors.

**US markets by sector**

In the United States, multifamily deal volume declined by nearly a quarter in 2022, on the heels of record volume in 2021. Multifamily assets collectively produced a 7.1 percent return, driven by rent growth.\(^9\) New development as a proportion of existing inventory increased slightly, exceeding the 5 percent mark for the first time in the past decade and indicating that developers are responding to strong demand for multifamily. Net absorption slowed considerably, dropping 81 percent—the largest one-year decline in absorption of the past decade across all sectors. However, despite lower absorption, the United States remains structurally short of three million to four million housing units (conservatively measured by Freddie Mac). More housing, particularly more affordable housing, is clearly needed.

In industrial, pandemic-driven shifts in shopping behavior (such as accelerated e-commerce) and supply chain arrangements (including onshoring) drove unprecedented demand for distribution and warehousing spaces in 2021, and investment dollars followed. However, deal volume totaled $144 billion, a 17 percent decline that followed a 65 percent increase in 2021. Development continued to be a focus in 2022: square footage under construction

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\(^9\) Returns tracked by the NCRIEF Property Index (NPI).
increased 24 percent. Despite all that building, vacancy rates dropped to 3.3 percent, and rents grew 10 percent. Though deal activity dropped, industrial was the highest-performing major real estate sector, returning 14.6 percent.

Office showed some improvement but has not recovered to prepandemic levels. Office attendance across US cities remains depressed, ranging from 41 percent in Philadelphia to 65 percent in Austin. Deal volume fell from record 2021 totals to the second-lowest total since 2014 (the lowest being in 2020). There were bright spots, however: net absorption turned positive after two negative years, and rent per square foot increased 1.6 percent. The only US sector with negative returns was office, which lost 3.4 percent for the year.

Retail real estate struggled mightily in the early days of the pandemic, but the picture has brightened. Deal volume in 2022 improved upon 2021 totals, rents reached a ten-year high, and occupancy levels improved. Retail vacancy at year-end 2022 was 50 basis points lower than in 2019. Still, because of expanding cap rates, retail returns were relatively modest at 2.7 percent.

Already a multidecade headwind for retail real estate, the shift in retail spending to e-commerce accelerated massively in the early days of the pandemic. However, what was then believed to be several years’ worth of acceleration appears now to have been fleeting, as e-commerce penetration stagnated in 2022 (Exhibit 28).

Further, US consumer spending grew 11 percent per year between 2020 and 2022, providing the retail sector with a much-needed tailwind. City-level recovery has varied in line with population movement and relative office attendance. Compared with 2019 levels, Houston foot traffic is now 15 percent higher, New York is roughly on par, and San Francisco, which was hit especially hard by pandemic-driven outmigration, has recovered to just 90 percent of the previous level. Even within cities, neighborhood-level foot traffic recovery varies substantially. Urban-core neighborhoods most reliant upon office (such as central business districts) have not recovered as robustly as those in less office-rich environments. When people go into the office less frequently, they spend less money near the office.

Exhibit 28

US e-commerce growth slowed significantly after a boost in 2020.

E-commerce sales as a % of retail sales

<table>
<thead>
<tr>
<th>Year</th>
<th>E-commerce Sales as % of Retail Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>16.8</td>
</tr>
<tr>
<td>2018</td>
<td>18.1</td>
</tr>
<tr>
<td>2019</td>
<td>19.7</td>
</tr>
<tr>
<td>2020</td>
<td>24.7</td>
</tr>
<tr>
<td>2021</td>
<td>25.5</td>
</tr>
<tr>
<td>2022</td>
<td>26.3</td>
</tr>
</tbody>
</table>

3% per year

8% per year

25% per year

McKinsey & Company
Hospitality has made gains since global travel came to an abrupt halt in 2020. Deal volume, which was strong last year, held steady at $44 billion (Exhibit 29). Revenue per available room (RevPAR) increased 34 percent to $75, up from a ten-year low of $56 in 2021 and approaching the prepandemic high of $80 set in 2019, as both business and personal travel rebounded. Returns were relatively strong at 10 percent, making hospitality the second-highest-performing sector for 2022, trailing only industrial.

Exhibit 29

Deal volume in US retail and hospitality increased; multifamily and industrial tumbled from all-time highs.

<table>
<thead>
<tr>
<th></th>
<th>Multifamily¹</th>
<th>Industrial</th>
<th>Retail</th>
<th>Office</th>
<th>Hospitality</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deal volume</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total, $ billion</td>
<td>278</td>
<td>144</td>
<td>85</td>
<td>109</td>
<td>44</td>
</tr>
<tr>
<td>Total 2021, $ billion</td>
<td>342</td>
<td>173</td>
<td>81</td>
<td>145</td>
<td>44</td>
</tr>
<tr>
<td>YoY change, %</td>
<td>−19</td>
<td>−17</td>
<td>4.9</td>
<td>−25</td>
<td>0.2</td>
</tr>
<tr>
<td>Development as a % of supply</td>
<td>5.2</td>
<td>3.4</td>
<td>0.5</td>
<td>1.4</td>
<td>7</td>
</tr>
<tr>
<td>Total 2022, %</td>
<td>4.6</td>
<td>2.8</td>
<td>0.4</td>
<td>1.4</td>
<td>6</td>
</tr>
<tr>
<td>Total 2021, %</td>
<td>13</td>
<td>24</td>
<td>17</td>
<td>−5.8</td>
<td>19</td>
</tr>
<tr>
<td>YoY change, %</td>
<td>−1.6</td>
<td>0.8</td>
<td>0.6</td>
<td>−0.3</td>
<td>17</td>
</tr>
<tr>
<td>Occupancy</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total 2022, %</td>
<td>93.6</td>
<td>96.3</td>
<td>95.3</td>
<td>89.4</td>
<td>59</td>
</tr>
<tr>
<td>Total 2021, %</td>
<td>95.1</td>
<td>95.6</td>
<td>95.8</td>
<td>89.6</td>
<td>50</td>
</tr>
<tr>
<td>YoY change, %</td>
<td>−1.6</td>
<td>0.8</td>
<td>0.6</td>
<td>−0.3</td>
<td>17</td>
</tr>
<tr>
<td>Absorption</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total, million square feet</td>
<td>688</td>
<td>599</td>
<td>98</td>
<td>7.3</td>
<td>NA</td>
</tr>
<tr>
<td>Total, million square feet</td>
<td>133</td>
<td>734</td>
<td>105</td>
<td>−29</td>
<td>NA</td>
</tr>
<tr>
<td>YoY change, %</td>
<td>−81</td>
<td>−18</td>
<td>−6.8</td>
<td>124</td>
<td>NA</td>
</tr>
<tr>
<td>RevPAR² growth</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total 2022, %</td>
<td>7.5</td>
<td>25</td>
<td>4.7</td>
<td>−3.8</td>
<td>NA</td>
</tr>
<tr>
<td>Total 2021, %</td>
<td>15</td>
<td>18</td>
<td>2.1</td>
<td>−5.1</td>
<td>NA</td>
</tr>
<tr>
<td>YoY change, pp</td>
<td>−7.7</td>
<td>7.3</td>
<td>2.6</td>
<td>1.3</td>
<td>NA</td>
</tr>
<tr>
<td>Cap rate</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total 2022, %</td>
<td>5.0</td>
<td>3.9</td>
<td>6.4</td>
<td>6.7</td>
<td>8.8</td>
</tr>
<tr>
<td>Total 2021, %</td>
<td>4.1</td>
<td>3.5</td>
<td>5.8</td>
<td>5.7</td>
<td>3.9</td>
</tr>
<tr>
<td>YoY change, %</td>
<td>0.9</td>
<td>0.4</td>
<td>0.8</td>
<td>1.0</td>
<td>4.9</td>
</tr>
<tr>
<td>Total returns</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total 2022, %</td>
<td>7.1</td>
<td>14.6</td>
<td>2.7</td>
<td>−3.4</td>
<td>10.0</td>
</tr>
<tr>
<td>Total 2021, %</td>
<td>19.9</td>
<td>43.3</td>
<td>4.2</td>
<td>6.1</td>
<td>5.5</td>
</tr>
<tr>
<td>YoY change, %</td>
<td>−64</td>
<td>−66</td>
<td>−36</td>
<td>−44</td>
<td>82</td>
</tr>
</tbody>
</table>

¹Net residential units absorbed, thousands of units.
²Revenue per available room.
Source: CoStar; Green Street; National Council of Real Estate Investment Fiduciaries Property Index; Real Capital Analytics

McKinsey & Company
Spotlight on US property technology

Property technology (proptech) interest ebbed in 2022 in line with broader sentiment away from technology investments. Commercial proptech deal volume decreased to $12 billion from the 2021 all-time high of $31 billion, which was bolstered by two large acquisitions. The combined residential and commercial proptech market’s deal volume decreased to a five-year low. That decline was driven predominantly by a lack of large transactions in 2022; deal count fell just 19 percent, compared with the 62 percent decline in total deal volume (Exhibit 30).

Despite the slowdown in funding, demand fundamentals for the underlying technologies remain robust, as real estate is still an industry transitioning from traditional to digital. Those investing in the space include real estate dedicated venture capital and growth funds, traditional VCs, and buyout managers. Hundreds of privately held proptech companies at various life cycle stages will continue to need capital, and the number of firms interested in providing capital seems to be expanding. New entrants include real estate owners who have launched dedicated investment vehicles.

Exhibit 30

US property technology saw a slowdown in deal volume and activity.

US property technology deal volume, 2010–22

$ billion

Venture capital

Private equity

Number of deals

Note: Figures may not sum precisely, because of rounding.

1 Includes management buyout, management buy-in, add-on, secondary buyout, public to private, growth/expansion, PIPE.

2 Includes pre-accelerator/incubator, angel and seed, early-stage venture capital (VC), later-stage VC.

3 Includes PE growth/expansion capital to MRI Software for ~$3.5 billion and to Airbnb pre-IPO for ~$2 billion.

4 Includes buyouts of RealPage for ~$10.2 billion and CoreLogic for ~$6 billion.

Source: PitchBook, as of Jan 2023

McKinsey & Company
Real estate—an inflation hedge

Institutional investors have allocated to real estate over time in part because of a long-held belief in the asset class’s ability to protect real value during periods of higher inflation. Real estate’s performance in the United States during all seven such periods of the last 40 years, including 2021 through 2022, confirms this belief. In five of the seven inflationary periods, real estate not only protected value, it outperformed gold, an asset believed to be a strong inflation hedge. In four of the seven periods, real estate outperformed equities and fixed income, which together make up the vast majority of most institutional portfolios. In fact, in five of seven periods, real estate outperformed its own 40-year average annualized performance.

The asset class is indeed a strong hedge against inflation, but perhaps not for the reasons most investors think. It is widely understood that commercial and multifamily rents tend to increase during inflationary periods, but annual increases seldom keep pace with inflation. However, a substantial portion of inflation-sensitive operating costs (such as energy) are borne by tenants and thus do not impact NOI, particularly in commercial buildings. Higher materials and labor costs for new construction increase replacement costs, driving up the value of existing real estate. But the main reason real estate is a strong inflation hedge is counterintuitive: contracting cap rates. This result is surprising, as most periods of heightened inflation in the United States are coupled with rising interest rates, a reflection of the Federal Reserve’s main tool in combating inflation. Indeed, the spread between cap rates and treasuries compressed in three of the five past inflationary periods, suggesting that investor demand outpaced supply, perhaps due to the very belief in the asset class’s inflation-hedging powers.

10 Returns tracked by the NPI.
11 Bureau of Labor Statistics; NPI.
After more than a decade of rapid fundraising growth, strong macroeconomic headwinds slowed—but did not stop—private debt’s growth. In a year when other private classes fell back to earth somewhat, private debt set a new fundraising record, led by several megafund closes.

The continued momentum in 2022 was understandable, as debt’s current yield and senior position in the capital stack have long made it a haven in volatile periods. The diversity of strategies within private debt also helps explain its consistent growth. As in 2020, when private debt was the only private asset class that recorded fundraising growth, investors’ ability to allocate to one or another strategy based on the prevailing market environment has contributed to consistent top-line growth through business cycles. In 2022, mezzanine strategies were most in favor, posting record fundraising totals and more than tripling 2021’s haul. Direct lending fundraising declined from 2021, but only marginally, raising over $100 billion for the second consecutive year.

Private debt was not immune to the macroeconomic conditions last year, however. There was a notable drop in private debt deal volumes, driven by the slowdown in PE and only partially offset by market share gains taken from bank and syndicated financing channels. Performance also declined from 2021’s high as lower marks offset current yield gains.
Fundraising

Global private debt fundraising rose to a new high of $224 billion, growing 2.1 percent year over year and marking a fifth consecutive annual increase (Exhibit 31). Annual fundraising in private debt has more than tripled since 2013, growing at an annual rate of 12 percent, the fastest growth among all private asset classes.

As was the case with other private asset classes, North America–focused fundraising grew 11 percent, while fundraising in Europe and Asia declined 10 and 25 percent, respectively, in US dollar terms. The drivers of this geographic discrepancy are consistent with those covered elsewhere in this report: timing of funds coming to market (Europe’s largest-ever private debt fund was raised in 2021, for example), the strong US dollar, and macroeconomic and geopolitical concerns in Europe and Asia.

Fundraising for mezzanine lending increased 2.4 times to $46 billion last year, reaching its highest total ever. A confluence of factors contributed to this rapid increase. First was simply the timing of fund closings: the mezzanine market includes four very large funds, three of which came to market last year. Those three funds raised more than $8 billion apiece. Collectively, their $32 billion haul accounted for more than 69 percent of the strategy’s total. Second, investors may perceive the strategy to be well positioned for this point in the credit cycle. As banks and direct lenders adopt more conservative risk postures, borrower demand for mezzanine financing (which until recently was dampered by cheap and abundant senior credit) may increase. Indeed, in percentage growth terms, mezzanine strategies have notched some of their best fundraising years—2008, 2016, and 2022—during periods of rising risk premiums.

Exhibit 31

Private debt fundraising hit an all-time high.

Global private debt fundraising by strategy, $ billion

<table>
<thead>
<tr>
<th>Year</th>
<th>Direct lending</th>
<th>Special situations</th>
<th>Mezzanine</th>
<th>Distressed debt</th>
<th>Venture debt</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>44</td>
<td>71</td>
<td>78</td>
<td>77</td>
<td>43</td>
<td>132</td>
</tr>
<tr>
<td>2012</td>
<td>44</td>
<td>71</td>
<td>78</td>
<td>77</td>
<td>43</td>
<td>132</td>
</tr>
<tr>
<td>2014</td>
<td>112</td>
<td>134</td>
<td>132</td>
<td>137</td>
<td>112</td>
<td>132</td>
</tr>
<tr>
<td>2016</td>
<td>134</td>
<td>132</td>
<td>137</td>
<td>148</td>
<td>134</td>
<td>180</td>
</tr>
<tr>
<td>2018</td>
<td>180</td>
<td>132</td>
<td>137</td>
<td>148</td>
<td>180</td>
<td>219</td>
</tr>
<tr>
<td>2020</td>
<td>219</td>
<td>137</td>
<td>148</td>
<td>224</td>
<td>219</td>
<td>224</td>
</tr>
</tbody>
</table>

1 Excludes secondaries, funds of funds, and co-investment vehicles to avoid double counting of capital fundraised. Source: Preqin

McKinsey & Company
Fundraising for special situations strategies grew by 80% in 2022, while distressed fundraising declined precipitously on the heels of its two highest years ever. Distressed and special situations strategies have raised more than $200 billion in aggregate since the onset of the pandemic in 2020. Opportunities to deploy these funds also have increased: after a benign 2021, the share of US loans pricing at distressed levels was 11 percent at the end of 2022, up from 2 percent at the beginning of the year. In Europe, the share of loans priced at distressed levels increased to 7 percent from less than 1 percent a year prior.²

Fundraising for closed-end direct lending strategies totaled $114 billion in 2022, down 14 percent from the prior year. The slowdown in PE buyout activity (which is responsible for much of the demand for private loans) and wariness over rising default rates may have reduced investor appetite for the strategy. That said, 2022 was still the second-highest fundraising year for direct lending, which exceeded $100 billion in capital raising for the second consecutive year. Investors are increasingly rotating allocations from fixed-income securities into private loans due to their attractive current yield and privileged position in the capital structure. Furthermore, the floating-rate coupon of most direct loans has proved to be a major draw for investors seeking refuge from rising inflation and interest rate hikes.

Across all private debt strategies, investors increased their commitments to larger and more-pedigreed debt funds. Eleven funds of $5 billion or more closed in 2022, accounting for 43 percent of private debt’s fundraising total. While this trend is consistent with fundraising for other private asset classes over the last year, private debt’s baseline was already one of relative concentration. Between 2017 and 2021, for example, 45 percent of the average annual private debt funding flowed to the 25 largest funds in

2022 was the second-highest fundraising year for direct lending, which exceeded $100 billion in capital raising for the second consecutive year.

² Refinitiv.
the industry, compared with just 26 percent in PE (Exhibit 32). Over the same period, the average private debt fund’s size across the United States and Europe nearly tripled to $1.6 billion. The asset class is characterized by lower returns and thinner margins than equity strategies, increasing the imperative for scale to drive profitability. Scale also breeds competitive advantage: lenders with deeper pockets are more capable of offering borrowers a variety of different financing solutions, providing liquidity on short notice, and holding larger positions without taking on undue concentration risk. This last advantage came into focus over the course of 2022, when direct lenders shied away from large single-credit holds, which had been growing in popularity, and multi-lender deals returned to prominence.

AUM and deal activity
Private debt AUM totaled $1.3 trillion as of June 30, 2022, up 12 percent from a year prior. North America remained the largest region, accounting for 62 percent of the total, roughly 2.3 times larger than Europe. Direct lending funds represented 44 percent of the private debt market, up from 32 percent in 2017, driving 55 percent of all AUM growth over the last five years.

Comprehensive data on private debt deal volumes across strategies and geographies is limited because of the opaque nature of activity in the space. For market segments where data is available, deal volumes declined from the prior year,

Exhibit 32
The private debt market has become more concentrated.

Trailing 5-year cumulative fundraising, % by fund manager rank

<table>
<thead>
<tr>
<th>Fund Manager Rank</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
</tr>
</thead>
<tbody>
<tr>
<td>Top 5</td>
<td>16</td>
<td>17</td>
<td>18</td>
<td>17</td>
<td>19</td>
<td>21</td>
</tr>
<tr>
<td>Top 6–10</td>
<td>12</td>
<td>10</td>
<td>9</td>
<td>9</td>
<td>9</td>
<td>10</td>
</tr>
<tr>
<td>Top 11–25</td>
<td>16</td>
<td>16</td>
<td>16</td>
<td>17</td>
<td>16</td>
<td>17</td>
</tr>
<tr>
<td>Top 26–100</td>
<td>32</td>
<td>31</td>
<td>32</td>
<td>31</td>
<td>30</td>
<td>28</td>
</tr>
<tr>
<td>Top 101–250</td>
<td>17</td>
<td>19</td>
<td>18</td>
<td>17</td>
<td>18</td>
<td>17</td>
</tr>
<tr>
<td>Long-tail managers</td>
<td>6</td>
<td>7</td>
<td>8</td>
<td>9</td>
<td>9</td>
<td>7</td>
</tr>
</tbody>
</table>

Note: Figures may not sum precisely, because of rounding.
Source: Preqin

McKinsey & Company

13 Preqin.
consistent with other private markets asset classes. In United States middle-market sponsored direct lending, for example, deal volumes totaled $109 billion, 16 percent below 2021’s record total (Exhibit 33). The decline was largely caused by lower PE activity that reduced the need for debt financing in the sponsored market. Despite lower volumes overall, however, private lenders gained market share in 2022. As bank and syndicated financing channels dried up, particularly in the latter half of the year, private capital stepped into the void to finance PE transactions that were still being completed. Refinitiv estimates that direct lenders captured approximately 80 percent of the sponsored middle-market volumes in H2 2022.

**Performance**

The pooled net IRR as of September 30 for private debt funds raised between 2000 and 2019 was 0.2 percent, down more than 15 percentage points from 2021 and the lowest return posted by the asset class in more than a decade. The decline was largely the result of valuation markdowns driven by rising interest rates and increasing rates of stress and distress in liquid credit comparables. As public credit markets traded off over the course of the year, private managers marked down their holdings accordingly, including on loans expected to be held to maturity and paid off at par.

The volatile market conditions were a boon to private credit performance in other ways, however. As discussed previously, most direct loans have floating-rate pricing, which means that quarterly coupon payments increase as interest rates rise. The Secured Overnight Financing Rate (SOFR), the most-used base rate, increased by more than 400 basis points over the course of 2022. Also, spreads widened through the year, further increasing the expected yield of new loan issuances. The combination of these two factors drove yields

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**Exhibit 33**

**Sponsored middle-market direct lending volumes declined 16 percent.**

**Direct lending middle-market sponsored loan volume, $ billion**

<table>
<thead>
<tr>
<th>Year</th>
<th>Volume</th>
</tr>
</thead>
<tbody>
<tr>
<td>2014</td>
<td>34</td>
</tr>
<tr>
<td>2015</td>
<td>46</td>
</tr>
<tr>
<td>2016</td>
<td>59</td>
</tr>
<tr>
<td>2017</td>
<td>73</td>
</tr>
<tr>
<td>2018</td>
<td>103</td>
</tr>
<tr>
<td>2019</td>
<td>87</td>
</tr>
<tr>
<td>2020</td>
<td>71</td>
</tr>
<tr>
<td>2021</td>
<td>131</td>
</tr>
<tr>
<td>2022</td>
<td>109</td>
</tr>
</tbody>
</table>

Source: Refinitiv

**McKinsey & Company**

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14 Federal Reserve Bank of New York.
on new middle-market unitranche loans to more than 12 percent in the fourth quarter of 2022 (Exhibit 34).

Over the long term, private debt has offered modest, low-volatility returns relative to other private asset classes. The 2009–19 vintages, for example, have generated a median net IRR of 9.3 percent, on par with infrastructure but lagging PE and real estate. However, variance in returns among funds, as measured by the interquartile spread, is less than half of real estate’s and a third of PE’s.

Return profiles vary significantly across private debt strategies (Exhibit 35). Senior credit, predictably, has delivered both the lowest median returns (8 percent) and lowest dispersion, with a tight 3.9-percentage-point spread between the top and bottom quartiles. Distressed and mezzanine strategies have posted higher median returns with higher volatility, though mezzanine has outperformed distressed across all quartiles and with lower dispersion to boot.

Private debt through the cycle
Private debt has come of age in a historically benign macroeconomic environment. The 2010s were characterized by low interest rates, low unemployment, and steady economic growth. Coupled with post-GFC regulatory changes that forced banks to dramatically reduce their exposure to risky loans, market conditions could hardly have been more favorable for private debt managers to succeed. And succeed they have: private debt AUM has more than quintupled since 2009 (an annual growth rate of 14 percent), more than 500 new managers have entered the market, and performance has consistently exceeded public benchmarks. The growth of the asset class has both benefited from and enabled private equity’s concurrent rise, and private lenders have all but replaced banks in key segments of the sponsored middle market.

The first few years of the 2020s, by comparison, represent uncharted waters. A steep pandemic-driven recession in 2020 proved to be short-lived, but the sharp recovery dissipated in 2022 as

Exhibit 34
Direct lending yields rose rapidly in 2022.

<table>
<thead>
<tr>
<th>Sponsored middle-market unitranche spreads and yields, %</th>
<th>Middle-market unitranche spreads</th>
<th>Middle-market unitranche yields</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q1 2018</td>
<td>6.4</td>
<td>6.1</td>
</tr>
<tr>
<td>Q2 2018</td>
<td>5.8</td>
<td>6.0</td>
</tr>
<tr>
<td>Q3 2018</td>
<td>5.9</td>
<td>6.0</td>
</tr>
<tr>
<td>Q4 2018</td>
<td>6.0</td>
<td>6.1</td>
</tr>
<tr>
<td>Q1 2019</td>
<td>5.7</td>
<td>6.0</td>
</tr>
<tr>
<td>Q2 2019</td>
<td>6.1</td>
<td>5.9</td>
</tr>
<tr>
<td>Q3 2019</td>
<td>6.5</td>
<td>6.3</td>
</tr>
<tr>
<td>Q4 2019</td>
<td>6.6</td>
<td>6.1</td>
</tr>
<tr>
<td>Q1 2020</td>
<td>6.3</td>
<td>5.8</td>
</tr>
<tr>
<td>Q2 2020</td>
<td>5.9</td>
<td>6.0</td>
</tr>
<tr>
<td>Q3 2020</td>
<td>6.0</td>
<td>6.0</td>
</tr>
<tr>
<td>Q4 2020</td>
<td>6.2</td>
<td>6.5</td>
</tr>
</tbody>
</table>

Source: Refinitiv

McKinsey & Company
slowing growth, entrenched inflation, rising interest rates, and weakness in certain high-growth sectors set in. Distress in the liquid credit markets is consequently trending upward, pressuring returns and, potentially, challenging the perception of direct lending as a low-risk asset class. Making matters worse, many of the factors that fueled private debt’s growth over the prior decade may have run their course. As mentioned above, there is little additional room for market share gains in the US middle market, where banks already have exited almost entirely. Interest rates available on fixed-income securities have risen, reducing the need for institutional investors to rotate into higher-yielding credit securities to achieve performance objectives and stymieing refinancings. The multiyear upward march of PE valuation and leverage metrics has stalled, and earnings growth may come under pressure as well—all factors that may reduce the quantum of debt that backs a given asset base.

Yet the through-cycle outlook for private debt remains rosy. Though PE deal activity declined in 2022, PE buyout strategies are currently sitting on $1 trillion of dry powder that will drive new demand for private loans. Indeed, AUM housed in US direct lending strategies still represents an undersized portion of PE buyout AUM relative to average leveraged-buyout debt-to-capitalization ratios (Exhibit 36). Nearly $300 billion in loan maturities is coming due in the next three years, finally, a total approaching the entire amount of private credit dry powder.\textsuperscript{15}

The current market dislocation has further reduced banks’ tolerance for sub-investment-grade credit risk, opening the door for private lenders to take share in new segments of the credit market, including for larger borrowers, new assets (such as infrastructure), and additional geographies. This progression accelerated in 2022 as banks became

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\textsuperscript{15} PitchBook.
less willing to lend. Private lenders financed approximately 30 deals of $1 billion or more in 2022, up from fewer than five in 2019, demonstrating their increasing relevance to larger borrowers that would have traditionally sought financing in the broadly syndicated or high-yield markets. The opportunity in new markets is sizable. Indeed, despite its rapid growth over the prior decade, private debt is still the smallest segment of the broader credit landscape, representing less than 5 percent of total US credit assets by most estimates.

Finally, as the private credit market continues to mature, other private asset classes provide a road map for additional growth opportunities. One example is secondaries funds that, while already an established strategy in private equity, remain nascent in private credit. In 2022, falling public markets valuations and the denominator effect prompted LPs to seek liquidity for a record number of private credit holdings, with estimated transaction volume of $17 billion, nearly ten times 2017’s volume. The market remains undercapitalized, with more LPs seeking to offload positions than buyers to purchase them, but in the last two years, several dedicated credit secondaries funds have been launched to meet the rising demand.

16 PitchBook.
17 Institutional Investor.
18 Coller Capital.

Exhibit 36
US direct lending AUM remained small relative to PE buyout capital.

<table>
<thead>
<tr>
<th>Year</th>
<th>Ratio of US direct lending AUM to US PE buyout AUM</th>
<th>Debt/capitalization ratio of PE buyout transactions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>4.4</td>
<td>51</td>
</tr>
<tr>
<td>2010</td>
<td>4.8</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>5.4</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>5.5</td>
<td></td>
</tr>
<tr>
<td>2013</td>
<td>8.1</td>
<td></td>
</tr>
<tr>
<td>2014</td>
<td>7.5</td>
<td></td>
</tr>
<tr>
<td>2015</td>
<td>8.2</td>
<td></td>
</tr>
<tr>
<td>2016</td>
<td>9.7</td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td>10.9</td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td>12.4</td>
<td></td>
</tr>
<tr>
<td>2019</td>
<td>12.6</td>
<td></td>
</tr>
<tr>
<td>2020</td>
<td>14.0</td>
<td></td>
</tr>
<tr>
<td>2021</td>
<td>15.7</td>
<td></td>
</tr>
<tr>
<td>2022</td>
<td>16.4</td>
<td></td>
</tr>
</tbody>
</table>

Source: Preqin; Refinitiv
Infrastructure and natural resources (NR) overcame broader market headwinds in 2022 to set a new fundraising record of $158 billion. Investors flocked to the asset class because of its ability to provide stable cashflows, less correlated returns, and a hedge against inflation. On the supply side, the closing of a record number of global megafunds boosted fundraising. AUM grew as well, reaching a new high of $1.3 trillion, 14.2 percent higher than in 2021.

Like other asset classes, infrastructure and NR strategies were affected by macroeconomic challenges. Deal volumes declined 27 percent as financing became more expensive and harder to access. And while infrastructure and NR fund performance declined somewhat from 2021, these funds were the top-performing private markets asset classes in 2022. NR outperformed all others, returning 15.6 percent in a second consecutive year of strong performance driven by rising commodity prices.

Beneath these headline statistics, revolutions in energy, mobility, and digitization are changing the face of infrastructure investing. The flow of capital into the asset class has pushed investors to look beyond traditional core infrastructure assets. Core-plus and value-add strategies are now investing in new asset categories and infrastructure service providers as GPs seek to accommodate the return expectations of a new class of infrastructure investor. While the long-term demand for capital is tremendous, with a projected global infrastructure spending gap of $15 trillion through 2030, current macroeconomic and geopolitical events are creating short-term pressure on high-growth sectors such as telecommunications and renewables.

19 McKinsey.
Fundraising

Global fundraising for infrastructure and NR increased by 7 percent, the highest rate among private markets asset classes. (Exhibit 37). The growth comes on the heels of a strong 2021, when fundraising surged 23 percent over the prior year. Multiple factors contributed to this growth, including investment into renewable-energy infrastructure (as part of the broader energy transition) and into telecom infrastructure (reflecting the rapid adoption of internet usage).

North America–focused funds experienced the greatest fundraising growth. Commitments to North America vehicles surged 82 percent to $94 billion, a new record. Asia fundraising increased 1 percent

Exhibit 37

Infrastructure and natural resources fundraising totaled a record $158 billion.

Global infrastructure and natural resources fundraising by region, $ billion

<table>
<thead>
<tr>
<th>Region</th>
<th>2017–22 CAGR, %</th>
<th>2021–22 growth, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>11.4</td>
<td>82.4</td>
</tr>
<tr>
<td>Europe</td>
<td>12.1</td>
<td>–31.2</td>
</tr>
<tr>
<td>Asia</td>
<td>–10.8</td>
<td>1.3</td>
</tr>
<tr>
<td>Rest of world</td>
<td>–25.2</td>
<td>–72.2</td>
</tr>
</tbody>
</table>

1 Excludes secondaries, funds of funds, and co-investment vehicles to avoid double counting of capital fundraised.
Source: Preqin

McKinsey & Company
to $8 billion, while Europe-focused fundraising declined 31 percent to $53 billion. Some of the discrepancy in fundraising growth between North America and Europe may represent a true shift of investors’ regional preferences over the past year. But much of it may be idiosyncratic. The infrastructure and NR asset class is increasingly characterized by large funds (the average fund size reached $1.6 billion last year), so it is particularly susceptible to the timing of which funds are in market in a given year. Also, many of the megafunds that closed in North America last year have a global mandate and are likely to deploy some portion of their capital in Europe and Asia, so the single-year dispersion in fundraising by region may be overstated.

Fundraising for core-plus infrastructure and NR vehicles grew by 68 percent, retaking its place as the largest strategy, after two years of depressed fundraising (Exhibit 38). Fundraising for the strategy has grown at an annual rate of 11.4 percent over the past decade, driven by investors’ willingness to take on equity risk and move up the risk curve in a hunt for yield as traditional infrastructure returns compressed. To accommodate this evolving investor profile, the definition of infrastructure investment has now expanded to include a range of higher risk-and-return opportunities beyond traditional core opportunities, including operating companies or early-stage technology ventures, as well as assets such as data centers, modular healthcare units, and airport security systems.

Meanwhile, growth in other strategies was muted. Core fundraising was roughly flat, while debt and opportunistic strategies declined for the second year in a row. Opportunistic strategies in particular have fallen out of investor favor, with 2022 totals down more than 87 percent since the strategy’s peak in 2017. The shift to large fund vehicles

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**Exhibit 38**

**Infrastructure core, core-plus, and value-add fundraising reached record highs.**

<table>
<thead>
<tr>
<th>Global infrastructure and natural resources fundraising by strategy, $ billion</th>
<th>2017–22 CAGR, %</th>
<th>2021–22 growth, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Infrastructure core plus</td>
<td>8.9</td>
<td>68.4</td>
</tr>
<tr>
<td>Infrastructure core</td>
<td>22.8</td>
<td>−0.2</td>
</tr>
<tr>
<td>Infrastructure value-added</td>
<td>31.0</td>
<td>6.6</td>
</tr>
<tr>
<td>Infrastructure debt</td>
<td>−7.0</td>
<td>−41.9</td>
</tr>
<tr>
<td>Natural resources</td>
<td>−27.1</td>
<td>−65.5</td>
</tr>
<tr>
<td>Infrastructure opportunistic</td>
<td>−34.1</td>
<td>−37.7</td>
</tr>
</tbody>
</table>

*Secondaries and funds of funds are excluded to avoid double counting of capital fundraised. Source: Preqin*
observed across private markets, including infrastructure, potentially contributed to opportunistic fundraising’s decline. Smaller funds make up a greater share of opportunistic strategies, with 44 percent of dollars committed since 2006 to vehicles of less than $1 billion, versus 31 percent for other strategies. Most large funds execute a core-plus strategy.

A notable highlight last year was the extraordinary growth in infrastructure megafunds: five funds exceeding $10 billion in size closed in 2022. In total, these funds raised $75 billion, accounting for 47 percent of total fundraising in the asset class (Exhibit 39), a new high for concentration within the asset class. The previous high for megafund fundraising came in 2019, when $10 billion–plus funds cumulatively contributed 16 percent to the annual total. This shift is consistent with returns. Funds larger than $5 billion have outperformed, with lower dispersion. For all such funds raised between 2000 and 2019, the median net IRR through September 30 stands at 12.0 percent; in contrast, funds between $1 billion and $5 billion returned 9.8 percent, and funds less than $1 billion returned 8.2 percent.20

Exhibit 39

Funds of more than $10 billion raised $75 billion in aggregate in 2022.

Global infrastructure and natural resources fundraising by fund size and close year, $ billion

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt; $250 million</td>
<td>41</td>
<td>62</td>
<td>57</td>
<td>44</td>
<td>38</td>
<td>62</td>
<td>89</td>
<td>88</td>
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1Secondary, funds of funds, and co-investment vehicles are excluded to avoid double counting of capital fundraised.
Source: Preqin

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20 Burgiss.
Infrastructure and NR’s global AUM grew by 14 percent to $1.3 trillion as of the first half of 2022. Over the last five years, AUM has grown 14 percent per year. AUM is concentrated in the United States and Europe, which collectively represented 81 percent of the global total. Europe’s 20 percent annual AUM growth over the last five years is the fastest among all regions. Growth in North America AUM has slowed, causing its share of the global total to fall to 50 percent in 2022, from 60 percent in 2012. This regional shift in AUM is more indicative of the growth of infrastructure investments in Europe, Asia, and the rest of the world regions than a slowdown in North America; indeed, all four regions grew more than 12 percent per year over the past decade.

Performance
Compared with the dramatic decline in performance in some other private markets asset classes, returns posted by infrastructure funds declined only modestly last year. The pooled-net IRR for the first three quarters of 2022 was 8.7 percent, down from 14.6 percent in 2021. Over the longer term, the 9.3 percent median-net IRR for vintage 2009–19 infrastructure funds is just below that for real estate (11.5 percent) and on par with the IRR for private debt (9.3 percent).

NR funds posted strong performance for the second straight year. Buoyed by energy price inflation, NR funds produced a pooled net IRR of 15.6 percent in the first three quarters of 2022, after returning 30.3 percent in 2021. However, the long-term performance of natural resources remains muted. The 6.5 percent median net IRR for vintage 2009–19 NR funds is the lowest among all the private markets asset classes. The asset class’s muted returns are a result of the long period of depressed conventional energy prices between 2013 and 2020.

Infrastructure’s evolving composition
Infrastructure’s mandate has evolved over time in response to prevailing macro trends. Growing efforts to decarbonize the economy, along with proliferating ESG commitments and substantial competition for traditional brownfield infrastructure investments, have attracted a larger share of infrastructure dollars to alternative energy and clean-tech assets. The deal activity for alternative energy infrastructure equaled 26 percent of the total in 2022, up from 7 percent in 2005 (Exhibit 40). The US Inflation Reduction Act and the energy infrastructure investment it requires provided a jolt to infrastructure in 2022. However, this longer-term trend away from conventional energy investment paused in 2022, when a confluence of factors...
drove the prices of conventional energy-related commodities sharply higher.

Similarly, the “digitization of everything” has increased investment in telecommunications infrastructure in recent years. Deal volume in the communications sector accounted for 30 percent of infrastructure deal volume in 2022, up from less than 17 percent in 2007.

**Energy**

The transition from conventional hydrocarbon energy sources to renewable sources such as wind and solar has become a global priority. The shift involves policy changes, such as last year’s US Inflation Reduction Act, and societal preferences, such as the growing popularity of electric vehicles and residential solar installations.

Private markets investing mirrors the trend, wherein LPs and GPs have gradually shifted their focus away from conventional energy toward renewable alternatives. In 2014, 47 percent of the private energy funds closed had conventional energy mandates, while 40 percent focused on renewables. By 2021, the landscape changed dramatically, with conventional energy funds representing only 14 percent and renewables comprising 69 percent.

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**Exhibit 40**

Deal activity since the GFC has gradually shifted from traditional infrastructure to alternative energy.

**Sector share of global infrastructure deal value, 2005–22, %**

Note: Some deals have been excluded due to negligible size and missing information. Alternative energy includes clean technology, geothermal, solar, hydro, and wind power. Traditional energy includes power, water, and utilities. Communications technology includes telephone networks, internet services, cable and wireless networks. Social infrastructure include all government, medical, and education buildings. Traditional transport includes roads, bridges, tunnels, and other transport. Source: Preqin
The 2021–22 spike in energy prices forced investors and allocators to adapt. Conventional energy’s share of funds raised increased to 28 percent, perhaps because investors were seeking to capitalize on what in 2021 was the strongest performance posted by NR strategies in more than a decade. Renewables fundraising, meanwhile, declined precipitously to its lowest total since 2014 (Exhibit 41). Though the reversal of the long-term trend was stark, most market participants view it as transitory. In some ways, in fact, more expensive (and less reliable) conventional energy sources increase the demand for renewable generation. According to a recent Preqin survey, 100 percent of infrastructure fund managers predict the energy transition will be a primary driver of the asset class over the next ten years.

Exhibit 41

The number of renewable-energy fund closes hit its lowest level since 2014.

Energy funds closed by type,\(^1\) 2011–Q3 2022, % share

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<tr>
<td>Renewable</td>
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Note: Figures may not sum precisely, because of rounding.
\(^1\)Analysis includes both infrastructure and natural resources funds, including upstream assets.
Source: Preqin

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More private markets managers are incorporating considerations for ESG factors into their corporate policies, operating procedures, and investment decisions. In 2022, 1,069 more investors committed to the United Nations Principles for Responsible Investment (PRI),21 and a further 88 asset owners became PRI signatories, bringing the total to 681.22 The proportion of total private capital fundraising that came from managers with an investment policy that includes ESG issues rose to 66 percent in 2022;23 a new high.

This progress is a result of many factors. First and foremost, the evidence supporting a positive correlation between ESG and financial performance continues to mount, as long as the underlying company is healthy. For example, recent McKinsey research found that publicly traded ESG outperformers that also outperformed peers on margin and growth delivered 200 basis points in excess return to their shareholders over companies that only outperformed

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21 A United Nations-supported network of investors promoting sustainable investment.
22 Principles for Responsible Investment, annual report, 2022.
23 Preqin.
financially.\textsuperscript{24} New government policies that provide incentives for certain ESG investments—most notably the US Inflation Reduction Act of 2022—are likely to strengthen this correlation further. Second, LPs are increasingly incorporating ESG metrics into their capital allocation processes. One recent survey indicates that nearly three-quarters of LPs would consider eliminating a manager from consideration if it was unable to provide acceptable standards of ESG-related disclosures.\textsuperscript{25} Finally, macroeconomic forces, including higher energy prices and geopolitical conflict, have strengthened long-term investor interest in alternative energy sources and overall energy independence.

Consideration of ESG is not limited to fundraising and deal activity. Across the entire investment life cycle, from fundraising and asset selection to value creation and exit planning, ESG is on the minds of investors. Across our clients, we see ESG becoming a competitive differentiator and driver of returns. A pre-investment ESG diligence includes a materiality scan, ESG performance and benchmark, value-at-stake analytics, and an ESG maturity assessment.

After making an investment, GPs have five value creation levers they can pull to improve their portfolio:

1. \textit{Top-line growth}. Attract B2B and B2C customers with more sustainable products and achieve better access to resources through stronger community and government relations.

2. \textit{Cost reduction}. Lower energy consumption and reduce water intake.

3. \textit{Regulatory and legal interventions}. Achieve greater strategic freedom through deregulation and earn subsidies and government support.

4. \textit{Productivity uplift}. Boost employee motivation, and attract talent through greater social credibility.

5. \textit{Investment and asset optimization}. Enhance investment returns by better allocating capital for the long term, and avoid investments that may not pay off because of longer-term environmental issues.

\textsuperscript{24} McKinsey research to be published. The research defines outperformers as companies whose score on a series of assessed ESG metrics improved over time.

\textsuperscript{25} Global Private Equity Barometer, Coller Capital, Winter 2022–23.
E: Sustainable investing goes mainstream

The E in ESG has come into sharper focus in recent years, with GPs employing a range of strategies to accelerate and capitalize on the ongoing energy transition. Perhaps the most visible strategy is the so-called impact funds, which typically include an explicit ESG agenda as part of their investment strategy. Fundraising for these vehicles continued its upward climb last year, with first-half fundraising nearly eclipsing the full-year 2021 total of $28 billion, which was itself a record. The size of impact funds is rapidly growing with the maturation of the strategy: Of the 13 total impact funds of over $2 billion in size, nine have closed in the last two years.

ESG AUM exceeded $100 billion for the first time in 2022. AUM for the strategy grew at 35 percent per year over the last decade, far outpacing the rate of AUM growth in the broader private markets (Exhibit 42). It is also important to note that this measure of ESG AUM dramatically understates ESG’s relative importance within the broader $10 trillion–plus private markets landscape. Hundreds of billions of dollars in private investments that are focused on the energy transition or otherwise aligned to a sustainability-driven investment thesis sit outside these dedicated impact funds, though data transparency and measurability for this capital is currently limited—a common problem within private markets ESG.

Sustainable investments, whether deployed from impact funds or through broader vehicles, can take a variety of different forms (see the following section, “Accelerating the energy transition”). According to research from McKinsey’s Sustainability Practice, deal volume in global climate technology bucked the broader market trend last year by growing 7 percent year over year to set a record of nearly $200 billion

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Exhibit 42

**ESG-focused AUM exceeded $100 billion for the first time.**

**ESG-focused AUM by year, $ billion**

![Graph showing ESG-focused AUM growth from 2012 to 2022](source: Preqin)

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(Exhibit 43). Approximately 40 percent of that total was deployed in venture capital strategies, highlighting the importance of private investing in the development of new climate technologies. Five minority investments last year went to businesses valued at over $5 billion apiece. Two of these focused on renewable power generation, and one each focused on transport electrification, water, and building equipment.

The power sector was the primary target for sustainable investments in 2022 for the third year running, accounting for just over half of all deal activity. Investments targeting power generation have been most common in recent years. The transportation sector, including investments in EV manufacturing and EV-charging infrastructure, ran a distant second at 14 percent of deal volume. Compared with 2021, the sectors that grew fastest

Exhibit 43

Climate tech deal volume increased to $196 billion.

Private equity climate tech investments by sector, $ billion

1 Includes completed buyout/LBO, growth/expansion, PIPE, add-on, accelerator, angel, seed, early-stage venture capital (VC), later-stage VC, grants, and infrastructure investments.

Source: Pitchbook; Preqin

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were water, into which investment more than quadrupled, and carbon, into which investment has grown 38 percent per year since 2017.

Accelerating the energy transition
As we discussed in last year’s report, GPs seeking to invest in the sustainability transition can employ a range of strategies:

— **Brown-to-green** strategies focus on transforming “dirty” business models to be more environmentally friendly, typically by refocusing product, technology, or service offerings. For example, refineries can be retrofitted to ethanol plants, and offshore services businesses can pivot away from offshore oil and gas and toward offshore wind. These strategies are often pursued via a structure in which the “brown” asset is placed in an off-balance-sheet vehicle into which an investor contributes capital that is used to fund the green transition.

— **Supply chain decarbonization** consists of investing in companies that provide critical inputs in the decarbonization value chain—for example, companies that supply businesses with advanced materials, components, or equipment required for decarbonization.

— **Green growth** consists of creating new green products. Examples include recyclable plastic packaging, sustainable textiles, green steel production, and carbon-neutral fuel.

— **Enabling technology** focuses on emissions measurement, accounting, and mitigation support to help emitting companies manage and abate their carbon footprints. Examples include emissions accreditation and trading platforms, as well as ESG/HSEQ26 software.

— **Investing in winners** involves scaling businesses that already have proprietary or leading decarbonization technology or capabilities. Potential targets could include manufacturers of EV components (including batteries) or low-carbon agriculture products.

Most investors today recognize the importance of sustainability. To capture full value from the sustainability transition, investors will need to deepen their insights into green technologies, regulations, and market demand.

**S: Private markets strive for greater gender and ethnic diversity**
Diversity, equity, and inclusion (DEI) have together become an important part of the fundraising, hiring, and investing landscape for private markets participants. To cite just one salient example, LPs report a willingness to allocate twice as much capital

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26 HSEQ = health, safety, environment, and quality.
to a gender-diverse deal team and nearly three times more capital to an ethnically or racially diverse deal team, all else being equal. GPs are taking notice: the percentage of PE firms that report internal diversity statistics during the fundraising process has risen steadily since 2014 and exceeded 50 percent for the first time in 2020 and 2021 (Exhibit 44).

While DEI has become increasingly important to GPs and LPs alike, a gap remains in representation for women and ethnic and racial minorities across PE and other alternative investing firms. In entry-level investing roles across the US and Canada, representation of women is at 36 percent, and representation of ethnic/racial minorities is at 39 percent. At each succeeding level of seniority, representation drops. While a similar phenomenon occurs outside of private investment firms, PE representation nevertheless lags corporate America across all senior levels.

In 2022, McKinsey surveyed 400,000 employees at more than 300 organizations for the annual Women in the Workplace report, as well as 42 global private markets firms that collectively employ more than 60,000 people for the annual State of Diversity in Global Private Markets report. Together, the two research efforts offer insight into the representation of women and ethnic and racial minorities in private investing. In the rest of this chapter, we discuss where the numbers stand and conclude with thoughts on how firms can bring a more diverse set of perspectives to the table.

**Representation of women across private markets**

In North America PE, women make up nearly half of all entry-level positions, but their share drops as seniority rises, with women filling less than a third of positions at the principal level and above. While the drop is partially caused by a historically imbalanced talent pipeline (fewer women filling entry-level roles

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**Exhibit 44**

**More PE firms are sharing diversity metrics during fundraising.**

**PE firms reporting diversity metrics during fundraising,** % of respondents

![Chart showing the increase in PE firms reporting diversity metrics during fundraising from 2014-2021.]

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28 “Our Women in the Workplace and State of Diversity in Global Private Markets research programs continue. To join the effort and contribute data, please click here.”
In years past, women also experience lower rates of promotion.

At the entry level, female representation in PE is now similar to that of corporate America (Exhibit 45). However, at the managing director level, corporate America is six percentage points higher than PE. In the C-suite, the gap widens further to 11 percentage points. As the pipeline for the next generation of women leaders grows, hiring will continue to be an important lever for (eventually) increasing senior representation. However, work is needed to reach parity in promotion rates.

Throughout the global PE industry, women more often fill non-investing roles than investing roles (Exhibit 46). In entry-level positions globally, women make up 57 percent of non-investing roles but just 34 percent of investing roles. Representation falls more steeply across seniority levels in investing roles as well. The percentage of women in investing roles drops 22 points from entry level to managing director, compared with an 18-point drop for non-investing roles. The sharpest drop for both investing and non-investing roles occurs at the level of principal.

Private markets firms can improve representation of women through three principal levers: external hiring, internal promotions, and attrition. Lateral hiring can be an expedient tool for increasing representation at later stages of the PE pipeline. On average, in 2021, 31 percent of non-entry-level investing-track hires into US and Canada PE firms were women. This figure is 35 percent at the vice president level and dips to 22 percent for the director/principal level and 18 percent for the managing director/partner level. These rates are slightly higher than current representation levels at each seniority tier, indicating that lateral hiring is a promising approach.

Exhibit 45

**Compared with PE, corporate America has greater female representation at senior levels.**

![Bar chart showing representation of women in private equity and corporate America across different seniority levels.]

**Exhibit 48**

<table>
<thead>
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<th>Role</th>
<th>Private equity</th>
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<tr>
<td>C-level</td>
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<td>26</td>
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</table>

1 Private equity in the US and Canada.

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helping to reduce the representation gap, albeit modestly. None of these statistics suggest parity.

Addressing differences in promotion and attrition rates between genders can help address senior representation over time. Promotion rate differences between men and women early in the funnel can result in a “broken rung,” that is, a gap in share at the next level of seniority greater than 5 percent. In Americas PE, women in 2021 were promoted from entry level to associate at roughly the same rate as men; however, there is a gap in promotion parity in more senior roles, with women promoted at a lower rate.

Attrition rates also vary by gender. In prior years, men were leaving their employers at higher rates than women, but our research shows a different pattern. In 2021, women left their firms at higher rates than their male colleagues at almost every level. On average, the attrition rate was 17 percent for women, versus 12 percent for men.
Ethnic and racial representation across the private markets

For racial and ethnic minorities, representation varies both between and within seniority levels by group. As with women, the share of racial and ethnic minorities drops as seniority levels climb, with the most precipitous drop at the principal level (Exhibit 47). Along with representation, attrition and hiring also vary by group.

Within US and Canadian PE firms, White professionals hold 70 percent of all investing roles. Asian professionals represent the largest racial minority group, while Hispanic and Black professionals hold only 4 percent and 3 percent of all investing roles, respectively. Racial and ethnic minorities are also less well represented on investment committees than in the ranks of managing directors—9 percent versus 17 percent (Exhibit 48). As with women, there is a significant gap in representation at the senior level versus the junior level.

As mentioned earlier, our study examined three key levers that have an impact on representation: external hiring, internal promotions, and attrition. Hiring has a net positive effect on representation of ethnic and racial minorities. However, the effect differs by seniority: hiring has an accretive effect for junior roles and a negative effect for senior roles.

Promotion rates vary by ethnic and racial group. White and Asian professionals are promoted more frequently across all seniority levels, while Black and Hispanic professionals experience lower promotion rates on average, particularly at senior levels. Attrition rates also vary by ethnic and racial group. Asian and Hispanic professionals experience the highest attrition rates of all ethnic and racial groups.

The path forward

The landscape around DEI in private markets is changing in no small part due to the push from LPs to share data during fundraising. However, GPs’ methods of calculating and reporting DEI vary considerably, as do the expectations and definitions...
Exhibit 48

Representation of ethnic and racial minorities in investing roles drops significantly at the senior level.

PE talent pipeline by ethnicity/race in US and Canada, share of investing employees by ethnicity/race, % of employees by level

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1 Based on data from 24 companies with ~7,500 employees in the US and Canada. Where a particular demographic represents 0% of a level, no number is shown.

2 Includes entry level, associate, and vice president.

3 Includes principal, managing director, and C-level.


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of DEI held by LPs. In coming years, this variation may change. LPs, GPs, and the broader stakeholder community need apples-to-apples metrics to compare DEI initiatives. Tracking and metric consistency also will help firms get better at measuring their progress.

To make progress, of course, firms need to act. To close the representation gap of women and racial and ethnic minorities at senior levels, firms can implement several practices:

1. **Increase transparency with clear metrics and tracking capabilities.** Firms can appoint champions to lead the creation and tracking of diversity metrics and assure granularity of data, particularly for intersectional groups.

2. **Diversify recruitment and hiring.** Firms can improve their hiring processes by increasing transparency and focusing on the desired skills and capabilities for each position in the investing landscape. Additionally, they can expand hiring reach by looking at talent pools from universities, backgrounds, and geographies they have not previously considered.

3. **Debias the promotion processes.** Better transparency about what is required for success in each role would foster a more equitable promotion process with clearly pinpointed objectives for advancement. Formal sponsorship and mentorship programs specifically for women and ethnic and racial minorities also can improve visibility in promotion processes.

4. **Reduce attrition.** Firms can improve retention by fostering an equitable and inclusive culture. Initiatives like employee resource groups, generous leave policies, and child care subsidies are some potential tools for creating a more inclusive environment. Flexible locating and remote work are initiatives especially valued by women.

Only time will tell if LP pressure on GPs will be enough of a catalyst to change the face of private markets. As DEI increases in importance within private markets, we request your help to participate in McKinsey’s 2023 State of Diversity in Global Private Markets study. Please sign up [here](#).
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