

STRATEGY IN FOCUS

PE

PD

Strategy in Focus: Special Situations and Mezzanine

In our latest Strategy in Focus report, we present a guide for LPs to two of the most recently discussed fund strategies in private debt. We examine AUM growth, performance and investor interest as the economic mood shifts

- Special situations funds have outraised distressed debt since 2022 as mandates evolve beyond specific points in the economic cycle
- Average performance of special situations funds is less connected to distressed debt since COVID-19; average median IRR of 8% since 2014
- Mezzanine debt's share of private debt AUM has steadily declined since a peak in 2006 but investor interest is returning

[READ FULL REPORT →](#)

Lead Analysts



RJ Joshua
VP, Head of Private Debt and Fees
rj.joshua@preqin.com



Nicholas Mairone
VP, Research Insights
nicholas.mairone@preqin.com

Private debt's second largest strategy

Special situations as a strategy has overtaken distressed debt in terms of global AUM, becoming more popular over the past five years



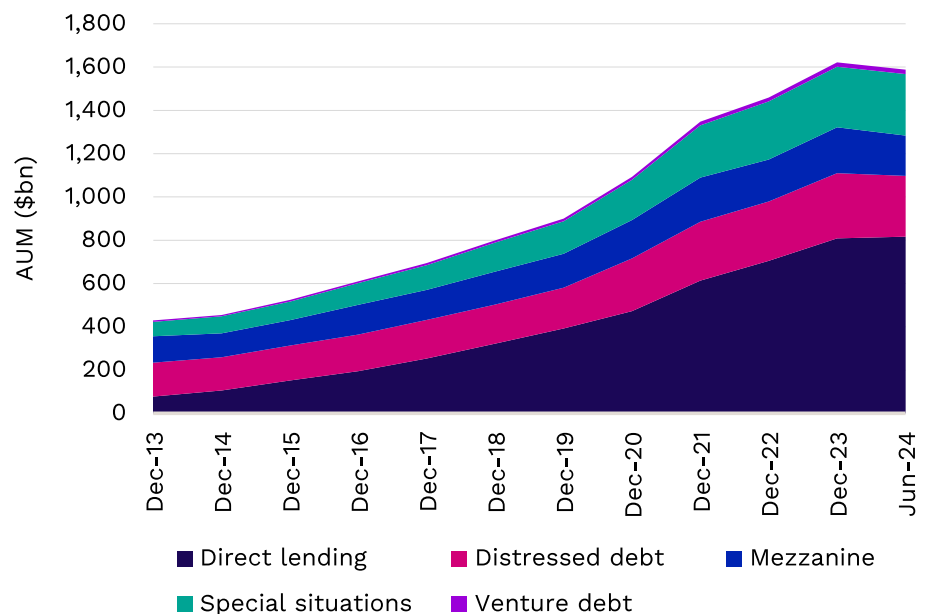
Nicholas Mairone
VP, Research Insights
nicholas.mairone@preqin.com

Special situations and distressed debt strategies mix elements of debt and equity strategies, with the former generally having a broader mandate than the latter. A distressed debt fund is most likely to be involved during a creditor's bankruptcy, while a special situations fund would intervene prior to that point. Some blended strategies – commonly called 'credit opportunities' or 'capital solutions' funds – are also beginning to emerge as GPs look to expand the pool of opportunities available to them.

While distressed strategies look for firms facing specific financial difficulty, a special situations fund may lend to firms undergoing any type of unique situation deemed temporary. Distressed strategies generally fell out of favor in the 2010s amid unfavorable macro conditions after the Great Financial Crisis (GFC). In June 2024, special situations as a strategy overtook distressed debt for the first time, if only by a small margin, to become the second largest private debt strategy by assets under management (AUM) (Fig. 1.1). Global special situations strategy's AUM was \$283.4bn, versus \$281.1bn for distressed debt; this is significantly smaller than direct lending's AUM of \$816.8bn.

Fig. 1.1: Special situations AUM narrowly passes distressed debt

Private debt assets under management by fund type

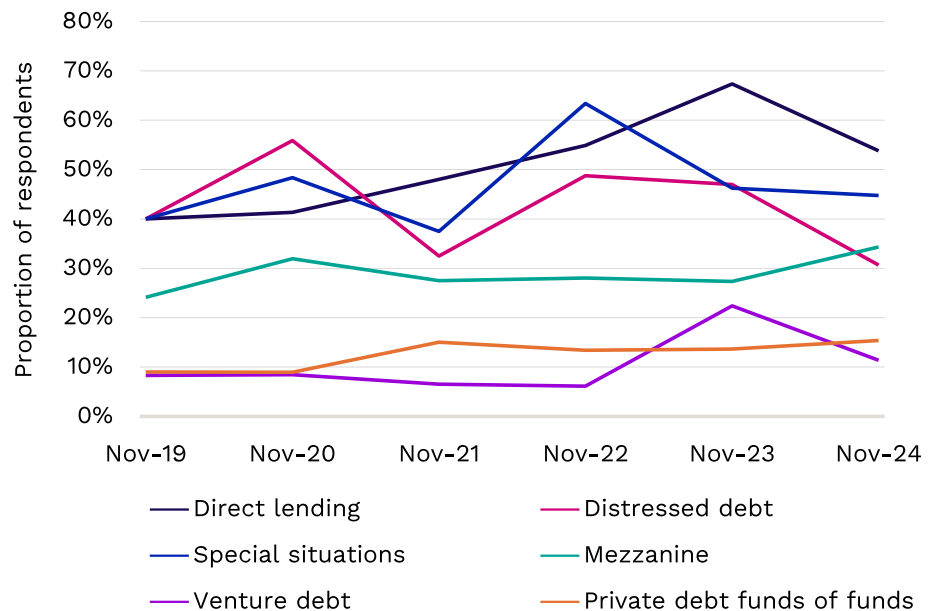


Source: Preqin

Interest in special situations funds remains robust (Fig. 1.2). When asked in November 2024, 45% of more than 250 investors surveyed believed special situations funds presented one of the best opportunities of private debt strategies, second only to direct lending. This figure was relatively steady year on year (46% in November 2023).

Fig. 1.2: Investor interest in special situations strategy surpasses distressed debt

Private debt assets under management by fund type



Source: Preqin Investor Surveys, November 2019–2024

Each year since 2022, special situations funds have outraised distressed debt strategies, with special situations funds raising on average \$33.4bn annually from 2022 to 2024 (Fig. 1.3). That is slightly above the \$28.2bn average raised from 2017 to 2021, the five-year period prior. From 2009 to 2016, this figure was just \$12.0bn. While this significant uptick coincided with an overall increase in private debt fundraising, there are some unique drivers of special situations funds’ increase in fundraising.

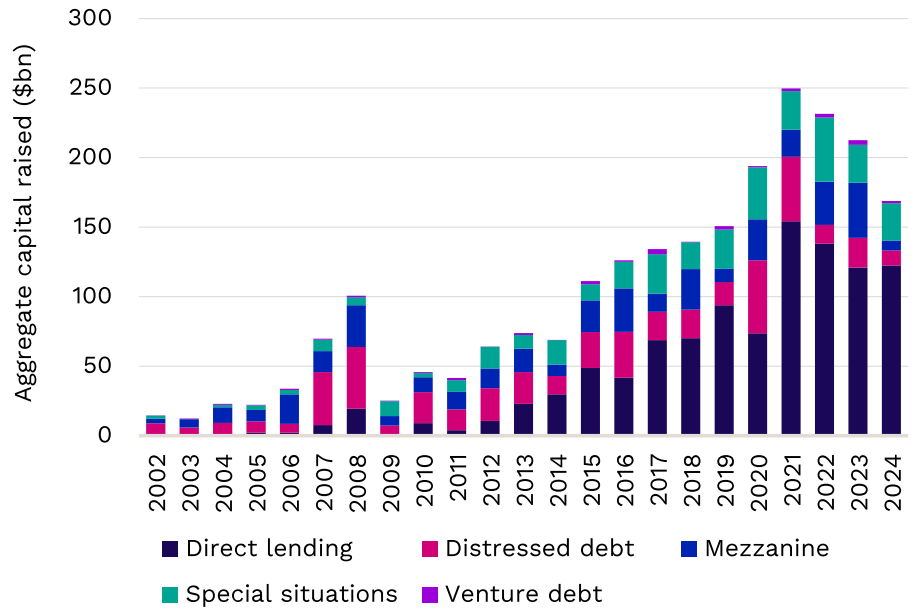
Some fund managers have blended their traditional distressed debt businesses with a wider mandate into ‘opportunity’ or ‘capital solution’ funds, leaning them towards special situations funds. This expands the pool of opportunities available to them and may help ease LP concerns about funds being too limited in scope. As these spread, they naturally draw capital away from a distressed strategy and towards a special situations strategy. This can be partly attributed to issues within distressed debt itself, with returns lagging somewhat in the years after the GFC. Wider mandates also allow special situations funds to take advantage of a broader range of opportunities not limited to specific points in the economic cycle.

Most special situations funds raised are focused on North America in a slightly higher proportion than private debt funds as a whole. Part of this is due to a bankruptcy process that historically has been faster than in many other advanced economies and part is due to the US simply being the largest market for all private assets. In 2024, 65% of special situations funds raised focused on North America, while 27% focused on Europe, per Preqin’s classifications (Fig. 1.4). From 2020 to 2024, 74% of the \$165bn raised focused on North America, while 16% focused on Europe.

The proportion of capital raised by special situations funds in North America is in line with the capital targeted. As of January 2025, 66% of capital targeted by special situations funds in market was focused on North America (Fig. 1.5).

Fig. 1.3: Special situations funds have outraised distressed debt funds for three years

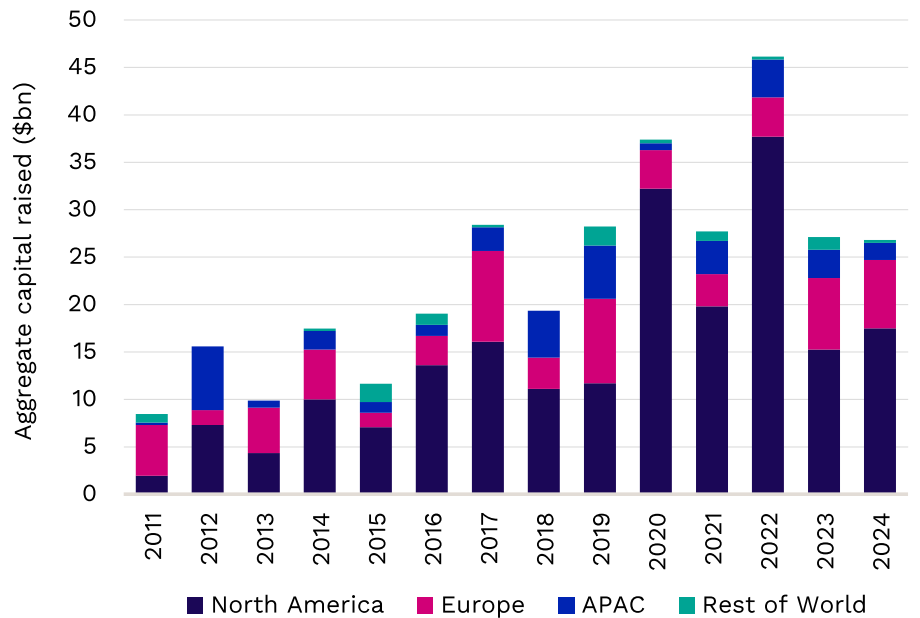
Private debt fundraising by strategy



Source: Preqin

Fig. 1.4: Most special situations funds focus on North America

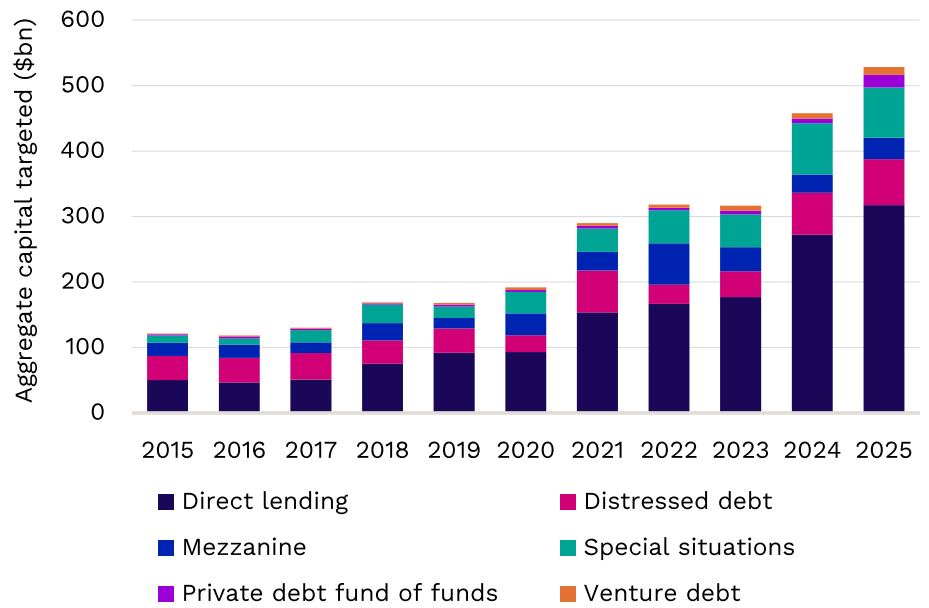
Special situations fundraising by region focus



Source: Preqin

Fig. 1.5: Special situations funds continue to target North America

Special situations funds in market by region focus

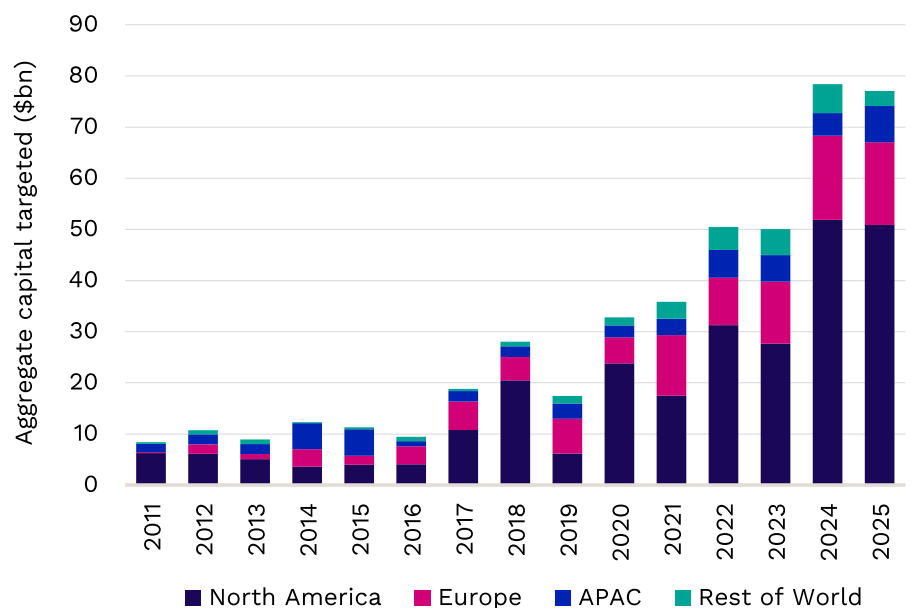


Source: Preqin

Over the past few years, the amount of capital being sought by private debt fund managers has increased substantially, rising to \$529bn as of January 2025, more than double the pre-COVID-19 level of \$191.7 billion in January 2020. The number of private debt funds in market have risen to above 1,300 as of January 2025, more than three times the number of funds in January 2020. Though this increase is being driven by direct lending, which currently sees 743 funds in market seeking \$317bn, special situations funds have also seen an uptick in funds currently being raised (Fig. 1.6).

Fig. 1.6: Special situations fundraising ambitions moderate

Private debt funds in market by strategy



Source: Preqin

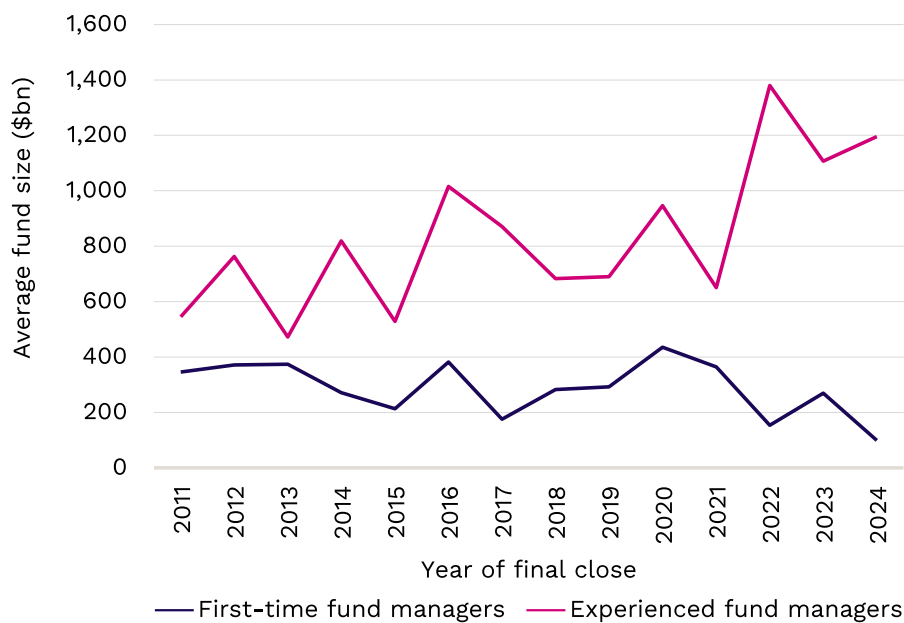
As of January 2025, fund managers were seeking \$77bn in special situations funds, down slightly from \$78bn in the year prior but more than double the \$33bn sought in January 2020, a 135% increase in funds sought. This is a smaller increase than direct lending and distressed debt have seen, with a 242% and 171% rise, respectively. This stands in contrast to the amount of funds being raised, where special situations funds have outraised distressed strategies, with the former raising \$165bn from 2020 to 2024, compared to \$144bn for distressed debt (Fig. 1.3). Some of these funds raised may be due to market optimism about distressed debt opportunities in the aftermath of COVID-19, which led GPs to launch more distressed debt funds.

First-time fund managers raise larger funds within special situations

Within private debt as an asset class, the average fund size for a first-time manager was \$195mn from 2020 to 2024, while that same figure for special situations funds was \$264mn (Fig. 1.7). At the same time, experienced managers (those who have raised four or more funds) within special situations funds have seen similar size funds to experienced managers across all of private debt (\$1.1bn and \$1.0bn respectively from 2020 to 2024). It is unclear why this is the case, but it may be related to the specialties needed to be successful in the strategy, such as experienced lawyers or restructuring experts.

Fig. 1.7: Experienced managers in special situations funds grow fund size

Average special situations fund size: first-time vs experienced managers*



Source: Preqin

*We define experienced managers here as those with four or more funds

Overall, while special situations fundraising and AUM have not experienced the same rapid growth as direct lending, the strategy continues to see some success and steady expansion as it manages to expand GP mandates beyond traditional distressed debt opportunities. Fewer fund managers have entered the market than the rest of private debt, as the special situations strategy has not gained the popularity of direct lending nor seen the GP interest that distressed debt did in the aftermath of COVID-19.

Despite a slower growth rate than direct lending, the special situations strategy's recent passing of distressed debt as the second largest private debt strategy globally is notable and a sign of the strategy's prominence in private markets, with underlying economic and market factors pointing towards some continued strength.

Economic volatility favors special situations

The lines will continue to blur between special situations and distressed debt strategies as the wider scope of the latter has bolstered returns

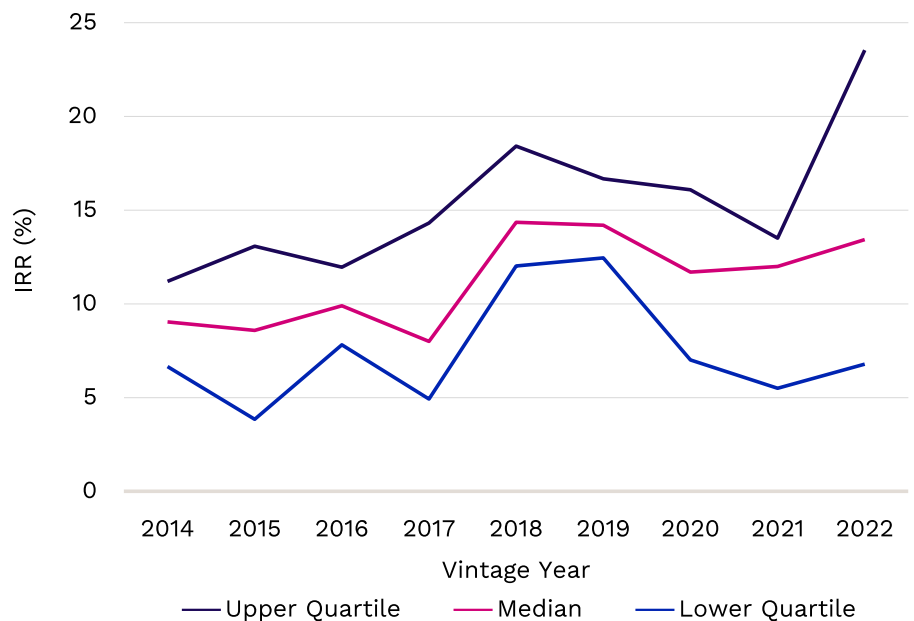


Nicholas Mairone
 VP, Research Insights
nicholas.mairone@preqin.com

Since the GFC, the relative position of special situations and distressed debt strategies has shifted, with the former overtaking the latter’s AUM. Going forward, we would expect this trend to continue as many distressed debt managers look to expand their mandates by offering ‘capital solutions’ funds, which may overlap in mandate with traditional special situations funds. Distressed debt tends to be sensitive to macroeconomic and market conditions while special situations funds attempt to have a more diversified opportunity set. Looking at special situations fund returns, the average lower quartile return across the 2014-2022 vintages was 7.4%, never falling below 3.8% (Fig. 2.1). Further, median returns never fell below 8% in those vintages.

Fig. 2.1: Median IRR relatively steady since 2018

Special situations funds’ performance, upper and lower quartiles



Source: Preqin Pro

Looking across vintages, special situations fund returns are comparable to distressed debt peers, with some outperformance in the more recent distressed debt vintages (Fig. 2.2). This may be due to the unique circumstances of COVID-19 related market displacements, which opened the door for distressed funds.

Fig. 2.2: Historically, similar net IRRs to distressed debt funds

Special situations and distressed debt fund benchmarks



Source: Preqin Pro, data as of 11 March 2025

Given overall similar return profiles, and consistent performance across managers, LPs may favor special situations funds over distressed funds in some cases, with the latter more capable of taking advantage of specific market disruptions. This is not to say that distressed debt funds cannot outperform – it may be the case that distressed debt sees a wider dispersion of returns, meaning that the top-performing distressed debt managers offer significantly higher returns than the worst performing managers, intensifying the need for appropriate due diligence.

Volatile economic outlooks are a potential boon

The economic outlook over the next few years is increasingly uncertain. Even with interest rates down from their peaks, they are well above their levels from the 2010s. At the same time, for the first half of the 2020s, real growth is relatively high and central banks remain focused on inflation, ready to switch policy stances at a moment’s notice. The outlook for the second half of the decade is uncertain, with inflation proving somewhat stickier than anticipated. Compare this to the 2010s, when growth was slow but positive, and inflation was low. In the aftermath of the GFC, many policymakers were hesitant to allow any sort of broad-based credit stress, worried that it may lead to another acute economic or financial shock.

This potential mix – positive levels of economic growth and policymakers accepting some level of volatility in markets – opens the door for special situations funds. Fund managers can offer a variety of financing options for borrowers, with less concern about rapid policy interventions eroding the opportunity, as may be the case for distressed debt funds. Moreover, if economic growth is positive, there may be more policy leeway to allow for credit stress, expanding opportunities for fund managers.

Some challenges from shifting debt portfolios

One potential issue for special situations fundraising going forward is the nature of LP commitments to debt funds. When asked, most LPs state that they invest in private debt funds for income generation, with a much smaller figure responding with interest in generating returns, which may lead to a change in how a return-based debt strategy, such as special situations, is seen by LPs.

Another consideration for some managers may be that one of the reasons for long-term optimism of asset growth in debt funds is the shift to considering some debt strategies as fixed income products. This allows them to take up a larger share in client portfolios, where large allocations are usually given to fixed income. The special situations strategy will not be considered in the fixed income product grouping due to its investment profile, making LPs more likely to consider it separately from other lending strategies. This may limit insurance and retail investment, where liquidity and income are more important.

Overall, the special situations strategy retains a relatively positive outlook. LPs tend to have more stable positions for their investments in special situations funds than distressed debt, though there has yet to be a deluge of special situation funds in market, even as distressed managers seek new capital. Still, the special situations strategy will likely lag direct lending and other fixed income-adjacent strategies in terms of asset accumulation in the years to come as it lacks the consistent income generation that is drawing many LPs to private debt.

Investors signal mezzanine rebound

After declining in favor due to high interest rates, mezzanine debt as a strategy is seeing renewed investor interest



RJ Joshua
VP, Head of Private Debt and Fees
rj.joshua@preqin.com

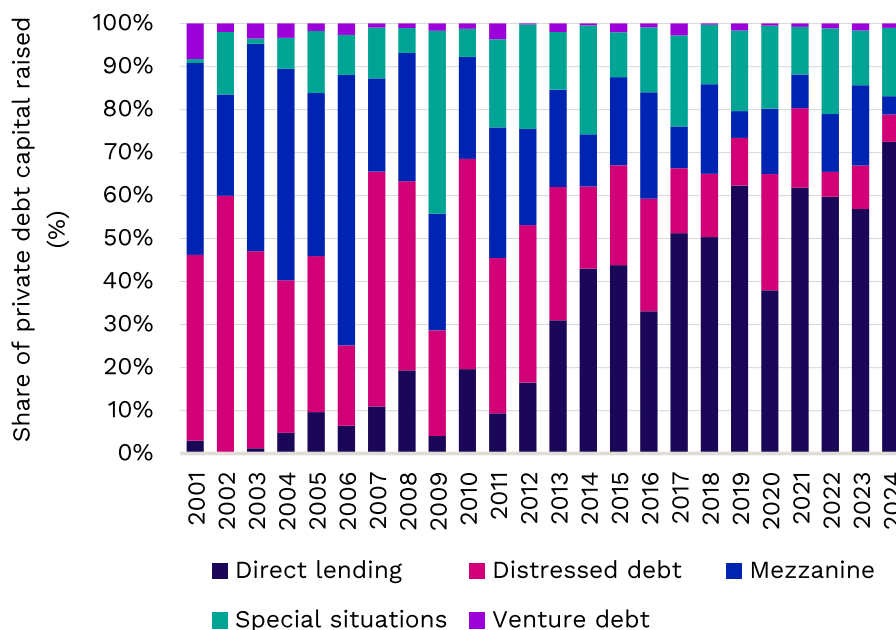
With public markets struggling year to date, especially on the equities side, and a mixed macroeconomic picture with resilient fundamentals, we see signs of increased investor interest in mezzanine debt – a strategy particularly favored by allocators seeking a combination of downside protection while maintaining strong performance potential.

In the 10 years to 2024, mezzanine averaged a 14% share of dollars raised (Fig 3.1). In 2024, fundraising was concentrated in direct lending, responsible for 72% of the funds raised, significantly up from its 10-year average of 50%. All non-direct lending strategies lost share as a consequence, but mezzanine was disproportionately affected.

Fig. 3.1: Mezzanine debt’s share of private debt AUM has steadily declined since 2006 peak

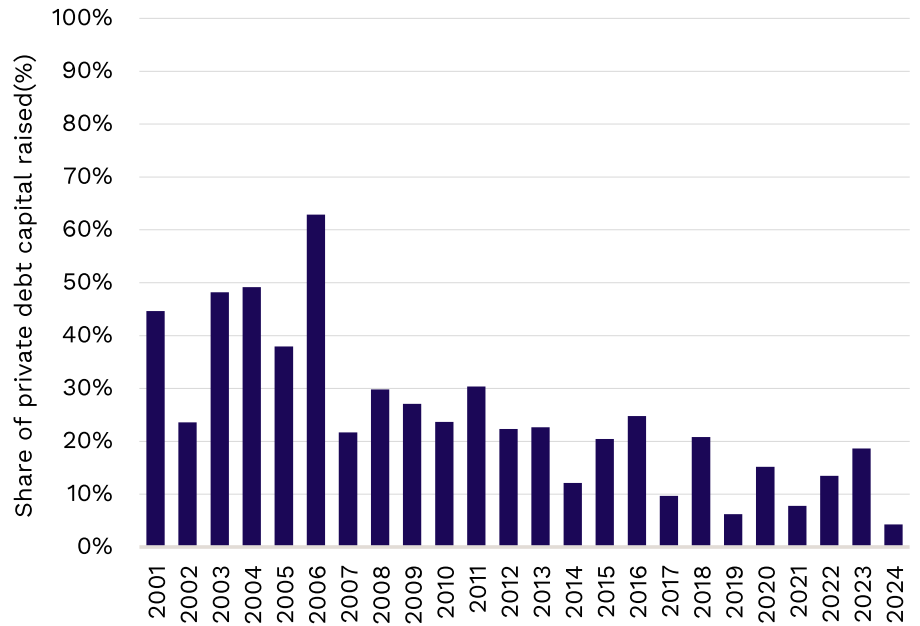
Private debt fundraising by strategy and mezzanine’s share of private debt capital raised

Private debt fundraising by strategy



Source: Preqin Pro, data as of 11 March 2025

Mezzanine share of private debt capital raised

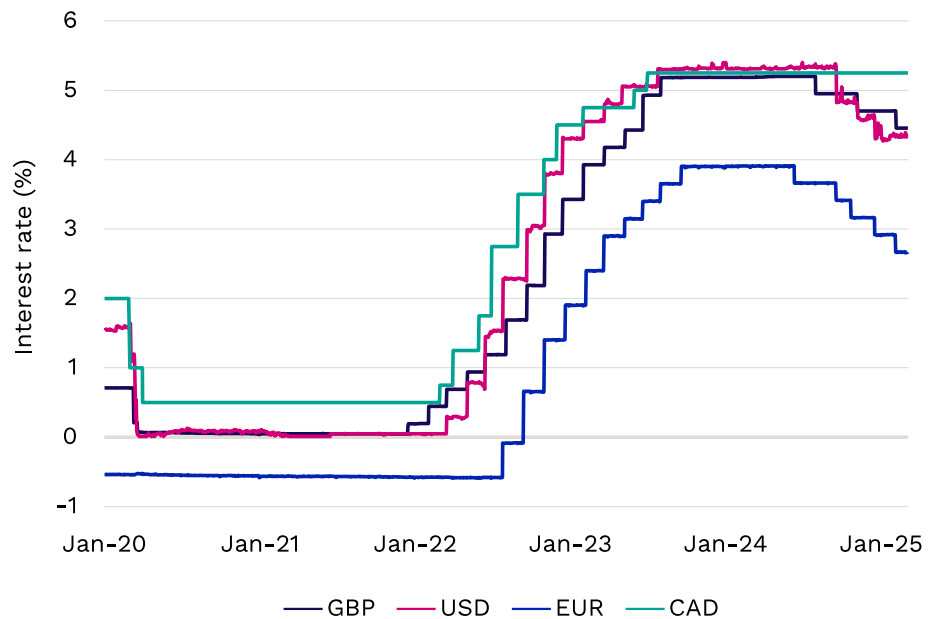


Source: Preqin Pro

The current interest rate environment may provide a turning point for sentiment towards mezzanine debt. Throughout 2024, we had elevated interest rates. Looking at overnight rates (Fig. 3.2), we can see that 2024 was a high-water mark for interest rates. This had two effects, one was to suppress LP demand for mezzanine – with senior loans yielding enough to meet their mandates, there was little reason to stretch to riskier mezzanine loans.

Fig. 3.2: Overnight rates have reduced from recent peak

Overnight interest rates for GBP, USD, EUR and CAD



Source: FRED

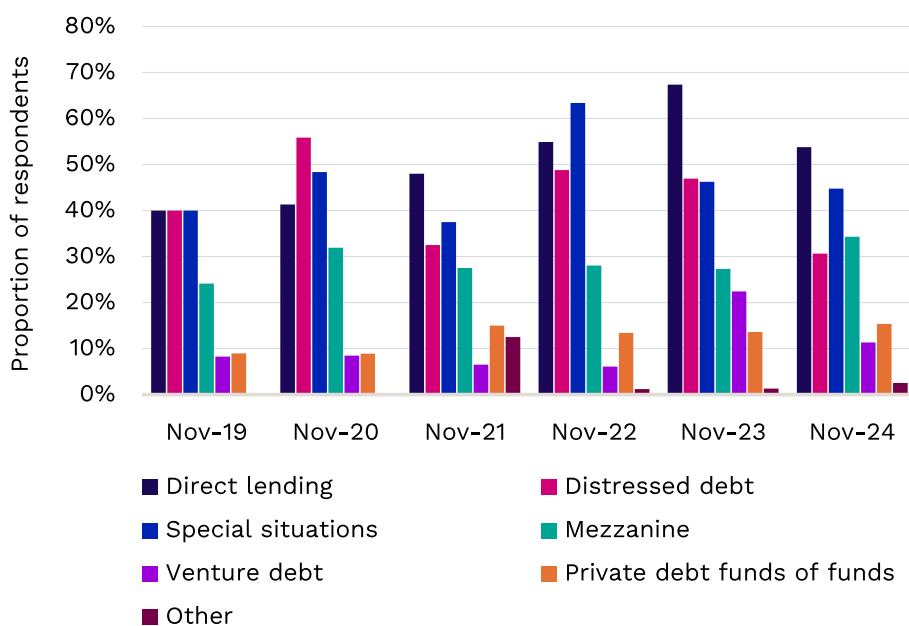
The second effect was from the portfolio company side. The higher interest rates likely damped demand for mezzanine loans from borrowers. Now as the interest rate outlook has stabilised to one of moderate cuts in 2025 (at the time of writing, consensus is for two or three 25bp cuts by the end of 2025),¹ we may see increased deal activity as rates come down, spurring increased borrow demand.

Early signs of a bounce in investor interest in mezzanine

This is backed up by our most recent investor survey results, where we see a sharp reduction in interest toward direct lending (from 67% of investors saying it presents the best opportunities in November 2023 to 54% in November 2024), and an uptick in interest towards mezzanine debt (from 27% to 34%) over the same period (Fig. 3.3). It may be that investors are seeking to anticipate rate cuts by allocating to higher returning mezzanine over direct lending.

Fig. 3.3: Direct lending interest falls back slightly

Investors were asked: ‘Which fund types present the best opportunities?’



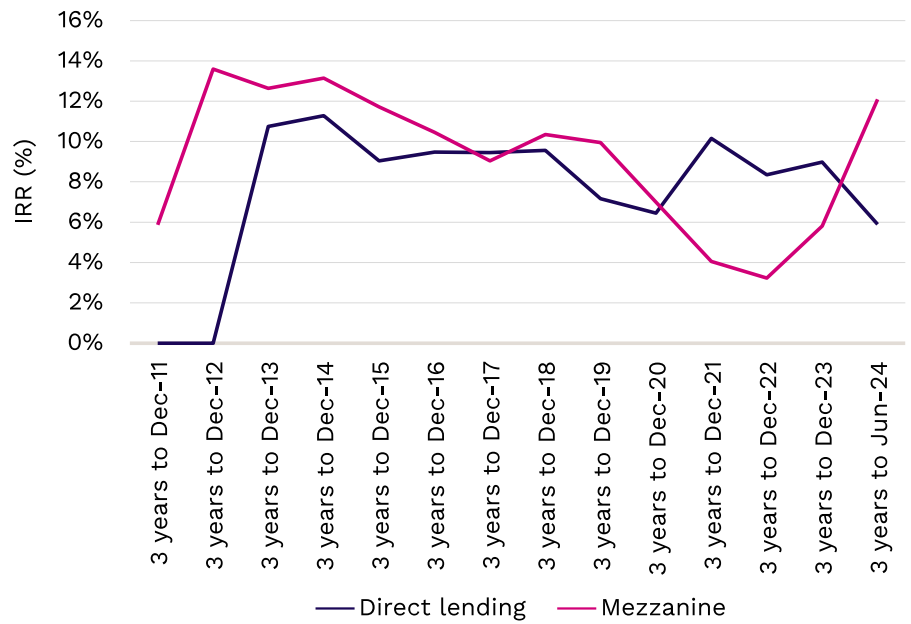
Source: Preqin Investor Surveys, November 2019–2024

It is worth noting that in an environment of strong economic growth, subdued inflation and moderate rate cuts would likely result in a continued benign default environment, all of which would support more junior portions of the capital structure such as mezzanine. So far the data is consistent with this scenario, although if inflation picks up that would likely prove to be a headwind, as the market would price in higher for longer rates. We see a meaningful pick up in performance for allocating to mezzanine over direct lending. In the three years to June 2024, direct lending yielded 5.9% IRR compared to 12.1% for mezzanine (Fig. 3.4).

¹ CME Fedwatch showed 32.6% implied probability of 350-375bp rates for 10 December 2025 meeting, accessed 13 March 2025

Fig. 3.4: Mezzanine shows higher returns than direct lending

Rolling three-year horizon IRRs by strategy



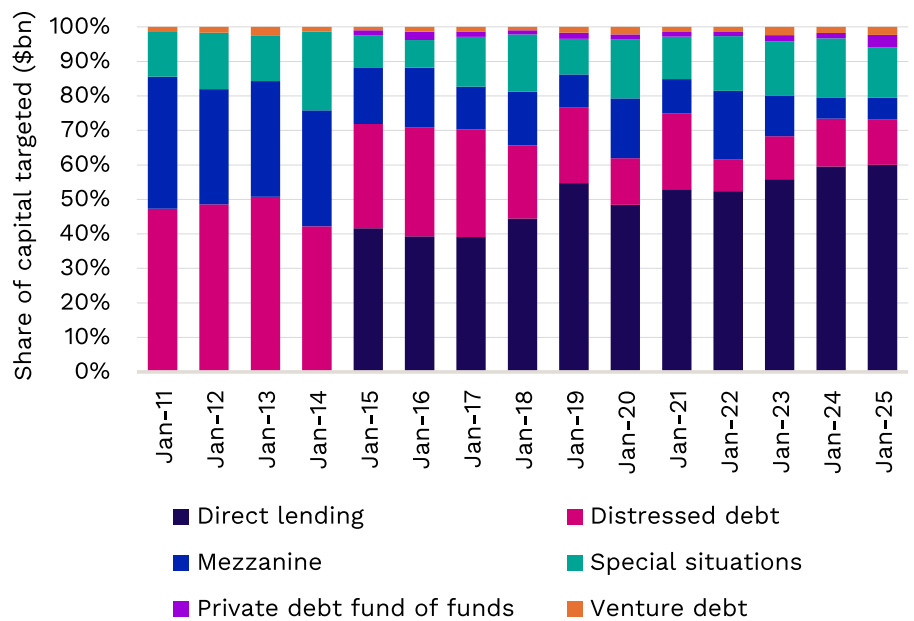
Source: Preqin Pro

GPs are expecting steady demand for mezzanine debt funds

Most GPs are in a good position to gauge the outlook for fundraising as they sound out LPs ahead of launching a fund. Funds-in-market data gives an indication of the outlook for mezzanine fundraising. Although the target capital to raise is lower than in the recent past, it is in line with the five-year average. Aggregate capital targeted as of January 2025 is \$32.8bn, compared to a five-year average of \$38.0bn (Fig. 3.5). In terms of geographic split, GPs are consistent between mezzanine and special situations

Fig. 3.5: GPs target direct lending for fundraising over mezzanine

Share of capital targeted by strategy



Source: Preqin Pro

funds, with 65% of mezzanine target fundraising for North America-focused funds compared to 66% for special situations funds. This is consistent with GPs following LP demand for higher returning strategies in the strongest economies.

Across private debt we see that raising a first-time fund is very challenging, and we see a similar picture for mezzanine. First-time managers' average fund size is at an all-time low of \$37.3mn in 2024, while the experienced fund managers' average size is \$443.8mn. Investor preference for the largest and most experience managers is due economies of scale within private debt.

Mezzanine may benefit in multiple economic scenarios:

We see signs of investor interest after a period of a declining share of fundraising and AUM. That being said, in absolute terms the strategy is holding steady. Looking ahead, the macroeconomic outlook and consequent interest rate will be key.

High growth, low inflation scenario: If we see a repeat of the last couple of years – declining inflation against strong growth – investors may favor mezzanine as they seek to maintain nominal yields in a declining rate environment.

Inflation resurgence scenario: If we see a resurgence in inflation, leading to higher rates and weaker growth, the most likely outcome is private debt investors continuing to heavily favor more defensive strategies, such as direct lending.

Public equity sell-off: If we see broadly sound economic fundamentals but a sell-off in public equities, we may see mezzanine shine in terms of investor interest. Investors would likely seek to derisk by shifting from equities into debt. But with return targets to meet, locking in the larger spread offered by mezzanine over direct lending may be appealing.

Empowering the global private markets community with essential data and insights.

preqin.com/insights – preqin.info@blackrock.com

Related insights+ research



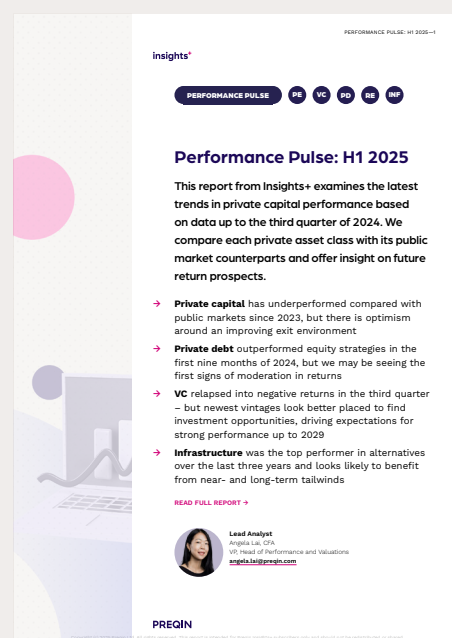
Preqin 2025 Global Report: Private Debt

[Read now](#)



Investor Outlook: H1 2025

[Read now](#)



Performance Pulse: H1 2025

[Read now](#)

All rights reserved. The entire contents of Strategy in Focus: Special Situations and Mezzanine are the Copyright of Preqin Ltd. No part of this publication or any information contained in it may be copied, transmitted by any electronic means, or stored in any electronic or other data storage medium, or printed or published in any document, report, or publication, unless expressly agreed with Preqin Ltd. The information presented in Strategy in Focus: Special Situations and Mezzanine is for information purposes only and does not constitute and should not be construed as a solicitation or other offer, or recommendation to acquire or dispose of any investment or to engage in any other transaction, or as advice of any nature whatsoever. If the reader seeks advice rather than information then it should seek an independent financial advisor and hereby agrees that it will not hold Preqin Ltd. responsible in law or equity for any decisions of whatever nature the reader makes or refrains from making following its use of Strategy in Focus: Special Situations and Mezzanine. While reasonable efforts have been made to obtain information from sources that are believed to be accurate, and to confirm the accuracy of such information wherever possible, Preqin Ltd. does not make any representation or warranty that the information or opinions contained in Strategy in Focus: Special Situations and Mezzanine are accurate, reliable, up to date, or complete. Although every reasonable effort has been made to ensure the accuracy of this publication, Preqin Ltd. does not accept any responsibility for any errors or omissions within Strategy in Focus: Special Situations and Mezzanine or for any expense or other loss alleged to have arisen in any way with a reader's use of this publication.