A Comparison of Long Dated Funds to Traditional Fund Structures

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Private equity firms and large institutional limited partners have created long-dated fund structures to address the unique needs of investors with significant capital to deploy. The long-dated fund structures seek to provide a lower risk and lower return investment option compared to traditional private equity. Traditional private equity partnerships have a term of 10 years with investments held for an average of 5 years. The long-dated funds seek to bridge the gap on a risk and return spectrum between traditional private equity and public equity. Long-dated funds will generally have terms of 15 years with an average holding period of 5 to 10 years per investment. Cliffwater has concerns with the current long-dated offerings including the firms' limited dedicated resources, their lack of a relevant track record, and an unclear value proposition.

Fund Investment Strategy & Terms

The long-dated funds have notable differences from traditional private equity structures.

- *Risk and return expectations: Long-dated funds will target stable companies with lower volatility but also lower return expectations. Portfolio company investments are generally characterized by strong operating metrics, stable teams, and lower use of leverage. Long-dated funds will typically target lower net IRR returns (10.0% to 12.5%) but higher net multiples on invested capital (3.5 to 4.3 times) relative to the 20% net IRR and 2.0 times net return traditionally targeted by buyout funds.*

- *Legal terms and fees: Management fees for long-dated funds are based on a percentage of invested capital (ranging from 1.0% to 1.5%) and carry will generally be lower (10% to 15%) relative to traditional private equity funds. Cliffwater believes the terms to be generally advantageous to limited partners but cautions that due to the longer period of time that management fees are accrued, the long-dated funds have the potential to accrue more in management fees relative to similarly sized consecutive investments within a traditional private equity model.*

- *Value proposition: The strategy's approach seeks to drive future earnings through growth and free cash flow generation of already well positioned companies. Long-dated fund strategies target equity checks ranging from $750 million to $1.25 billion and will primarily target control transactions. General Partners do not expect these investments to compete with their flagship offerings due to the size of equity check, longer holding periods, and lower return expectation of the strategy's targeted investments.*

Note: Terms and return expectations discussed are general representations of those typical provided by General Partners and are not meant to be representative of a specific long-dated opportunity.

Current Offerings

The General Partners who are raising capital for this investment strategy are large private equity firms that have multiple product offerings, are publicly traded or have some third party ownership, and invest in a diversified group of industry sectors and geographic regions. The long-dated investment strategy is new for each of the firms employing it or is early in its implementation. Managers have either utilized a dedicated investment team, or allocated responsibility of managing the fund to one or two senior individuals and utilized existing deal teams from the platform. A few additional firms have raised smaller,

similarly styled fund but have yet to successfully implement the strategy. Other large firms have raised separately managed accounts (or plan to do so) which employ a similar long dated strategy.

Current Long Dated Fund Offerings:

Firm	Strategy Name	Fund Size	Vintage
Blackstone	Blackstone Core PE	$5.0 billion	2016
Carlyle	Carlyle Global Partners	$5.0 billion	2016
CVC	Strategic Opportunities	Separately Managed Accounts	2015

Limited Partners that have pursued the long-dated investment strategy tend to be either sovereign wealth funds or large public pension plans seeking to deploy significant amounts of capital with managers who represent key relationships for their institution. These limited partners are attracted to the lower headline fees and longer-term investment horizons. Most long-dated funds have a high minimum investment of approximately $500 million but have made exceptions of taking select limited partners with commitments as low as $150 million.

Conclusion

While the longer dated funds are a way for investors to invest more capital with high quality private equity firms, there are several attributes that give Cliffwater pause. Cliffwater's primary concerns are centered on the new implementation of the strategy and the resources that General Partners have deployed relative to the amount of capital under management. Cliffwater recommends waiting for an offering where the manager can demonstrate a dedicated team, attractive economics for investors, a track record, and clear rationale as to what value the manager can bring to bear on portfolio companies.

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