

EMERGING MANAGERS
FUND GUIDE

Raising a First-Time Fund

 LanghamHall



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Introduction

For many years now, institutional investors have continued to increase their allocations to private markets to search for returns that meet or exceed their financial goals. Private funds provide diversification opportunities, access to a wider investment universe, and many would argue enhanced returns for such institutions, which explains why as many as 43% of Limited Partners ('LPs') said they are looking to increase their allocations to Private Equity last year¹. In 2021, Private Equity funds raised a record \$733 billion², while in Real Estate managers raised over \$175 billion of new capital³. With this new capital flowing into private markets, we have witnessed a rise in the number of start-up and spin-out fund managers coming to market, departing household names such as Advent, KKR, Schroders, TPG and more to start out on their own. Data shows that emerging managers outperformed the vehicles of established managers during 16 of the last 19 years⁴, explaining why 71% of LPs considered investing in spinouts in 2022, while only 8% are not investing in first time funds⁵.

For these individuals, launching a debut fund is an attractive proposition, but the task is not an easy one. Raising capital as a newcomer is tough, competition for deals remain intense and the current regulatory environment can be burdensome if not approached properly. Many of those that leave established firms are experts at originating deals and realising exits but have less operational expertise in areas such as investor reporting, regulation, NAV calculations, fund finance and fund structuring.

Our own experience of being a start-up ensures we have strong cultural links with spin outs and now as one of the last independent providers of fund services across three continents, Langham Hall has extensive experience in helping new fund managers navigate the challenges of launching their first fund. We have launched this guide to provide a high-level overview of many of the key aspects to consider when setting up. We hope you find it useful.

¹ <https://www.preqin.com/insights/research/investor-outlooks/preqin-investor-outlook-alternative-assets-h2-2021>

² <https://www.privateequityinternational.com/fundraising-hit-a-new-full-year-record-in-2021/>

³ <https://www.perenews.com/fundraising-in-2021-was-one-of-the-strongest-on-record/>

⁴ <https://www.buyoutsinsider.com/twelve-emerging-managers-to-keep-your-eye-on-in-2022/>

⁵ https://probitas.wpenginepowered.com/wp-content/uploads/2021/12/Private-Equity-Survey-2022_1203_2021_sm.pdf



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EMERGING MANAGERS FUND GUIDE
RAISING A FIRST-TIME FUND
GETTING STARTED

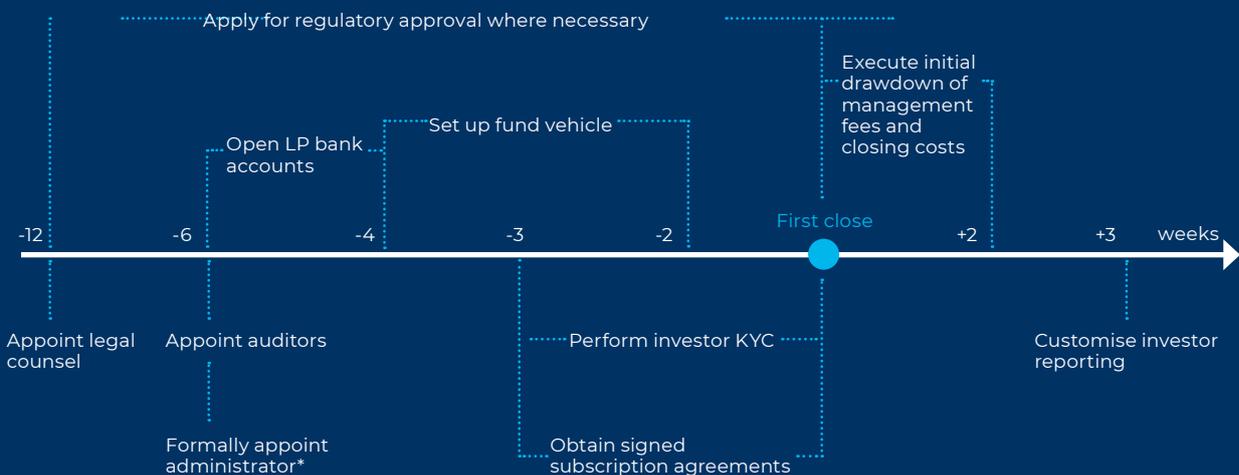
Getting Started - Establishment and Regulation

Setting up a fund comes with several key considerations, such as how to become authorised to provide investment advice, where to domicile a fund, and how to take a fund to market. Some managers choose to start with a deal-by-deal structure before progressing to a full commingled fundraise, but this too will require some regulatory thought.

Key considerations when selecting a domicile will be tax efficiency, target investor universe and resource required to run the fund. Managers setting up a new fund will benefit from having a clear timeline with milestone objectives, (such

as the one outlined in Fig. 1). Before setting up any vehicle, the first thing most managers will need to consider is how to obtain regulatory authorisation to provide investment advice, for which there are several different options.

Fig. 1 - Clear timeline with milestone objectives



*if using an offshore structure, it is likely these steps would happen prior to applying for regulatory approval.

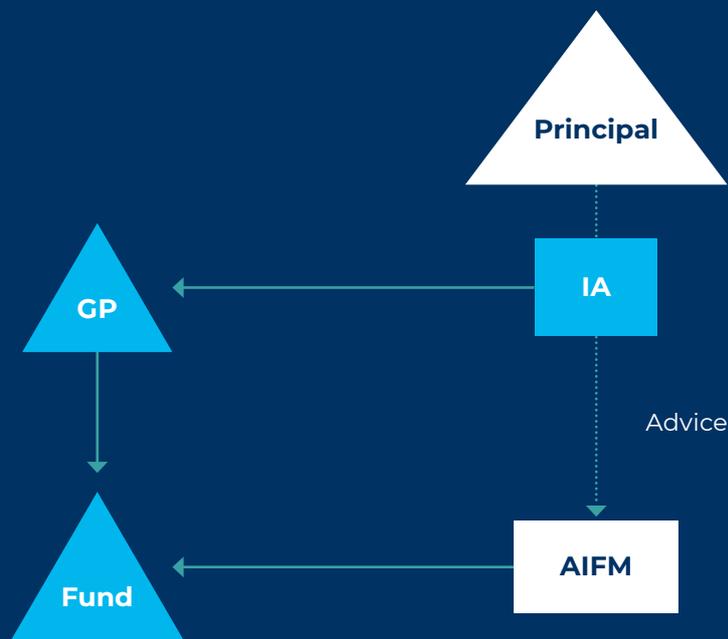
PROVIDING INVESTMENT ADVICE

In the UK, advising and arranging deals is generally considered a regulated activity by the Financial Conduct Authority ('FCA'), for which managers should have some form of regulatory permissions. In our experience, there are two main routes to take here; direct authorisation, or becoming an Appointed Representative ('AR') of a regulated Principal.

The Appointed Representative regime came into force in the UK in 1986, although wasn't widely used by fund

managers until it was adapted to a broader range of financial services activities in 2000. The regime allows market participants to carry out certain regulated activities under the supervision of their regulated Principal, most relevantly advising on investments, and arranging deals. Importantly, an AR cannot establish or operate a collective investment scheme, which requires a regulated Operator or the Alternative Investment Fund Manager ('AIFM') to be appointed (Fig.2).

Fig. 2 - The arrangement between the investment adviser, the principal and the fund



Becoming an AR allows an emerging manager to carry out regulated activity under the Principal's "umbrella" in a matter of weeks, rather than waiting six months or more for direct authorisation from the FCA. In addition, the regulatory capital requirement, which can be a high financial commitment for new managers, is also the responsibility of the Principal. Finally, the compliance function is essentially performed by the Principal, so there is no additional human capital required – another potentially high cost for those just starting out. However, managers looking to become an AR should also note that they will not be permitted to manage investments, and that they will need to give the Principal

access to staff, premises and confidential records so that they may supervise effectively.

In Europe, a similar regime exists, known as becoming a "Tied-Agent", although this is generally less commonly used. In the US, since the Dodd-Frank act came into force, many managers now need to register with the Securities and Exchange Commission as an "Investment Advisor" although some exemptions still remain, and these should be carefully considered when setting up.

Once a manager has decided which regulatory route to take, the next step is choosing a fund structure and domicile.

FUND STRUCTURING AND MARKETING

Before a fund can become operational, it needs capital. Fundraising is one of the first things managers will need to consider, which comes with several challenges. As well as trying to attract new institutional investors, emerging fund managers must also comply with the regulatory environment in which they operate – most notably in the European Union that means operating under the Alternative Investment Fund Managers Directive ('AIFMD'), which has been in place since 2013. Any manager that is either operating in Europe, or marketing to investors in Europe, will need to comply with the directive in some form. The rules on marketing vary between countries, so specialist legal advice should always be sought, but here we outline several of the options available to first time managers.

Choosing a Jurisdiction

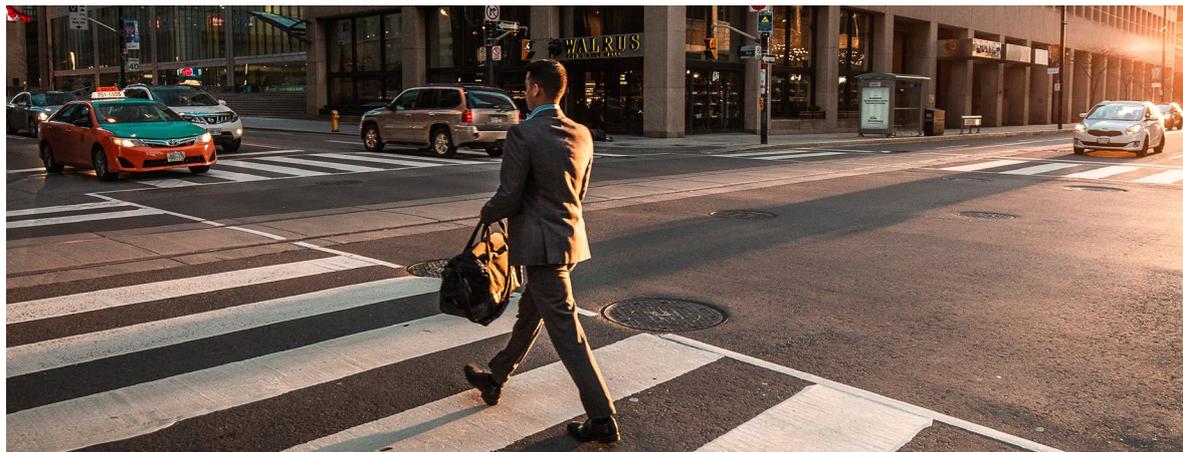
Selecting a jurisdiction for domiciling a fund vehicle is rarely a black and white decision. Key drivers are usually tax and marketing, but managers should also consider perception to investors, ease of operations and cost to run. Broadly here we are going to focus on marketing, particularly where European investors are concerned, but the importance of tax considerations should not be forgotten, and we always recommend a specialist tax advisor be engaged. Further, the appropriate structure should be carefully considered; many private funds take the form of an unregulated Limited Partnership (an L.P. or its equivalent, e.g. SCS/SCSp in Luxembourg), but others

such as PAIFs, SICAVs, Expert Funds, Cell Companies and more exist. For emerging managers, the most common structure we see used is the Limited Partnership due to its light touch regulation. However, managers should be aware of other options which may be more appropriate depending on specific circumstances.

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Onshore vs Offshore?

This was traditionally one of the first questions posed to managers setting up a new fund, and in the past jurisdictions such as the British Virgin Islands, Bermuda and the Bahamas were popular for fund structures. More recently, the major fund domiciles we have operated in are Delaware, Cayman Islands, UK, Jersey, Guernsey and Luxembourg, and so to some extent the question of onshore vs offshore still remains. The Cayman Islands in particular remain a hugely popular jurisdiction for managers



based in North America and Asia, and LPs in those jurisdictions routinely invest into Cayman Islands domiciled structures. Conversely, in the EU, there is less appetite for funds domiciled in the Cayman Islands, particularly since they were added to the EU's tax and AML blacklists (although they have since been removed from the former and are not expected to stay on the latter for a significant length of time). In our experience, a significant proportion of European LPs prefer to invest in structures domiciled closer to home, such as the UK, Channel Islands and Luxembourg.

Europe: To EU, or not-to-EU?

Where managers are targeting European institutional capital, one of the biggest considerations is the AIFMD, and its influence on routes to market across the 27 European Union member states. Broadly speaking, there are two options for access European capital: distributing a European domiciled, AIFMD compliant AIF under the marketing passport, or registering a non-EU AIF on a country-by-country basis under Article 42 of the AIFMD, otherwise known as the National Private Placement Regime ('NPPR').

Since the end of the Brexit transition period on 1st January 2021, the United Kingdom joined the list of non-EU (or "third-country") fund domiciles for the purposes of AIFMD, alongside existing jurisdictions such as Guernsey, Jersey and Cayman Islands. Any non-EU domiciled AIF will have to rely on NPPR to access European capital, a regime which is no longer in place or workable in some EU member states, e.g. Italy, France and Spain (Fig. 3). It is important to note that Switzerland is not part of the European Union, although does have its own requirements with respect to marketing which differ depending on the investors targeted.

There is no one size fits all when it comes to selecting a fund domicile, with marketing being just one element to consider. Tax leakage should also be carefully analysed throughout the structure, as well as practical considerations – running a fund in a jurisdiction where the manager has operations will come with some efficiencies, particularly where they already have adequate substance on the ground.

Fig. 3 - Comparison of jurisdictions which can be easily accessed under the NPPR, versus marketing an EU domiciled, AIFMD compliant structure

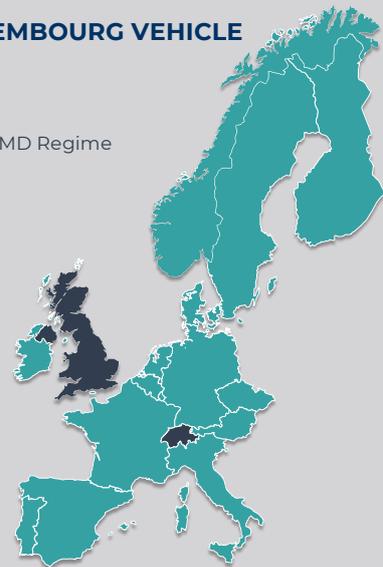
NATIONAL PRIVATE PLACEMENT REGIME (NPPR)

- Marketing possible
- Marketing possible with additional requirements
- Marketing impossible



LUXEMBOURG VEHICLE

- AIFMD Regime



N.B. Switzerland has its own set of rules as it is not a member of the EU.

The UK is accessed by NPPR as it is no longer a member of the EU.

NPPR vs AIFMD Passport: Advantages and Perceived Drawbacks

Registering under the NPPR versus setting up an AIFMD compliant structure is a debate we often have with our clients. There are advantages and disadvantages to both, which should be carefully considered by managers when setting up, including speed to market, cost and ease of operations (Fig. 4). Often at the outset, fund managers may not know where the LP interest in their team and strategy will come from, and so the new EU pre-marketing rules (that came into force on 2nd August 2021) have proved

useful. Managers may also accept subscriptions via reverse solicitation if they receive inbound enquiries from LPs but are not able to actively market using this method, (and it might be tough to prove genuine reverse solicitation for a first time fund).

For many sponsors, these factors will heavily influence where to domicile their fund vehicle and are a key consideration alongside tax and ease of operation.

Fig. 4 - Comparison of NPPR vs AIFMD Passport

| | NPPR | AIFMD PASSPORT |
|-------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| CHOICE OF DOMICILE | Wider range of fund domiciles available, e.g. UK, Channel Islands, Luxembourg. | Limited to EU domiciled funds, most commonly Luxembourg. |
| COST | Non-EU fund domiciles typically have a lower cost to operate. If marketed in the EU, Annex IV reporting is required, as well as a depositary-lite for Germany and Denmark. | Requirement to appoint an AIFM and depositary can increase operational costs. Typically requires a fundraise of >€150m to avoid being a drag on IRR. |
| OPERATING REQUIREMENTS | Funds commonly appoint an administrator to provide accounting, administration and investor services. Local directors should also be appointed to the general partner to maintain substance. A depositary-lite is required when registering in Germany and Denmark. | EU domiciled funds are subject to the AIFMD, so are required to be managed by an AIFM. In the case of full scope AIFMs, a depositary is also required. Local directors should be appointed to the general partner to maintain substance. |



| | NPPR | AIFMD PASSPORT |
|---------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| TIME TO MARKET | <p>Some countries require only a notification, rather than registration. Where registration is required, the process generally can take up to 3 months until marketing is approved and subscriptions can be accepted.</p> | <p>Once an AIFMD compliant structure is setup and marketing has been approved by the local regulator, marketing can begin immediately, and subscriptions can be accepted.</p> |
| MARKET ACCESS | <p>Not every country has a workable NPPR, so marketing is limited to those that do.</p> | <p>An AIFMD compliant structure can be marketed under the passport to 27 EU member states.</p> |
| INVESTOR PERCEPTION | <p>Some LPs do not like to invest in non-EU domiciled funds, and many have smaller capital allocations for those domiciled in e.g., Cayman Islands.</p> | <p>European institutional investors routinely commit capital to AIFMD compliant structures.</p> <p>Some institutions e.g., Germany Insurance Companies, have larger capital allocations for AIFMD compliant funds.</p> |

Pre-Marketing

On August 2nd 2021, the European Union implemented the Cross Border Distribution Directive ('CBDD') which aims to harmonise the pre-marketing rules across the bloc. Previously, each member state had a different approach to pre-marketing, with some considering all but final subscription documents being acceptable for distribution, while others all but prohibited the practice altogether. Under the new directive, pre-marketing can now be undertaken by any regulated EU entity, taken to mean any regulated AIFM or MiFID firm (e.g., an appropriately regulated placement agent), and allows for the distribution of marketing materials in draft form. The directive currently only applies to EU AIFMs (or other regulated entities) marketing an EU AIF; the AIFMD states that non-EU AIFMs may not be treated favourably, and to date only a handful of jurisdictions have implemented the equivalent rules for non-EU AIFMs. For other countries, these revert to national laws, and should be reviewed on a country by country basis.

Once pre-marketing permissions have been granted the fund can no longer rely on reverse solicitation for a period of

18
months



The CBDD allows fund managers to pre-market a fund strategy to gauge investor interest, before formally applying for marketing permissions and setting up a fund vehicle, a process which in itself comes with a considerable time and monetary cost. It should be noted that once pre-marketing permissions have been granted, the directive states that the fund can no longer rely on reverse solicitation for a period of 18 months subsequently.

GOING GREEN

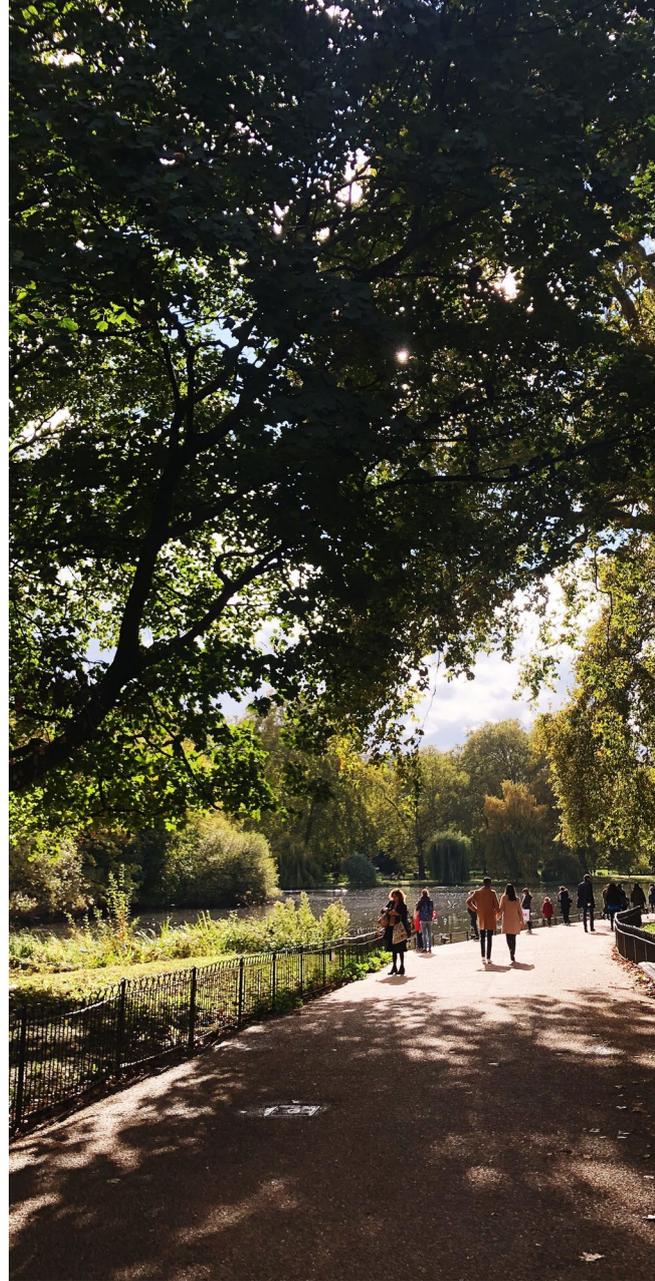
One of the biggest changes to fund regulation that managers now need to consider is the Sustainable Finance Disclosure Regulation ('SFDR'). The SFDR was implemented to require managers to give greater transparency around their investment processes with respect to ESG, and in particular how sustainability risks are considered. The SFDR is a complex piece of legislation that is still in its infancy, with the various Regulatory Technical Standards ('RTS') being implemented in stages over the coming years. Key to managers at the outset though, will be the classification of the fund, which can fall in to three categories;

- **Article 6 Funds:** these funds do not promote any environment or social characteristics
- **Article 8 Funds:** these funds promote some environmental or social characteristics, colloquially known as "light green" funds
- **Article 9 Funds:** these funds specifically promote environmental or social characteristics, and can be thought of as "impact" or "ESG focused" funds, colloquially known as "dark green"

It is estimated that some €2.5trn in European fund assets is now classified as either Article 8 and 9, with this number only set to grow. Choosing how to classify your fund is important. It will define the level of disclosures required in periodic reporting with respect to sustainability considerations in the investment process, and is also one of the factors considered by investors during the due diligence process. The SFDR could merit an entire guide in itself, but we encourage new managers to speak to us to understand the requirements in more detail.

€2.5^{trn}

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What next

It may sound like setting up a first fund comes with a mountain of decisions, but with the right advisors this should be a smooth process. We have outlined here just some of the key considerations we highlight to managers when setting up, but other aspects such as tax, fund terms, fund finance and more should not be forgotten. Reaching a first close is an achievement in itself, but deployment of capital and subsequent fund operations are next on the agenda for managers, which is often where the real value creation begins.

2

Fundraising

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FUNDRAISING

Running a fund is a multidisciplined challenge. Fundraising, operations, deal origination, portfolio management and eventually exiting are all aspects that need to be considered.

In our experience, most first-time managers are highly skilled in all of these areas but may still need support along the way. This can come in the form of a partner, or hiring a team, or in many cases, appointing an external advisor. This is often the case with fundraising;

some of the most successful managers start out with excellent deal pipeline, and the ability to generate superior returns from assets, but may not have wide access to the institutional capital needed to raise a fund.

We sat down with...

Ali Floyd, Managing Director at Campbell Lutyens, and Andy Dawson, Managing Partner at bd-capital, to discuss fundraising for emerging managers, including what investors are looking for, what challenges an emerging manager may face when raising their first fund, and what advice they would give to those going out on the road for the first time.



**ALI FLOYD,
MANAGING DIRECTOR
CAMPBELL LUTYENS**

CAMPBELL
LUTYENS 

Founded in 1988, Campbell Lutyens is an independent private markets advisory firm exclusively focused on primary fundraising, secondary transactions and GP capital advisory services in the private equity, private debt, infrastructure and sustainable investing markets.



**ANDY DAWSON,
MANAGING PARTNER
bd-capital**


bd-capital

bd-capital is a private equity firm with operational capability at its heart. The team combines investment professionals with business leaders – all former CEOs – bringing operational know-how and strong experienced leadership, in addition to best-in-class investment expertise, to the companies it partners with. With offices in London, Amsterdam and Madrid, bd-capital has a multi-sector specialist approach, investing in structurally growing niches within the healthcare, tech-enabled services and consumer sectors.

1. Firstly, can you tell us a little more about your view on the current fundraising environment?

AF: Let's be clear, the fundraising market is tough. There is an unprecedented supply of new funds coming to market, which has led to an extremely competitive environment, with it becoming increasingly tough to capture LP time and attention. In Europe, there are 18 Private Equity GPs that have raised funds over €5bn. A year ago, 2 out of the 18 were in the market, but today 16 of those are fundraising, with aggregate target commitments of €150bn – inevitably these managers get LPs attention first. This growth in supply has been driven by a shortening of time between fundraisings, from roughly four years to two, as well as a growth in target fund size. Clearly then, there is a greater supply of GPs raising capital than can be serviced by the demand of LPs. Fundraising against this backdrop is tough, but possible, and there are stand out cases of success amongst existing and emerging managers.

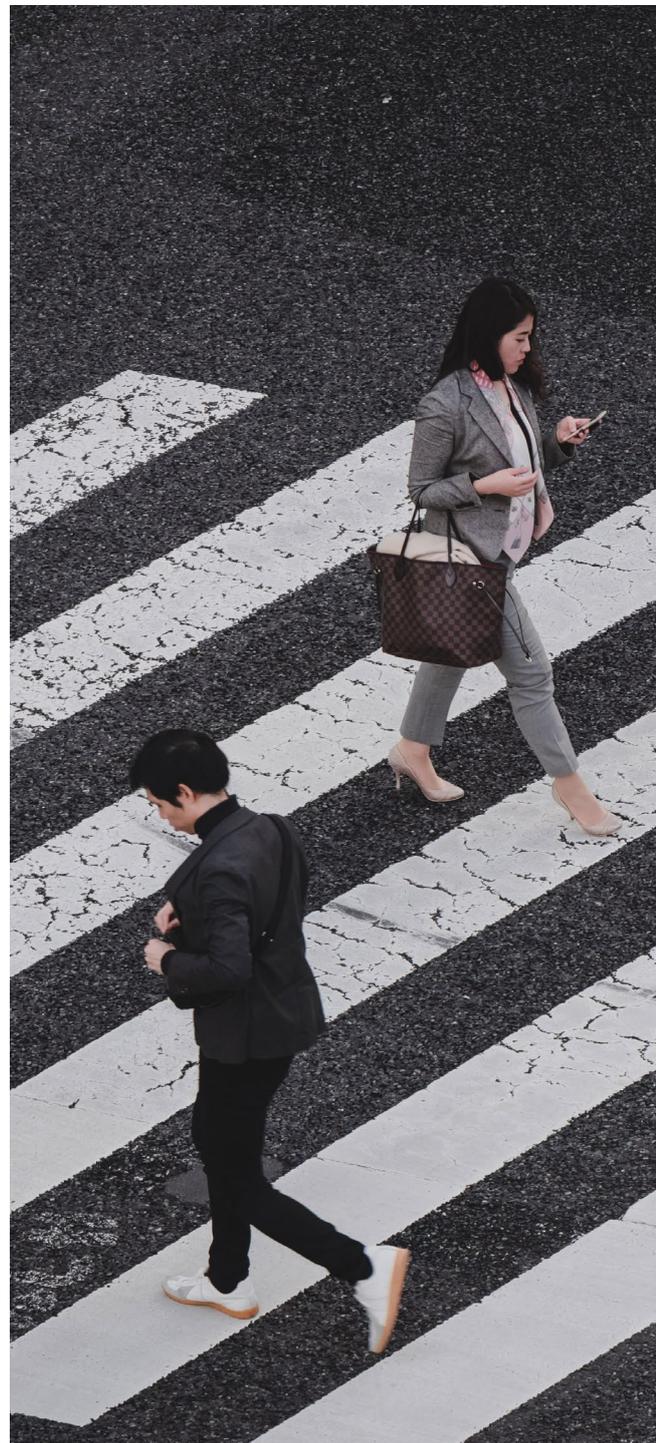
AD: There is a lot of talk about the record amounts of capital being raised within Private Equity, but in reality, a lot of that capital is being swallowed up by the largest established managers - no LP will lose their job doing a re-up with one of the big names. As a result, LPs are highly selective in their allocations to new managers. In 2019, roughly 30% of LP allocations went to the Top 10 managers in the world, whereas in 2021 this figure was around 50%. The result is a much tougher fundraising environment for all but the biggest market participants.

2. With respect to emerging managers, what do you see as the biggest challenge faced when raising a debut fund?

AF: Emerging managers face two main challenges. Firstly, getting anchor commitment and secondly, securing and executing the first few deals well. Anchor commitments are often seen as proof that an investor has faith in the strategy. Once this anchor commitment has been secured, the manager is able to execute a proof of concept with their first deals. The second challenge is getting these deals done and making sure they are

representative of the strategy the manager wishes to pursue. Getting these two points right at the outset is key to success.

AD: In my view, the biggest challenge for an emerging manager is how to gain the attention of LPs, and how to differentiate from other funds in the market. LPs review countless investment opportunities day in, day out, and in the current environment it takes more than just track record and experience to make



it to the top of the pile. For example, we at bd-capital differentiate by having a team comprised of both investment professionals and former CEOs. These former CEOs are part of our core team, not typical operating partners, and bring real life experience in building and running successful businesses to the table every day, which LPs recognise as being different and an evolution of the classic private equity model.

3. And do you expect many investors to commit capital to first time funds?

AF: We do see investors routinely commit capital to first time funds, but it is a subset of investors. It is not fair to say that we see all investors routinely commit to first time funds, rather the majority by number of investors and the capital available prefer to back established managers, but there do exist programmes within certain LPs which specifically look to invest in emerging managers.

AD: A large portion of the market does not actively seek to invest in new managers, rather preferring to allocate to established funds which can accept larger tickets and have a long history behind them. However, there exists a subset of LPs that do invest in emerging managers, recognizing that investing early often results in a stronger relationship between LP and GP, guaranteeing them “a seat in the room” as the business grows.

4. What would you describe as the key areas that most investors will focus on when deciding whether to invest with an emerging manager?

AF: The two key challenges I mentioned are also the two areas that investors will focus on. The first is the presence of an anchor commitment, and the second is the presence of seed assets. Securing an anchor commitment from an LP that is known and referenceable by their peers will give comfort to other investors that may be less familiar with the manager. In addition, having seed assets will act as proof of concept for new investors, that they can diligence beyond the investment strategy. It is possible to raise a blind pool fund without seed assets or a pipeline, but it is rare, especially in the current market.

Beyond these two areas, there is a longer list of diligence factors that must be considered by LPs, including the investment strategy, the team, the track record, the pipeline, execution capabilities and more.

AD: In our view, most LPs will want to understand the key differentiators of any fund they are considering allocating to and see real evidence of this... not just PowerPoint pages. What is it that sets this fund manager apart from any other? Being able to articulate this is key to attracting the attention of LPs. One of the most powerful ways of doing this is a seeded portfolio.



In addition, many LPs will want an incentive for investing in an emerging manager, such as favorable fee terms, co-investment opportunities and more.

5. And from your perspective, are there certain investor types, or even geographies, that are more amenable to emerging managers?

AF: In terms of investor types, there is no clear leader in terms of those that are more likely to invest with emerging managers. Larger institutions may struggle to spend time performing diligence on multiple managers, so may prefer to write fewer, larger cheques. Some LPs have specific programmes that focus on emerging managers, as well as on areas such as coinvest.

There isn't a specific preference for a geographical location but in some cases, there may be a domestic or regional preference where local LPs are likely to know the managers better.

AD: No, there isn't a certain investor type or geographical location which is more amenable to emerging managers. However, in our experience it is unlikely that the largest LPs will commit to

emerging managers – concentration risk notwithstanding, the time, cost and resource required to diligence a new relationship is hard to justify against existing allocations. That said, many larger LPs like to spend time with new managers so they can track them and potentially join them in a subsequent fund. The word “re-up” pains any first-time fund manager but once you are established, performing well and growing, it can become your friend!

6. Finally, what is the one piece of advice that you would give to a manager going out on the road for the first time?

AF: Focus first and foremost on anchor commitments from your extended network of investors who you have worked with before ahead of entering the wider market.

AD: Be committed to what you are doing and ensure you are doing it for the right reasons. It is not easy to create a new investment firm; new managers must be focused, determined, play as a team and have a clear vision in order to tackle the many challenges they will face on the path ahead.



3

Fund Operations

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FUND OPERATIONS

Once capital has been successfully raised and a first close held, then there is the challenge of operating a fund. This includes aspects such as production of management accounts, producing an investor capital account statement which will form part of the investor reporting, and producing a NAV for the fund. Additionally, consideration needs to be given as to how the fund will be capitalised and deals will be financed, including the drawdown/distribution process and any fund finance facilities that may be in place.

In recent years, outsourcing to a specialist administrator has become commonplace across the industry, particularly for new managers who may only have small teams. By outsourcing fund administration and regulatory functions, managers can access a partner that has wide ranging experience across similar structures and strategies, allowing them to focus on generating alpha.

INVESTOR REPORTING

Investors are becoming increasingly sophisticated when it comes to their reporting requirements, with a number of industry bodies, e.g., INREV, ANREV, BVCA continually issuing new reporting guidelines, with the ultimate goal of increasing transparency. More recently, the implementation of the Sustainable Finance Disclosure Regulation ('SFDR') in Europe has meant that many managers are now required to disclose how they are considering sustainability risks in their investment decisions, as well as providing reporting on the Principal Adverse Impacts ('PAIs') of their investments from 1st January 2023 (although this is on a "comply or explain" basis rather than being compulsory for AIFMs with 500 or fewer employees). The Institutional Limited Partners Association ('ILPA') also regularly issues guidance on

investor reporting, and we would encourage new managers to talk to us about what this means in practice.

In addition to producing reports, there is the question of how to actually disseminate these, and we are increasingly seeing the use of an investor portal for this purpose.

FUND FINANCE

In any typical investment fund, cash is typically only drawn from investors as and when it is required. This reduces the cash drag on the fund, whilst giving a higher IRR for the investors. From an operational perspective however, drawing capital whenever it is needed is not always practical, for example if a fund is particularly active then this places a high administrative burden on the investors, or if deals are done at short

From
1 Jan 2023
managers are required to report on the Principal Adverse Impacts of their investments.

notice, then this does not always leave sufficient time for cash to be drawn down.

The solution is often to drawdown cash on a quarterly basis, with a credit line provided to the fund in the interim, known as a “subscription” or “capital call” facility. If permitted in the LPA, this facility will be secured against the LPs undrawn commitments, with a number of factors including the creditworthiness of the investor base being taken into account.

Where subscription facilities are not permitted or not viable, then a facility based on the underlying fund portfolio can be used, known as a NAV facility. These loans are becoming increasingly popular as holding periods for Private Equity investments increase, especially in light of the recent pandemic. According to eFront, the average holding period in Private Equity has grown from 3.8 years in 2010, to 5.4 years in 2020⁶, with greater returns coming from those companies held for 5 years or greater. Use of a NAV facility allows managers to inject fresh cash into portfolios without drawing any additional capital from investors, or conversely allows them to make distributions to investors pre-exit.

It should be noted that in recent years the ILPA has continued to issue guidance of the use of fund finance facilities, particularly subscription facilities, warning against their use as a means of artificially inflating fund returns. Amongst the guidance, ILPA recommends that these facilities not be used for more than 180 days, and do not account for more than 15-25% of uncalled capital⁷.

ILPA recommends that
credit facilities not be
used for more than
180 days



WATERFALL MECHANICS

Standard for most of the alternatives industry is a model of management fee plus carried interest, with the former being levied on commitments and the latter being calculated as part of the net profits of the fund. Additionally, the majority of funds will also have a “hurdle,” meaning the rate of return required for a manager to be eligible for carried interest. A simplified waterfall would follow the below distribution model;

1. Distribution of all proceeds to the investor equal to the initial commitment
2. Distribution of proceeds to the investor up to the equivalent hurdle rate
3. Distribution of proceeds to the fund manager up to the equivalent carried interest split, known as the “catchup” rate
4. All subsequent distributions split between the investor and manager as agreed in the fund terms (traditionally an 80:20 model although this is subject to negotiation)

In addition, some funds may have claw-back provisions in their LPA, which allow an investor to “claw-back” any additional

⁶ <https://www.privateequitywire.co.uk/2021/04/22/299092/private-equity-holding-periods-reach-all-time-high-2020>

⁷ https://ilpa.org/wp-content/uploads/2020/06/ILPA-Guidance-on-Disclosures-Related-to-Subscription-Lines-of-Credit_2020_FINAL.pdf

carried interest that may have been paid to the manager. Further, in an American style, “deal-by-deal” waterfall, carried interest is paid on each deal, whereas a European “whole-of-fund” waterfall means that carried interest is calculated over the life of the fund. It is not uncommon for emerging managers to have escrow arrangements, where part of the carried interest is kept in escrow for a timeframe agreed in the LPA, and we have seen this as high as 50% of the carried interest amount.

Importantly, we are firm believers that the waterfall should be appropriately modelled at the outset. Understanding the step down in management fees (if any) after the investment period, for example, is something not commonly thought about – particularly as it can be as long 6 or 7 years before this clause even kicks in for managers. This can be anything from a percentage of utilised capital, through to NAV, acquisition cost, or fair market value. The waterfall will always form a key part of the LPA, but we find converting words to real world numbers is invaluable for many managers starting up.

PORTFOLIO DATA

In any modern business, data is a large part of day-to-day operations. This is especially true in investment funds, where data from an underlying portfolio is used to measure investment performance and report to investors. However, the collection and consolidation of this data is not always easy, with different frequencies, formats and reporting parties all playing a role. In Real Estate for example, often the underlying asset data, e.g., rent collections, capex, opex etc. will come from a local property manager. The timeliness and accuracy with which this data is collected will have a knock-on effect on the fund level accounts, and ultimately the investor reporting. For managers setting up for the first time, this is an important consideration – without proper controls on this data collection then the manager can often find themselves needing to intervene, which only serves to distract from their core business.

Langham Hall Performance Reporting

In recent years, investors have become increasingly sophisticated in their reporting requirements, particularly where fund level performance is concerned. In response to this, Langham Hall has worked with a leading big data provider to develop a more flexible, timely and secure solution to performance reporting.

By using computable data in an open architecture system, rather than traditional accounting data, we are able to generate flexible reports for accounting, including management accounts and carry calculations, as well as for fund and investment level data. Developing such a system from the ground up means that this technology is developed around our existing data flow procedures, rather than trying to manipulate a third-party software to fit in to our processes.

The use of computable data in this manner means we can create bespoke reports for even the most complex of structures, rather than trying to create workarounds to accommodate ad-hoc new reporting requirements, which often leads to errors.

For more information or to schedule a demonstration, please get in touch.

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