July 2020

Private Equity Fees and Terms Study

How Partnerships Compare Across Key Metrics

KEY ELEMENTS

- **Callan analyzed fees and terms for 90 private equity partnerships to help institutional investors evaluate, and even negotiate, a partnership's terms.**
- **More than three-quarters of the partnerships were buyout funds, and North American funds made up the vast majority of the dataset.**
- **We found a relatively high level of uniformity for fees and terms among the partnerships evaluated.**
- **This indicates that general partners have significant bargaining power—for now. That could change as the impact of the pandemic resets the dynamics of the private equity market.**

"Ninety private equity partnerships were included in this study, representing fund offerings that were in the market and reviewed by Callan in 2018 and 2019."

Ashley DeLuce
Callan Private Equity Consulting Group

To help institutional investors better evaluate private equity funds, Callan conducted an extensive analysis of the fees and terms for private equity partnerships. Using that data, we created this study to help investors evaluate a partnership's terms compared to its peers, an especially useful tool when reviewing terms and conditions with general partners (GPs). We also envision that GPs will find the study useful as a way to benchmark their partnership terms compared to other managers.

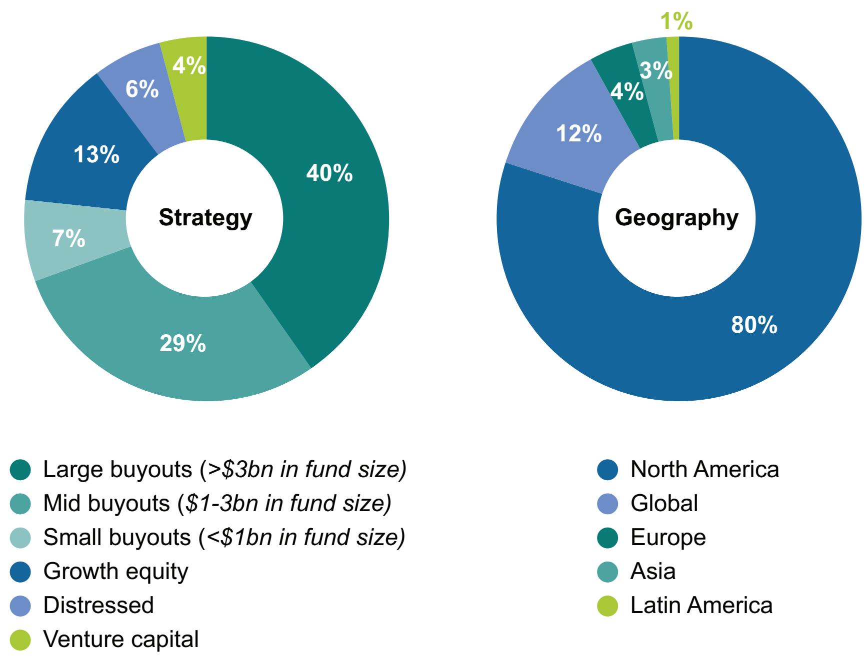
Ninety private equity partnerships were included in this study, representing fund offerings that were in the market and reviewed by Callan in 2018 and 2019. The data were pulled from the limited partnership agreements of these funds. We focused on these principal terms to provide a concise snapshot of the market:

- Minimum limited partner (LP) commitments
- GP commitments
- Management fees
- Type of "waterfall" used
- Carried interest percentage
- Hurdle rate

To evaluate the terms across multiple measures, we include the median, average, maximum, and minimum for each one. The study is weighted toward buyout funds (76% of our dataset), as well as North American funds (80%).

Exhibit 1

Partnership Characteristics



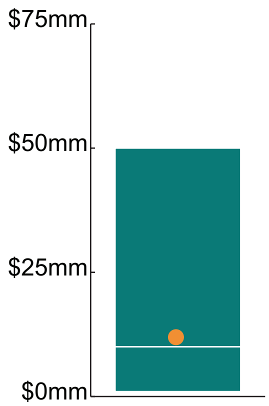
We found a relatively high level of uniformity for fees and terms among the partnerships in our study, indicating that LPs faced constraints on their bargaining power with GPs. At this point in the cycle, GPs are in the driver's seat, which in our view makes careful manager selection even more critical. Of course, that may change as the impact of the COVID-19 pandemic resets the dynamics of the private equity market.

LP and GP Commitment Levels

As reflected in the table below, a $10 million minimum LP commitment is fairly standard in the industry (representing 46% of the dataset). About a quarter of the dataset has higher minimums, typically in an effort to constrain the LP base to only larger investors.

Exhibit 2

Minimum LP Commitment

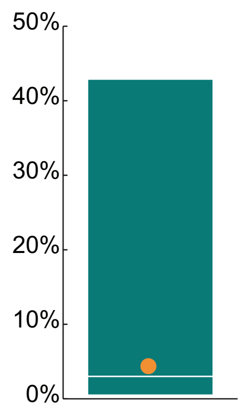


Maximum	$50.0mm
Median	$10.0mm
Minimum	$1.0mm
Average ●	$11.7mm

The dataset reveals that 3% is the market standard for the GP commitment. Anything significantly below that may indicate a lack of alignment between the general partner and limited partners. Commitments on the higher end typically involve balance sheet capital from the GP.

Exhibit 3

GP Commitment



Maximum	42.9%
Median	3.0%
Minimum	0.5%
Average ●	4.3%

Definitions

Minimum LP Commitment: the amount required to invest in a private equity partnership

GP Commitment: the percent of fund commitments expected to be financed by the general partner, which may consist of a mixture of cash and management fee waivers. In some cases, it also reflects commitments from the GP's balance sheet.

Management Fee Levels

In terms of the management fee, we captured both the fee paid during the investment period (typically the first 5-6 years of a fund's life) as well as after the investment period. The median management fee of 1.75% during the investment period is almost always paid on committed capital. This then drops after the investment period to a median of 1.50%, almost always paid on invested capital. But 17% of the dataset does not have this step-down, and management fees are paid on the same capital base, typically committed capital or net invested capital, over the fund's entire term. Management fees higher or lower than our findings can signal to investors whether they are overpaying a general partner or benefiting from fee savings.

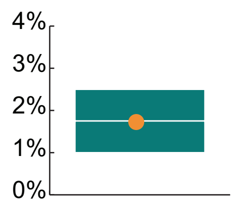
Definition

Management Fee: Throughout a typical private equity fund's life, the management fee percentage—and what it is a percentage of—steps down over time. During the investment period, it is a typically higher percentage and paid on a larger amount of capital. After the investment period, there is a reduction in the fee percentage and it is paid on a smaller capital base. The investment period typically expires after five or six years, depending on the partnership, or when the GP launches a successor fund.

Exhibit 4

Investment Period Management Fee

Fee Range



Maximum	2.50%
Median	1.75%
Minimum	1.00%
Average ●	1.76%

What the Fee is Paid on

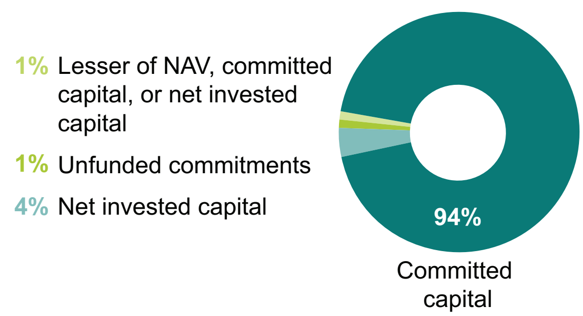
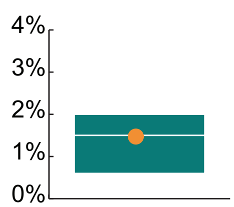


Exhibit 5

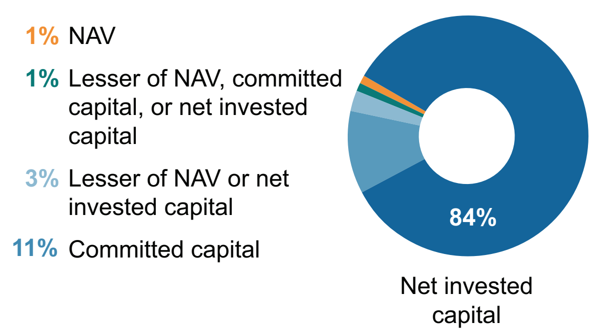
Post-Investment Period Management Fee

Fee Range



Maximum	2.00%
Median	1.50%
Minimum	0.60%
Average ●	1.50%

What the Fee is Paid on



Management Fee Offsets

Every fund in the dataset offset management fees by any transaction, monitoring, or other fees received by the fund. Given that the vast majority of fee offsets are 100%, anything significantly below that is not in keeping with the rest of the market.

Exhibit 6

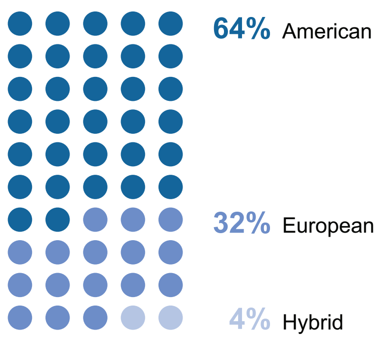
Management Fee Offset

Waterfall

Most funds have either an American (deal-by-deal) waterfall or a European (fund-as-a-whole) waterfall, meaning that carried interest is either paid to the GP on a per investment basis (more GP-friendly) or on a cumulative basis across all investments (more LP-friendly). The majority of the dataset has an American waterfall, but a significant portion, roughly a third, has a European waterfall.

Exhibit 7

Type of Waterfall



Definitions

Carried Interest: The percentage of realized profits paid to the general partner as an incentive/performance fee.

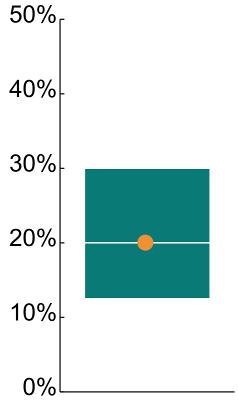
Waterfall: This refers to the distribution of gains to the limited partners and general partner. In an American waterfall, carried interest is calculated on a deal-by-deal basis, which benefits the GP. In a European waterfall, carried interest is calculated on a fund-as-a-whole basis, benefiting the LP. In some cases, the waterfall is a blend of both approaches.

Carried Interest and Hurdle Rate Levels

The industry standard for carried interest is 20%, although there are some funds with carried interest as high as 30%. These are often venture capital funds or funds that are in particularly high demand. For these funds, it is important for investors to determine the impact on net returns and ensure the general partner is able to offset it through strong performance.

Exhibit 8

Carried Interest Ranges



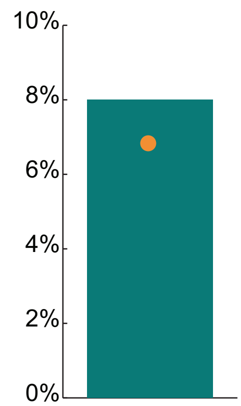
Maximum	30.0%
Median	20.0%
Minimum	12.5%
Average ●	20.3%

> *Definition*
>
> **Hurdle Rate:** The return threshold the GP must achieve prior to realizing any carried interest. It can be a simple or compounded return calculation.

The hurdle rate is typically 8%, and none of the funds analyzed had a higher hurdle rate. But we found that 13% of funds, primarily growth equity and venture capital, had no hurdle rate at all. The majority of partnerships use a compounded calculation for the hurdle rate, although 8% used the more GP-friendly simple hurdle rate calculation.

Exhibit 9

Hurdle Rate Ranges



Maximum	8.0%
Median	8.0%
Minimum	0.0%
Average ●	6.8%

Takeaways

Given the recent boom in the private equity industry, partnership terms have been leaning in the general partner's favor. With annual commitment levels tripling over the last 10 years, according to PitchBook, the demand for private equity has resulted in many oversubscribed funds, limiting the bargaining power of LPs. Across a market cycle, however, this power can shift back toward LPs, often resulting in fee discounts and/or more LP-friendly terms.

When evaluating a partnership for potential investment, we help institutional investors to determine whether the terms are consistent with the rest of the market, with particular emphasis on the alignment of interests between GPs and LPs. This snapshot is intended to be used as a benchmark for that exercise on an ongoing basis, as we expect to publish this study annually.

About the Author

Ashley DeLuce, CAIA, is a vice president in Callan's Private Equity Consulting group. She joined this group in July 2017 and assists in all aspects of private equity consulting, including research and client servicing, portfolio reviews, manager searches, research projects, and performance reporting for clients. She is a shareholder of the firm.

Ashley joined Callan in May 2015 and previously worked in Callan's Client Report Services group preparing quarterly and monthly performance measurement reports.

Ashley earned a BA in history and interdisciplinary studies from the College of William and Mary. She has earned the right to use the Chartered Alternative Investment Analyst designation.

If you have any questions or comments, please email institute@callan.com.

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