The pros and cons of long-dated funds

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Private equity moves at a glacial pace. While the average shelf life of a PE fund is often assumed to be eight to ten years, many funds require considerably more time to wind down. PitchBook data shows that it takes between 11 to 14 years for a PE fund to reach an RVPI of less than 0.5. Another slice of data to consider: 53% of 2004-vintage buyout funds remain active to this day. For perspective, *Friends* was still on the air and Lance Armstrong was still winning Tours de France in 2004. If that seems like a long time, expect to see more cases of this going forward. So-called long-dated funds are starting to proliferate, with clear intentions of lasting 15 years or longer. Over the past two years, more established buyout shops like Carlyle, Blackstone and Apollo have gravitated toward the strategy for a number of reasons. In our latest analyst note, we lay out the pros and cons of the strategy as well as the likely consequences of investing in them.

First, the pros: 1) *Fewer taxable events*, which will allow funds to defer capital gains taxes and reinvest those gains in new or existing portfolio companies, thereby boosting long-term capital appreciation. 2) *Lower transaction costs*, which include legal, advisory and accounting costs each time a company is bought and sold (which would happen less often in a long-dated scheme). 3) *Operational improvements*, which have become more important as the traditional strategies of paying down debt and relying on multiple expansion have become less effective. Long-dated funds will fit well with PE's current focus on the buy-and-build model, which GPs are increasingly relying on to produce immediate top-line growth in a pricy, low-growth environment. 4) *Reinvestment risk*, which for LPs will translate into fewer due diligence efforts with less turnover between funds.

5) *Fees*, which will likely be lower than traditional funds and represent a more passive version of PE, not unlike the public markets' shift to index investing.

There are potential cons, as well. 1) *Liquidity*, which will require more time to achieve and likely require GPs to promise higher returns, i.e. an added liquidity premium. 2) *Value-add*, which is a bigger question mark for long-dated funds due to those liquidity concerns. It isn't obvious how much value can be added to investments once they hit the decade mark. Meaningful value-add could require targeting companies with much more fundamental issues to sort out, a risk in itself for the LPs who finance them. GPs would need to provide better plans at the outset that identify potential value-add by Year Eleven and beyond. It isn't clear how good private equity will be at this, but we're going to find out. 3) *Key man risk*, which only increases in probability for 15-20 year funds. A 20-year fund life could span half of a career (and what about younger professionals who change jobs at faster rates?). On the other hand, it isn't surprising to see long-dated funds originating in larger, more established shops. Firms like Blackstone and Carlyle are much more process-driven and less reliant on a handful of stars for their returns. As such, the long-dated trend is likely to be driven by bigger firms and LPs with the longest horizons (think endowments, sovereign wealth offices, family offices). We don't expect the trend to expand significantly beyond those categories, but the industry has surprised

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