Private Equity Now: The LP Perspective

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Over the past two weeks we've touched on the distribution dilemma in private equity, and most recently on the perspectives and tactics used by GPs. This week, we dive deeper into the LPs perspective and how allocators are managing private equity programs in the current environment. To quantify the issues: LPs observed a 9.5% distribution rate in 2023, well below the 2015-2019 average of 23.6% (per *Private Equity International* and *MSCI*). This trend poses a host of challenges for LPs who rely heavily on distributions.

Whether it's meeting financial obligations of beneficiaries, funding new investments or balancing portfolio allocations, LPs must rethink their cash flow and liquidity management initiatives. Today's dearth of realizations has LPs increasingly turning to the secondaries market as a strategic liquidity tool. This dynamic is driving LP-driven secondaries to ~$83 billion of volume in 2024, up from ~$25 billion in 2020 (per *Jefferies.*)

In recent years, private equity secondaries have bloomed from a cottage industry, extending back to the 1980's, to an essential part of the private equity ecosystem. For much of the market's existence, secondary transactions carried an unsavory stigma. Sellers were seen as distressed, and the resulting sale signaled the end of the GP/LP relationship. Neither LPs nor GPs were particularly receptive or supportive of the technology. Over the years, however, the asset class has proliferated in volume and sophistication. Institutional investors turned to the secondaries market not for distress, but with an eye towards portfolio optimization. It is a strategic tool for both GPs and LPs to actively manage their portfolios and liquidity.

Historically, secondary transactions consisted of traditional LP interest sales. The LP sells an interest, or portfolio of interests, in private equity funds to another LP, typically at a discount to compensate for the illiquid nature of the investment being acquired. A wide range of innovative solutions have emerged to address specific LP needs, including structured secondaries, managed portfolio sales, and net asset value (NAV) facilities.

Structured secondaries are customizable transactions that can be engineered to include a blend of common equity, preferred equity and/or debt. This allows an LP to achieve liquidity while retaining some of the upside. It can bundle multiple private equity fund interests into a managed portfolio sale offering an efficient method for selling multiple investments. NAV facilities provide LPs debt financing collateralized against their private equity interests, enabling access to liquidity without the need to sell or reduce ownership. The expansion, sophistication and adoption of various solutions and the overall growth of the secondaries market arm LPs with an expansive set of tools to manage liquidity more effectively in a historically illiquid market. The need to access liquidity solutions is more paramount than ever in a world of reduced distributions. When considering these options, LPs should weigh their pros and cons against the various needs of their constituents.