syntrinsic
An IMA Company

Understanding Private Market Fund Structures

OVERVIEW

Private market assets—private equity, debt and infrastructure—provide opportunities for growth and diversification opportunities but are typically considered an illiquid investment vehicle. An investment vehicle can be a stock or bond, or pooled fund structures such as mutual funds, exchange traded funds (ETFs), real estate investment trusts (REITs), evergreen funds, or limited partnerships.

In recent years, semi-liquid structures like evergreen funds have gained traction, driven by rising investor demand for private assets and a more favorable regulatory environment. These funds can provide a more accessible way to invest in private markets offering faster portfolio diversification, simplified cash flow management, and lower entry barriers through reduced minimums and qualifications.

However, these fund structures still limit an investor's ability to sell the investment at any time because they impose redemption limits at set intervals. These redemption limits are designed to support the underlying long-term strategy of the investment by avoiding forced asset sales. Because these limits can be unpredictable, investors should understand features and trade-offs of different private market fund structures when evaluating opportunities.

WHAT IS MARKET LIQUIDITY?

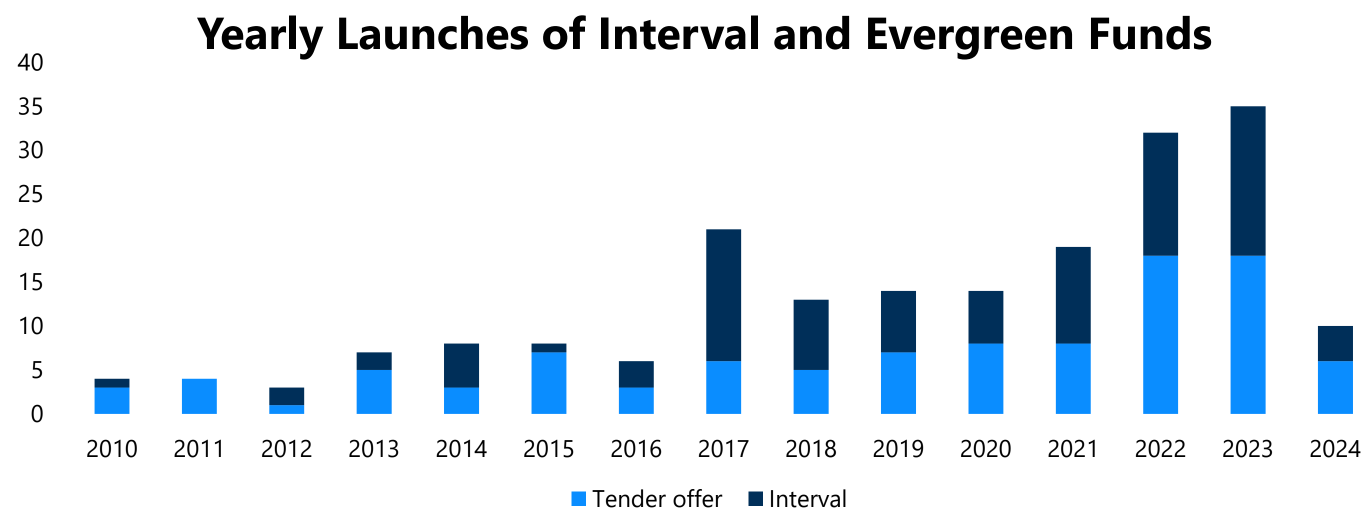
Market liquidity refers to the ability to convert an asset into cash quickly without materially affecting its price. Assets and fund structures can be either liquid or illiquid. While liquid assets – such as stocks and bonds – may exist within illiquid structures, illiquid assets (i.e. private debt, equity, and infrastructure) are harder to fit into liquid structures because illiquid assets cannot be converted into cash quickly which is required in a liquid structure. Money market funds, mutual funds, and ETFs are examples of liquid fund structures.

Illiquid assets, such as real estate, venture capital, private equity, private debt, and private infrastructure are difficult to sell without significant discounts because of a limited secondary market, a lengthy selling process, legal restrictions, and transaction costs.

In private markets, illiquid fund structures generally fall into two categories:

- **Traditional Drawdown Structure**- with lock-up periods of 10 – 12 years.
- **Evergreen Structures** - such as interval, tender offer, or business development company (BDC) funds – that are perpetual and offer partial liquidity, typically quarterly, subject to redemption limits.

In the 1990s, interval funds were introduced and in the 2000s other evergreen structures became available. These funds have gained prominence since 2017 due to rising investor demand, investors managers seeking a broader investor base, and a more favorable regulatory environment. This trend, often called the democratization of private markets, reflects increased accessibility to high-net worth and retail investors as opposed to just institutional investors.



Source: Pitchbook

COMPARING PRIVATE MARKET FUND STRUCTURES

Traditional drawdown funds typically operate as limited partnerships, with the investment firm acting as the general partner (GP) and the investors as limited parters (LPs). LPs commit capital during fundraising, and the GPs call the capital that LPs committed typically over 3 – 5 years as investment opportunities arise. The investments are managed by the GP and sold (exited) over a 10 -12-year period, with the proceeds from the sales distributed back to the LPs during the life of the fund until the fund is fully liquidated. During this time, the capital committed to the fund is locked up and inaccessible to the LPs.

Evergreen funds, by contrast, are perpetual, meaning there is not a finite expected fund life, unlike with traditional drawdown vehicles. Investors can subscribe to the fund monthly or quarterly, and the capital invested is deployed immediately. This is an attractive option for investors because it reduces the J-Curve effect, wherein funds initially experience negative returns in the early years of the fund life due to costs and investments, followed by a gradual recovery and increasing returns as the investments mature. In addition, evergreen funds can improve diversification in a portfolio because they provide investors access to a mature, already diversified pool of investments as opposed to a traditional drawdown fund which is calling capital to make new investments.

Evergreen funds also allow investors to redeem (sell) investments typically on a quarterly basis but do impose fund gates that place limits on the magnitude of outflows permitted from the fund – generally 5% of the fund’s net asset value (NAV) or outstanding shares to maintain portfolio stability.

Feature	Drawdown Fund	Evergreen Fund
Access	Commit capital during fundraising period	Subscribe over time (monthly or quarterly)
Fund Life	10-12 years	Perpetual
Cash Flows	Capital drawn over 3-5 years	100% invested upon subscription
Liquidity	Distributions paid once investments are exited	Investor discretion to issue redemption requests
Distribution Policy	Typically paid back after end of investment period	Distributions reinvested in new investments
J-Curve	Net returns can initially be negative during investment build-up	Not applicable - access to already built-up portfolio
Return Profile	Net internal rate of return (IRR) on drawn capital	Compound net return
Fund Gates	Not applicable	Limits placed on magnitude of outflows

DO FUND GATES MATTER?

While evergreen fund structures can offer more liquidity than traditional drawdown funds, this flexibility can be a double-edged sword. Under normal market conditions, quarterly redemption windows allow investors the option to rebalance portfolios or make strategic and/or tactical asset allocations changes.

During periods of market stress, however, simultaneous redemption requests can trigger a fund's gate – typically set at 5.0% of NAV or outstanding shares – which can limit outflows from the fund. For this reason, evergreen funds should still be considered illiquid relative to liquid fund structures such as a mutual fund or ETF. While gates restrict immediate access, they provide more flexibility than the complete lock up of drawdown funds. Conversely, drawdown funds benefit from long-term horizons, giving managers greater flexibility and time to navigate distressed markets.

Investors should note that remaining in an evergreen fund during periods of extended stress in markets can potentially lead to negative returns, particularly if the investment manager has exhausted all liquidity options and must sell the underlying assets at distressed prices to meet redemption requests.

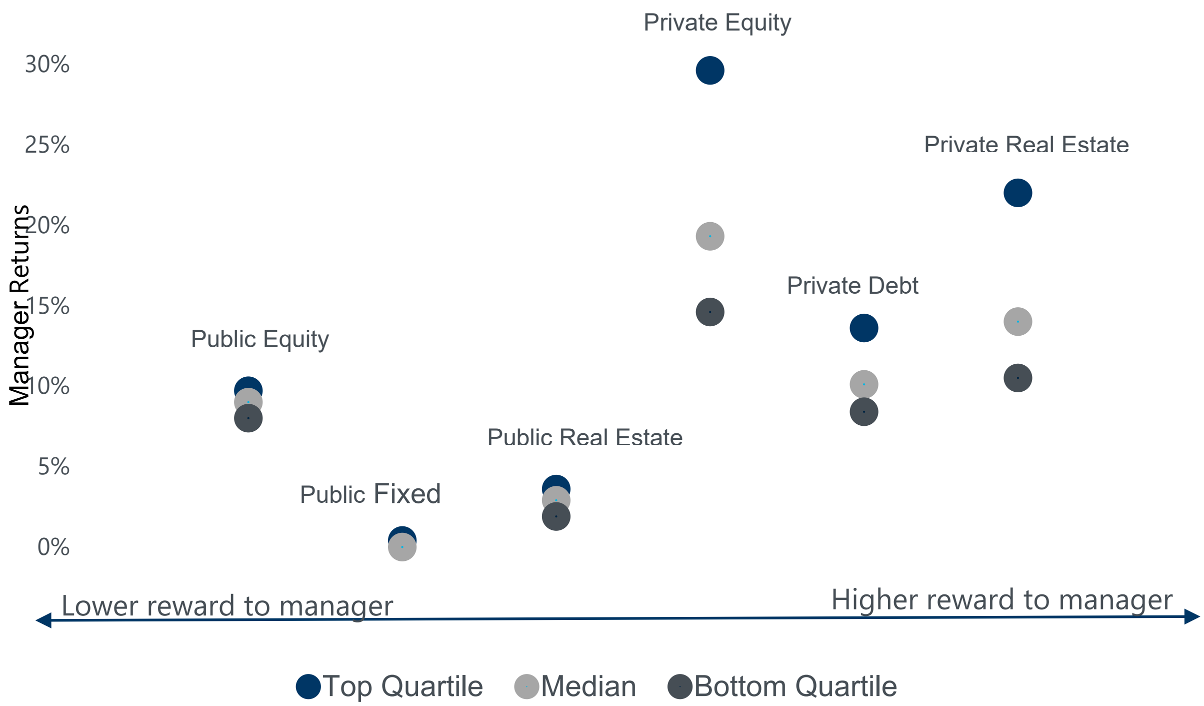
CONCLUSION

When investing in private assets, it is critical to understand the fund structure, the manager's experience, and the opportunity set within the underlying asset class. Liquidity-related risks are additional considerations for private market assets relative to public market assets.

Taking on these liquidity-related risks, when aligned with client objectives, may deliver higher expected long-term returns for private market assets relative to public. Strong manager selection is particularly important and can further enhance performance, as performance dispersion is materially wider in private markets (see chart below).

Evergreen fund structures can add another layer of complexity, making it essential to prioritize managers with proven expertise in managing these vehicles and implementing disciplined liquidity frameworks.

Dispersion Between Public and Private Fund Managers



Source: Blackstone, data as of 04/25/2024

DISCLAIMER

*Investment advisory services provided by IMA Advisory Services, Inc. (CRD#112091), a federally registered investment adviser, doing business as **Syntrinsic**. Registration as an investment adviser does not imply a certain level of skill or training. For additional information about our business, please review our Form ADV by visiting: https://adviserinfo.sec.gov and search for our firm name. Additional disclosures regarding **Syntrinsic's** business can be found by visiting: Disclosure | Syntrinsic Neither the information nor any opinion expressed herein is to be construed as solicitation to buy or sell a security or as personalized investment, tax, or legal advice.*