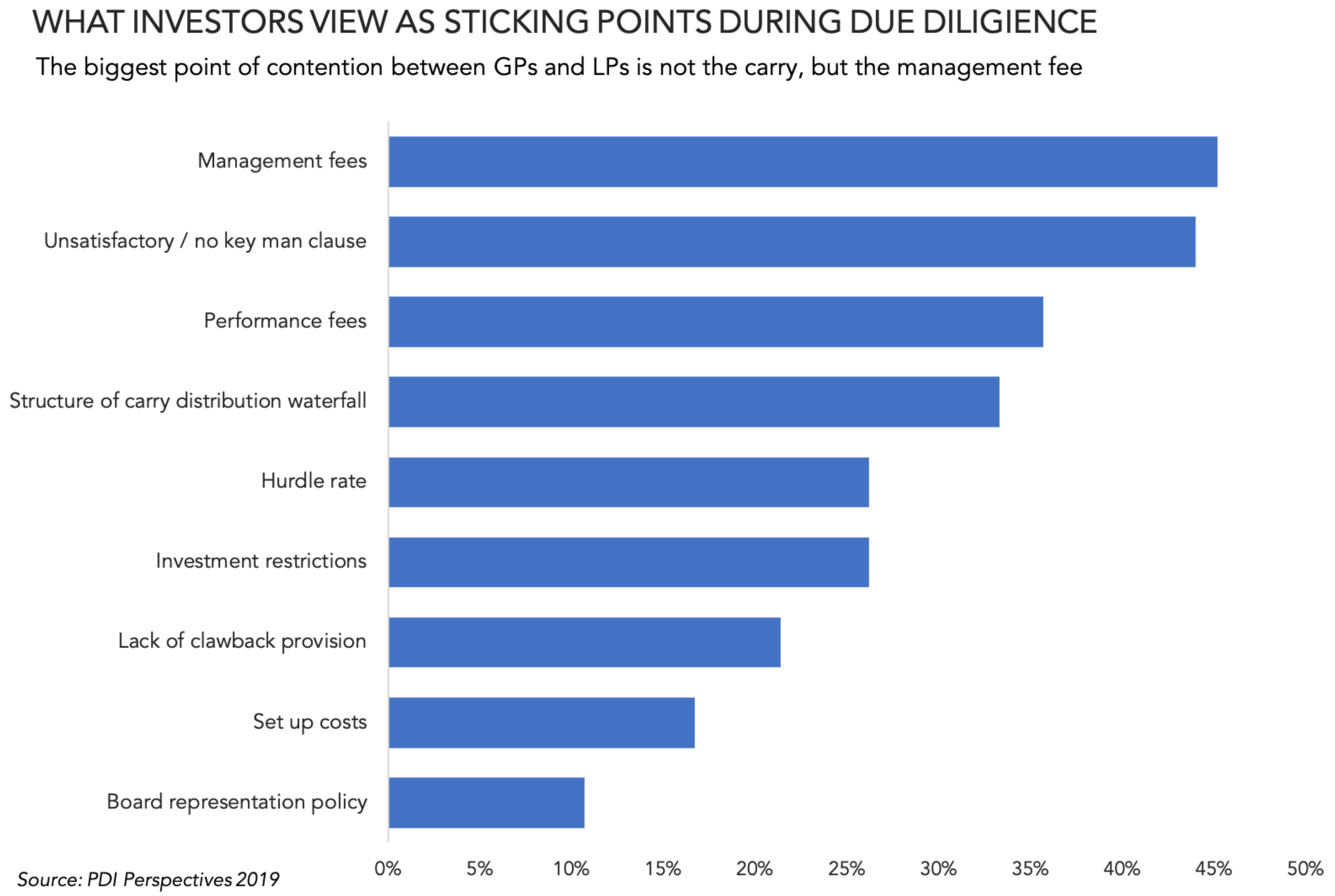
THE LEAD
https://theleadleft.com/pdi-picks-4-1-2019/

LPs take issue with management fees, not carry

Private Debt Investor | April 3, 2019



A majority of investors have trouble justifying private markets' fees internally, but a higher carry, lower management fee is likely an easier sell than the reverse.

Fees are often the elephant in the room for limited partners and private markets firms. General partners maintain that running a private credit or private equity firm is a costly and people-intensive endeavour, while investors emphasize the need to be able to justify the fees to their various constituencies.

It's no surprise, then, that management fees are the biggest sticking point between fund managers and potential investors during due diligence. Some 45.2 percent of investors said those levies caused disagreement, according to our PDI Perspectives 2019 poll. Performance fees were much less contested, with 35.7 percent saying that emerged as a point of contention.

The conclusion isn't completely surprising: it's much easier to justify payments to a manager when the firm has earned its keep. A senior investment professional at an endowment said many LPs would prefer a higher carry and a lower management fee, rather than the other way around.

More than 60 percent of investors either “strongly agreed” or “agreed” that private equity fees are hard to justify internally, according to our poll. A higher carry, lower management fee structure would seem to be an easier sell internally. And the fees need more than the sign off of the LP’s private credit or private equity portfolio manager. The LP’s board or committee more than likely needs to OK the fund commitment as well.

Alternative assets have enjoyed a boom time given the low-yield, low-return world we find ourselves in. It won’t always be that way though, and whether investors continue to commit to private markets funds may well depend on whether GPs’ value proposition exceeds the cost – and political pressure – that can come with private fund investments.