

Private Equity Fund Basics

Structure, Documents, and Negotiation

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History & What We do

- Pre 2008 – no dedicated staff or outside investment counsel
- 2008 financial crisis – SBCERS reevaluated investment practices
 - Moved towards best practices consistent with similar pension funds
 - Mitigate risk and address the increasing sophistication of portfolio
- Today, SBCERS has dedicated investment staff and outside investment counsel
- Reicker Pfau serves as SBCERS' primary outside investment counsel
 - Negotiate Investment Management Agreements (IMAs) and similar agreements with advisors and managers
 - Assist discretionary managers (e.g., Hamilton Lane)
 - Negotiate investments from non-discretionary managers (e.g., RVK)
 - Assist with day-to-day investment matters (e.g., Most Favored Nation (MFN) elections, amendments, manager requests, etc.)

Projects

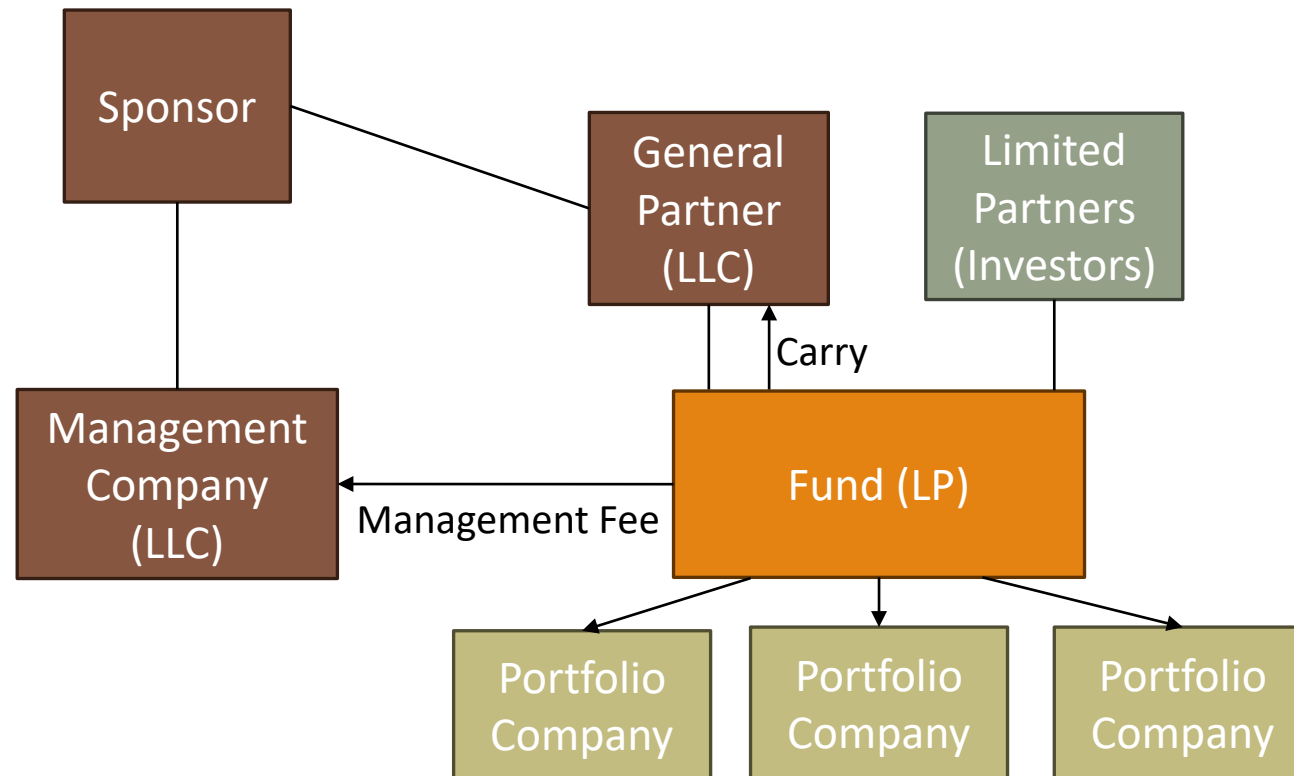
- Negotiated Investments in:
 - KKR Direct Lending Fund
 - Ares Pathfinder Core Fund
 - AG Direct Lending Fund
 - Deerpath Capital
 - AG Direct Lending Fund
- Negotiated Hamilton Lane Private Equity IMA and Real Estate IMA
- Assisted Hamilton Lane counsel in negotiations with:
 - Lone Star RE Fund
 - HitecVision NEF
 - NW1 IOS
 - KSL Credit Fund
 - US Industrial Club Fund
 - High Street Value Fund
 - DRA Growth and Income Fund
- Assisting with Custodial RFP

Private Equity Funds

- Pooled investment fund that:
 - Buys companies at the beginning of the fund
 - Improves them in the middle of the fund
 - Sells them at the end of the fund
- Investors make a financial commitment that is drawn down over time to fund investments
- Most are close-ended (~10 years); some are evergreen
- Some differences with private credit funds, but generally follow the same model

Fund Structure

Private equity funds are typically structured as limited partnerships and involve several entities



- Fund: Just a pool of capital for investments
- General Partner (GP): Has legal authority to act for the Fund
- Management Company: Does the day-to-day work, employs professionals, incurs expenses, etc.

Fund Structure

- **Parallel Funds**
 - Accommodate regulatory, tax, or investment requirements of particular investors
 - Usually offshore entities, like Cayman Islands
 - Invests alongside the main fund in all investments
- **Alternative Investment Vehicles**
 - Accommodate structuring needs for particular investments
- **Feeder Funds**
 - Accommodate investments in the fund by a group of investors, usually for tax purposes (e.g., blocker entity)
- **Co-Investment Vehicles**
 - Accommodate co-investments alongside the fund on a deal-by-deal basis

Fund Timeline

- Fundraising Period
 - 12-18 months
 - Sometimes discounts or incentives to subscribe at an early close
- Investment Period
 - 3-5 years
 - No new investments after investment period
- Divestment / Harvest Period
 - ~5 years from the end of the investment period
 - Typical fund duration is 10 years, with potential 2-year extension

Fund Economics

- Capital Commitments
 - Investors commit to invest a certain amount, as called by the GP during the investment period
- Distributions
 - Common PE Waterfall (“American” deal-basis waterfall):
 - First, capital contributions for investment back to investors
 - Second, preferred return on investment (~8%) to investors
 - Third, 20% of preferred return amount to GP (carry)
 - Fourth, 20% (or other carry amount) to GP, 80% to the investors
- Management Fee
 - For general management of the fund – employment of professionals, evaluation of investments, and day-to-day activities
 - 1.5% - 2.5% per annum and steps down after the investment period
 - Offsets for portfolio company fees, breakup fees, directors or consulting fees, etc.
- Organizational and Operating Expenses



Fund Documents

- Private Placement Memorandum (PPM)
 - Marketing document, summarizes the fund, team, strategy, etc.
- Limited Partnership Agreement (LPA)
 - Main document governing the fund
 - Applies to all investors
- Subscription Agreement & Questionnaire (Sub Docs)
 - Agreement and suitability questionnaire from each individual investor
 - Applies to the specific investor
- Side Letter
 - Provides rights specific to investor

Key Provisions

- Financial and Fee Provisions
- Investment Limitations
 - Single investment limits, foreign investment limits, industry/type limits, etc.
- Early Termination Events
 - Key Person Events
 - GP removal with (~51%) or without (~75%) cause
 - Suspension or termination of the investment period, or termination of the fund
- Competing Funds
 - Offer appropriate opportunities to the fund
 - No new fund until end of investment period or ~75% invested
- Transactions with Affiliates
 - Arms' length and disclosure requirements
 - Advisory Committee approval rights
- Exculpation and Indemnification
 - When is the GP *not* subject to exculpation or indemnification

SBCERS Requirements

- SBCERS' specific requirements are in the Side Letter
 - Withdrawal for legal reasons
 - Disclosure of confidential information per CA law – Public Records Act, Brown Act, Fee Disclosure Law
 - Conflicts of interest and placement agent policies
 - Tax provisions for “super tax exempt” status
 - GP fiduciary status
 - No indemnification
 - Sovereign immunity
 - Insurance requirements

Negotiation

- Review of Legal Documents – PPM, LPA, and Sub Docs
- Comment memo requesting changes
 - Review with SBCERS investment staff
 - Send to GP counsel with form side letter
- Negotiate points in comment memo and side letter with GP counsel
- Closing

Questions?

Thank you!