Callan Institute

Research

2021 Private Equity Fees and Terms Study

How Partnerships Compare Across Key Metrics

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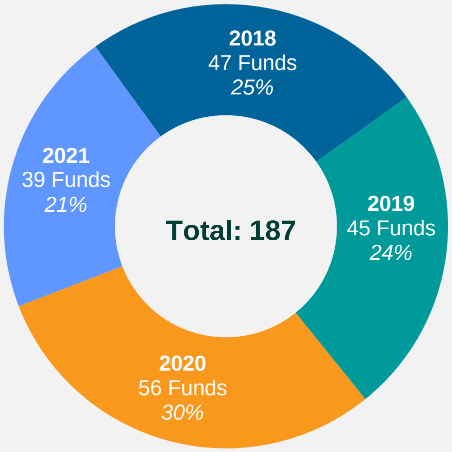
About This Study



Our Study Methodology

Callan's *2021 Private Equity Fees and Terms Study* is a comprehensive update to our inaugural study conducted last year. With each year, the study's dataset broadens, and this year we include a wider variety of general partners and strategy types. The study is intended to help institutional investors better evaluate private equity funds, serving as an industry benchmark when comparing a partnership's terms to its peers. This study can also be useful for general partners, to determine how their fees and terms compare to other managers.

This year's study includes 187 private equity partnerships, representing fund offerings reviewed by Callan that were in the market in 2018, 2019, 2020, and YTD 2021 (as of 08/21). It includes the 2018 and 2019 partnerships that were evaluated in Callan's 2020 study and adds 2020 and 2021 partnerships. The data were pulled from the limited partnership agreements or private placement memoranda of these funds that were reviewed as part of Callan's due diligence process. We focused on the following principal terms to provide a concise snapshot of the market:

– Minimum limited partner (LP) commitment
– Management fees
– Carried interest percentage
– General partner (GP) commitment
– Type of "waterfall"
– Preferred return

To evaluate the terms across multiple measures, we include the median, average, maximum, and minimum for each.

Key Findings

2/3

Share of funds with an American waterfall

See page 13 for details

20%

Median carried interest

See page 14 for details

2% Median management fee during investment period

Median management fee post the investment period **1.75%**

See pages 8 & 10 for details

3%

Median GP commitment

See page 7 for details

What's New

Larger Dataset

- While we include the same principal terms in this year's study as the last, the larger dataset enabled us to expand our analysis to incorporate comparisons by year and strategy type.
- The portion of venture capital (VC) and small buyout funds in the dataset has increased, and correspondingly, the share of large buyouts has fallen.
- Each time this study is completed, our dataset broadens and becomes increasingly representative of the private equity industry.

How the Results Compare

- With this study, we found consistency in some terms compared to our last study, but with some notable differences. It may be tempting to analyze the dataset as a time series, but changes from one year to the next are more reflective of the specific funds included rather than broader changes to private equity terms. We rarely see large changes in terms from one fund to its successor. This effect should diminish as the dataset grows.
- The biggest impact on the results stemmed from the increase in Callan's coverage of small buyout and VC funds, which tend to have different management fees and carried interest levels than other strategies.

COVID-19 Impact

- Even during the pandemic, private equity fees and terms did not experience drastic changes. We saw some management fee discounts, typically first-close discounts to incentivize LPs to commit more quickly, but otherwise terms looked similar to their pre-pandemic counterparts.
- Despite a dip in fundraising in 2020, demand for private equity in 2021 continued to strengthen, resulting in many oversubscribed funds and quick fundraises. As the industry becomes ever more competitive and crowded with private equity sponsors, terms may shift back in favor of LPs.

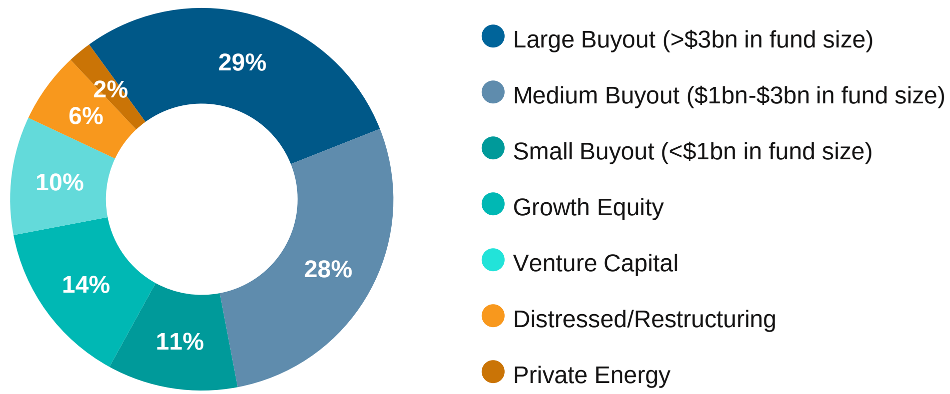
Buyout Funds Dominate Dataset

By strategy, the dataset is weighted toward buyout funds, which represented 68% of the partnerships reviewed by Callan from 2018-YTD 2021. These strategies varied widely in size, ranging from small (11% of the dataset), medium (28%), and large (29%).

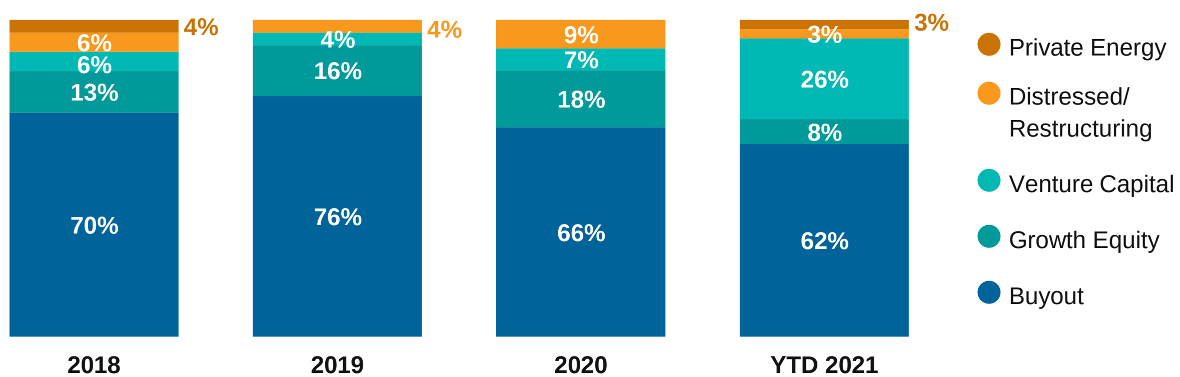
With the expansion of the dataset, the percentage of venture capital funds grew from 4% in our last study to 10%, and small buyouts rose from 7% to 11%; correspondingly, large buyouts decreased from 40% to 29%. These changes are more indicative of a shift in the types of funds reviewed by Callan during this time period than any broader trends in the industry.

Distressed/restructuring funds consistently represent a small portion of the dataset at 6% across all years. And private energy is even smaller at 2%.

Partnerships by Strategy, 2018-YTD 2021



Strategy Breakdown by Year



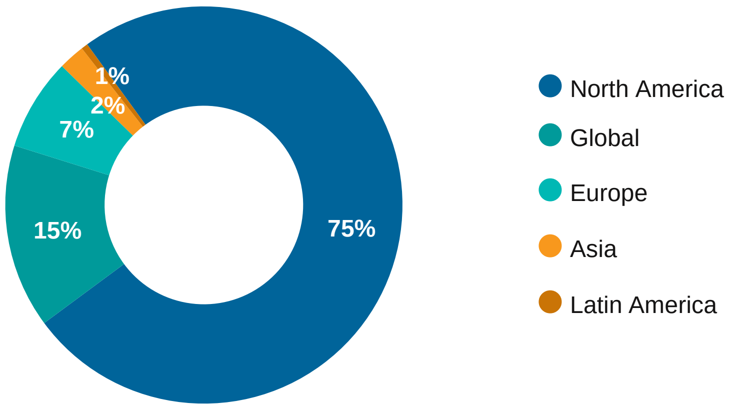
Note: Throughout this report, charts may not sum to 100% due to rounding.

North American Strategies Represent the Biggest Share

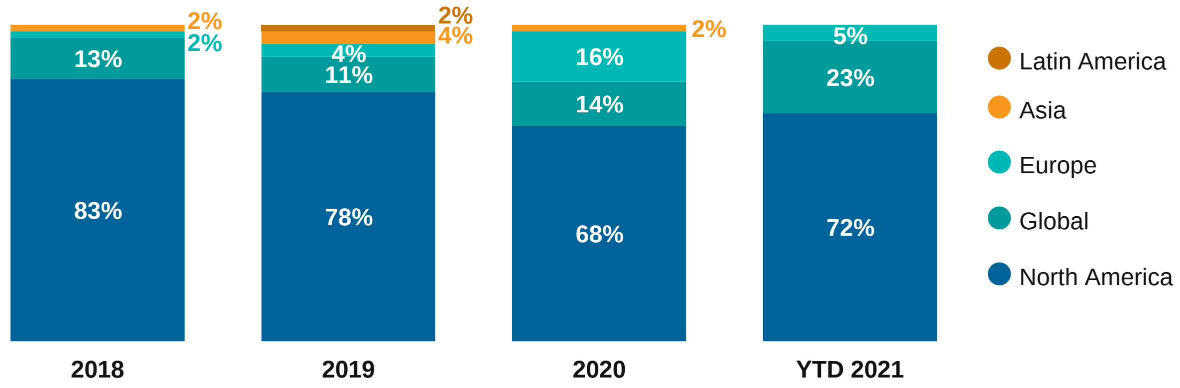
In terms of geography, the study is tilted toward North American and global strategies, which represented 90% of the dataset. It also included a small portion of European strategies at 7% and Asian strategies at 2%.

The dataset by geography has been relatively consistent over time. Over the last four years, it has been dominated by North American and global strategies, which have represented 82%-96% of the funds included each year. European strategies have consistently represented a small portion, ranging from 2%-16% each year. And Asian and Latin American strategies have consistently represented a small sliver of the funds included.

Partnerships by Geography, 2018-YTD 2021



Geographic Breakdown by Year



Most Funds Require $10 Million Minimum LP Commitment

Similar to the 2020 study, $10 million remained the most common minimum LP commitment, representing 49% of the dataset. It was followed by a $5 million minimum, at 26% of the dataset.

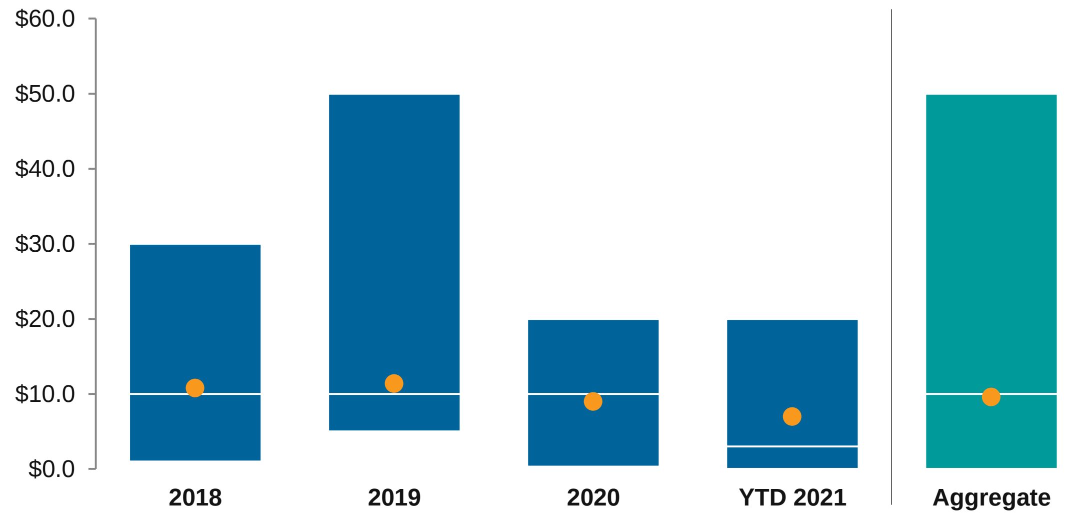
The average minimum LP commitment has come down in the more recent years, and the median experienced a steep drop in 2021, to $3 million. The average also fell, to $7 million. These declines are the result of a higher percentage of small buyout and venture capital strategies that year, which often have lower minimums due to their smaller fund sizes. In 2021, 44% of funds had minimum LP commitments under $10 million.

High LP minimums, such as $20 million and above, are typically used by GPs to constrain their LP base to a more concentrated set of larger investors.

Definitions

Minimum LP Commitment: the commitment amount required to invest in a private equity partnership

Minimum LP Commitment ($millions)



	2018	2019	2020	YTD 2021	Aggregate
Count	36	38	51	27	152
Max	$30.0	$50.0	$20.0	$20.0	$50.0
Median	**$10.0**	**$10.0**	**$10.0**	**$3.0**	**$10.0**
Min	$1.0	$5.0	$0.3	$0.0*	$0.0*
Average ●	$10.8	$11.4	$9.0	$7.0	$9.6

* Some partnerships included in the YTD 2021 data did not state a minimum LP commitment in their LPA.

Note: Not all terms were collected across all partnerships, causing differences in the counts. If the information wasn't provided or available at the time of Callan's review, those partnerships were not included in charts on this and subsequent pages.

Median GP Commitment Is Stable Over Time

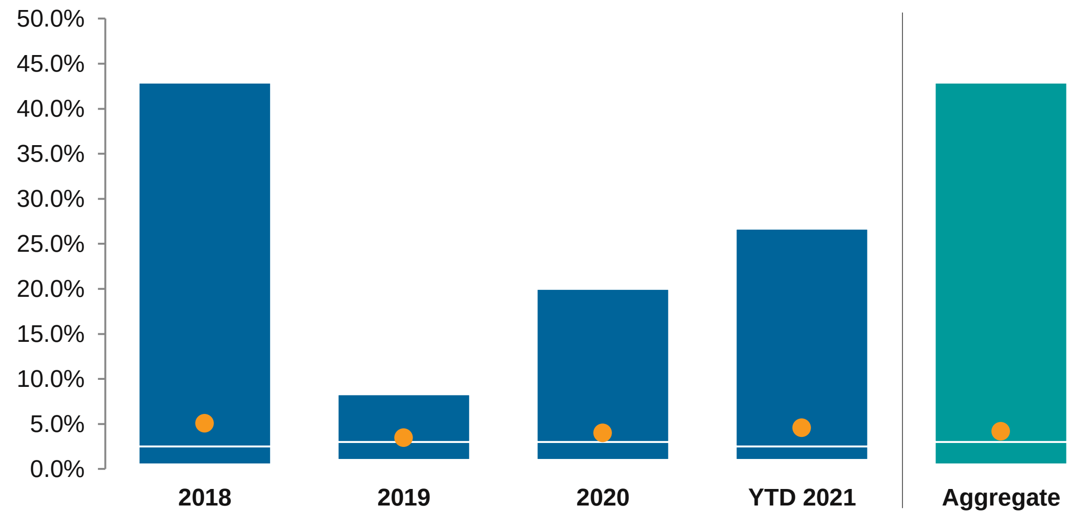
The median GP commitment has hovered around 2.5%-3.0% over the last four years with the aggregate median at 3.0%. The average has been slightly higher, ranging from 3.5%-5.1%. A strong GP commitment is important to ensure adequate alignment between the general partner and its limited partners.

GP commitments on the higher end, particularly the outliers in excess of 10%, typically involve balance sheet capital from the firm.

Definitions

GP Commitment: the percent of fund commitments expected to be financed by the general partner, which may consist of a mixture of cash and management fee waivers (and may also reflect commitments from the GP's balance sheet)

GP Commitment (%)



	2018	2019	2020	YTD 2021	Aggregate
Count	41	44	54	34	173
Max	42.9%	8.3%	20.0%	26.7%	42.9%
Median	**2.5%**	**3.0%**	**3.0%**	**2.5%**	**3.0%**
Min	0.5%	1.0%	1.0%	1.0%	0.5%
Average ●	5.1%	3.5%	4.0%	4.6%	4.2%

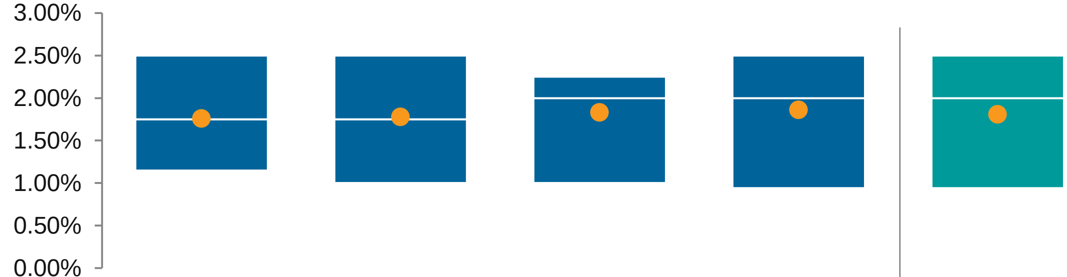
Large Jump in Investment Period Fee

We captured both the management fee paid during the investment period (typically the first 5-6 years of a fund's life) as well as after. Throughout a typical private equity fund, the management fee percentage—and what it is a percentage of—steps down over time. During the investment period, it is a typically higher percentage and paid on a larger amount of capital. After the investment period, the fee percentage typically drops and is paid on a smaller capital base.

The median management fee during the investment period was 2.00%, a large jump from our last study, which showed 1.75%. The average also increased from 1.76% to 1.81%. However, individual managers are not increasing their management fees from one fund to the next. Rather, the 2021 and 2020 funds in the study encompassed more venture capital and small buyout strategies, which tend to have higher fees, and fewer large buyouts, which tend to have lower fees.

During the investment period, management fees are almost always paid as a percentage of committed capital. There has been little variation in this structure over the last four years.

Management Fee: Investment Period (%)



	2018	2019	2020	YTD 2021	Aggregate
Count	40	43	56	38	177
Max	2.50%	2.50%	2.25%	2.50%	2.50%
Median	**1.75%**	**1.75%**	**2.00%**	**2.00%**	**2.00%**
Min	1.15%	1.00%	1.00%	0.94%	0.94%
Average ●	1.76%	1.78%	1.83%	1.86%	1.81%

What the Fee Is Paid on, 2018-YTD 2021

Fees Vary Widely by Strategy Type

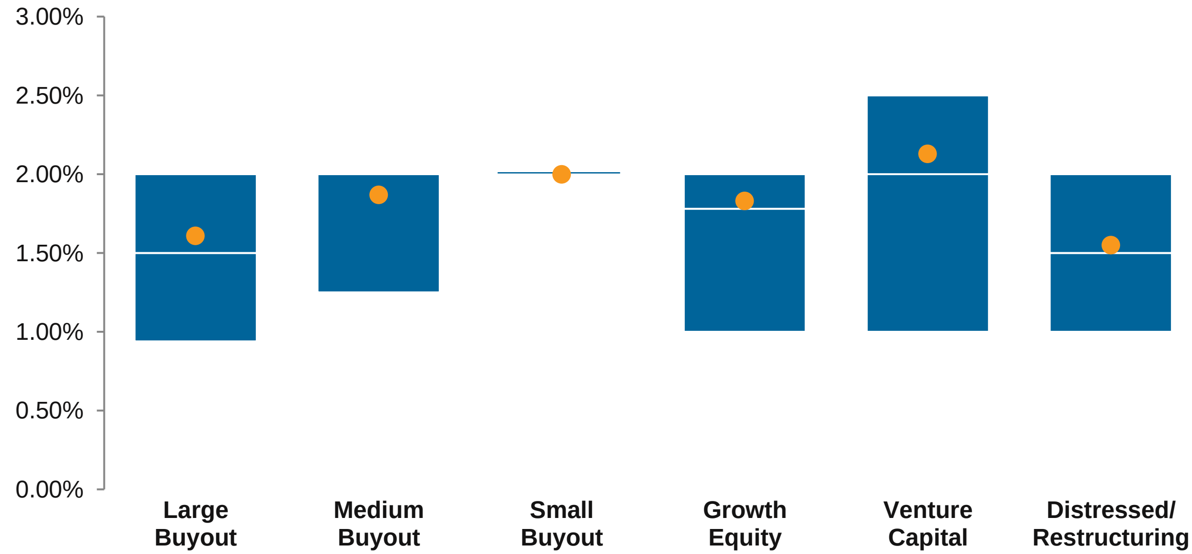
Management fees during the investment period can vary widely depending on the strategy type. Large buyouts tend to have lower fees, principally because those fees are paid on a larger capital base. For example, 1.50% of a $20 billion fund equates to $300 million in annual fees, while 2.00% of $1 billion only equates to $50 million. We generally prefer to see management fees decline as fund sizes increase. The average management fee for large buyouts was 1.61%, 1.87% for medium buyouts, and 2.00% for small buyouts (in fact, all the small buyouts included here charged 2.00%).

Venture capital had the highest management fees, with the maximum reaching up to 2.50%. The potential for high returns within VC helps to justify the higher fees.

Growth equity management fees tend to skew closer to buyout fees than VC fees. The average growth equity fee of 1.83% is comparable to medium buyout's average of 1.87%.

Distressed/restructuring funds had the lowest management fees of any strategy type with a median of 1.50% and an average of 1.55%.

Management Fee: Investment Period (%)



	Large Buyout	Medium Buyout	Small Buyout	Growth Equity	Venture Capital	Distressed/ Restructuring
Count	51	50	21	23	19	11
Max	2.00%	2.00%	2.00%	2.00%	2.50%	2.00%
Median	**1.50%**	**2.00%**	**2.00%**	**1.78%**	**2.00%**	**1.50%**
Min	0.94%	1.25%	2.00%	1.00%	1.00%	1.00%
Average ●	1.61%	1.87%	2.00%	1.83%	2.13%	1.55%

Private energy is excluded from the analysis above given the small size of the universe.

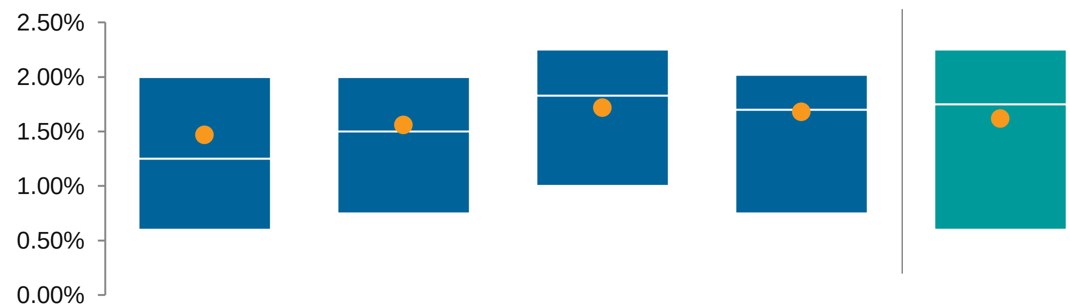
Post-Investment Period Fees Rise

Similar to management fees during the investment period, we saw an increase in management fees post the investment period with this study. Our last study indicated median management fees of 1.50% post the investment period, which increased to 1.75% in this study, again driven by an increase in the number of venture capital and small buyout funds in the dataset.

Post the investment period, the capital base almost always drops from committed capital to invested capital. However, 16% of funds did not have any kind of a step down and fees were paid as a percentage of the same capital base, typically committed or invested capital, throughout the life of the fund.

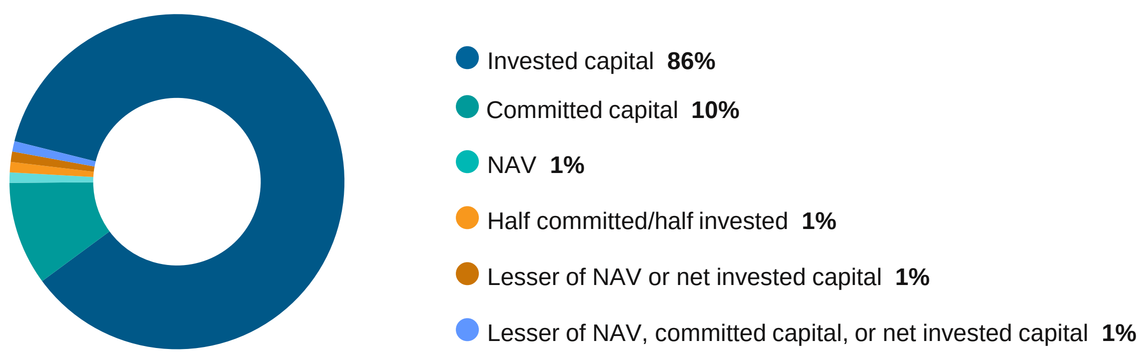
Management fees higher or lower than our findings can signal to investors whether they are overpaying a general partner or benefiting from fee savings.

Management Fee: Post-Investment Period (%)



	2018	2019	2020	YTD 2021	Aggregate
Count	35	40	56	35	166
Max	2.00%	2.00%	2.25%	2.02%	2.25%
Median	**1.25%**	**1.50%**	**1.83%**	**1.70%**	**1.75%**
Min	0.60%	0.75%	1.00%	0.75%	0.60%
Average ●	1.47%	1.56%	1.72%	1.68%	1.62%

What the Fee Is Paid on, 2018-YTD 2021

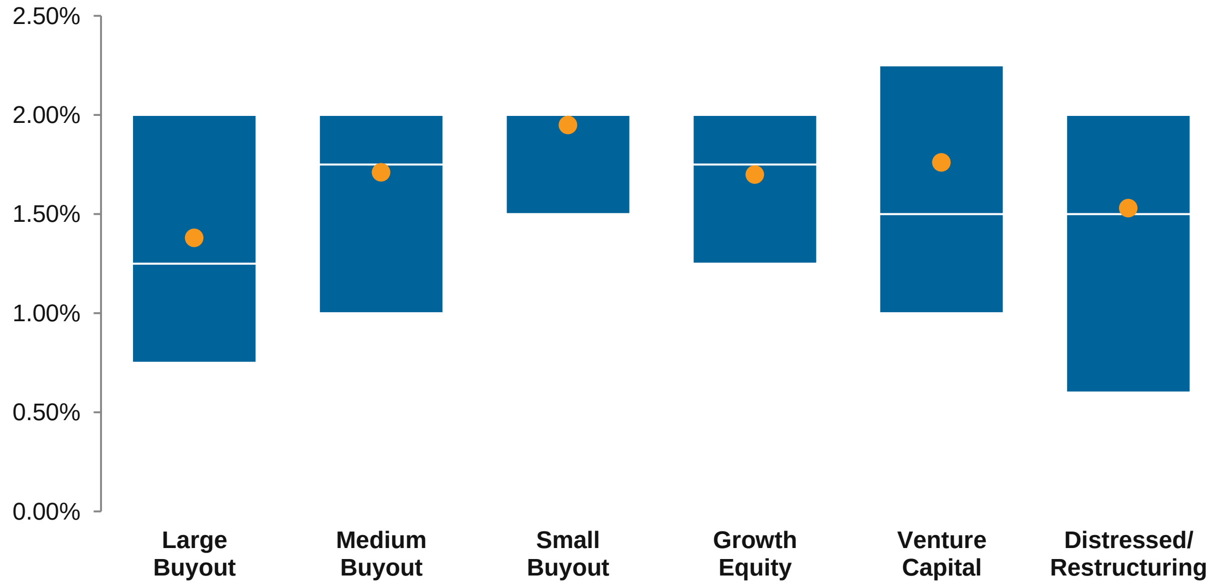


Small Buyouts Charge the Highest Fee

While venture capital still had the highest maximum fee post the investment period, the median and average fee percentages fell more drastically than other strategies. Despite this percentage drop, many VC strategies continued to charge that percentage on committed capital (a higher capital base relative to invested capital), so, in terms of dollars, the fees did not drop as dramatically.

At 1.95%, small buyouts had the highest average management fees post the investment period, while large buyouts had the lowest. Growth equity and medium buyouts continued to have similar management fees post the investment period, with both dropping to a median of 1.75% and averages of 1.70% and 1.71%, respectively. Distressed/restructuring funds had the smallest drop in median and average post-investment period fees, principally because management fees were already low to begin with.

Management Fee: Post-Investment Period (%)



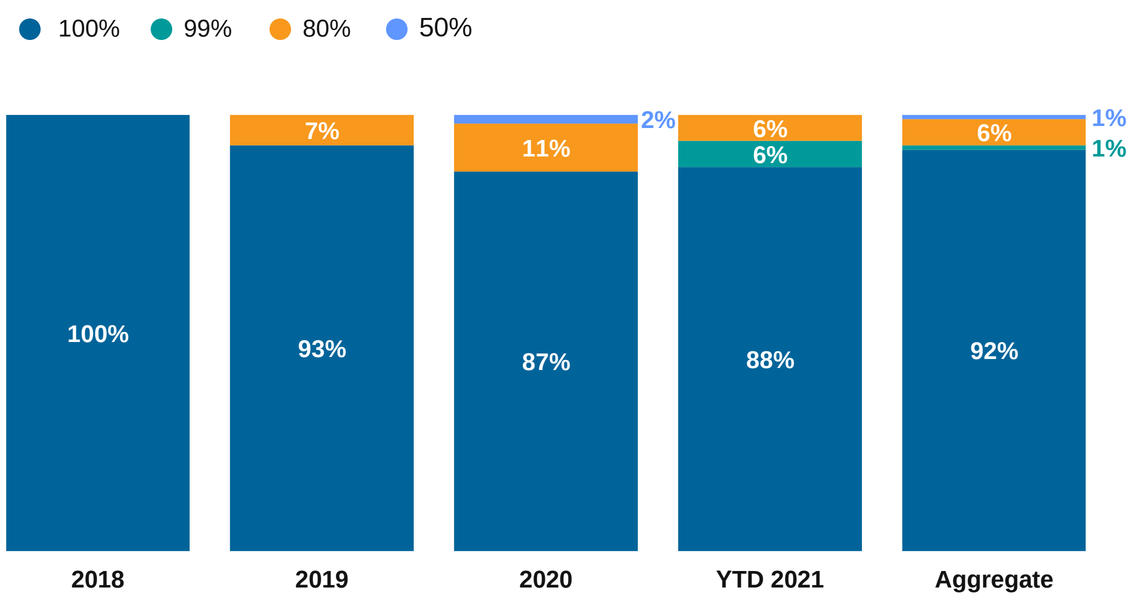
Count	50	47	20	22	13	11
Max	2.00%	2.00%	2.00%	2.00%	2.25%	2.00%
Median	**1.25%**	**1.75%**	**2.00%**	**1.75%**	**1.50%**	**1.50%**
Min	0.75%	1.00%	1.50%	1.25%	1.00%	0.60%
Average ●	1.38%	1.71%	1.95%	1.70%	1.76%	1.53%

For management fees with an annual step down post the investment period, Callan calculated the average fee over the period. Private energy is excluded from the analysis above given the small size of the universe.

100% Fee Offsets Dominate

Every fund in the dataset offset management fees by any transaction, monitoring, or other fees paid to the GP. Most had a 100% management fee offset, although a few funds had a 99%, 80%, or 50% offset. Given that the majority of the industry has a 100% fee offset, anything significantly below this threshold is not in keeping with the broader market.

Management Fee Offset (%)



	2018	2019	2020	YTD 2021	Aggregate
Count	41	44	54	32	171

Definitions

Management Fee Offset: any transaction, monitoring, or other fees paid to the general partner that are offset against the management fee

American Waterfalls Are the Most Prevalent

Most funds had either an American (deal-by-deal) waterfall or a European (fund-as-a-whole) waterfall, meaning that carried interest is either paid to the GP on a per investment basis (more GP-friendly) or on a cumulative basis across all investments (more LP-friendly). The majority of the dataset had an American waterfall, and this has remained relatively consistent over the last four years. The remainder, just under a third, had a European waterfall, and a few funds maintained a hybrid version of the two. The type of waterfall did vary by geography, as the name indicates. A higher percentage of European funds had a European waterfall (64%), while only 24% of North American and global funds maintained a European waterfall.

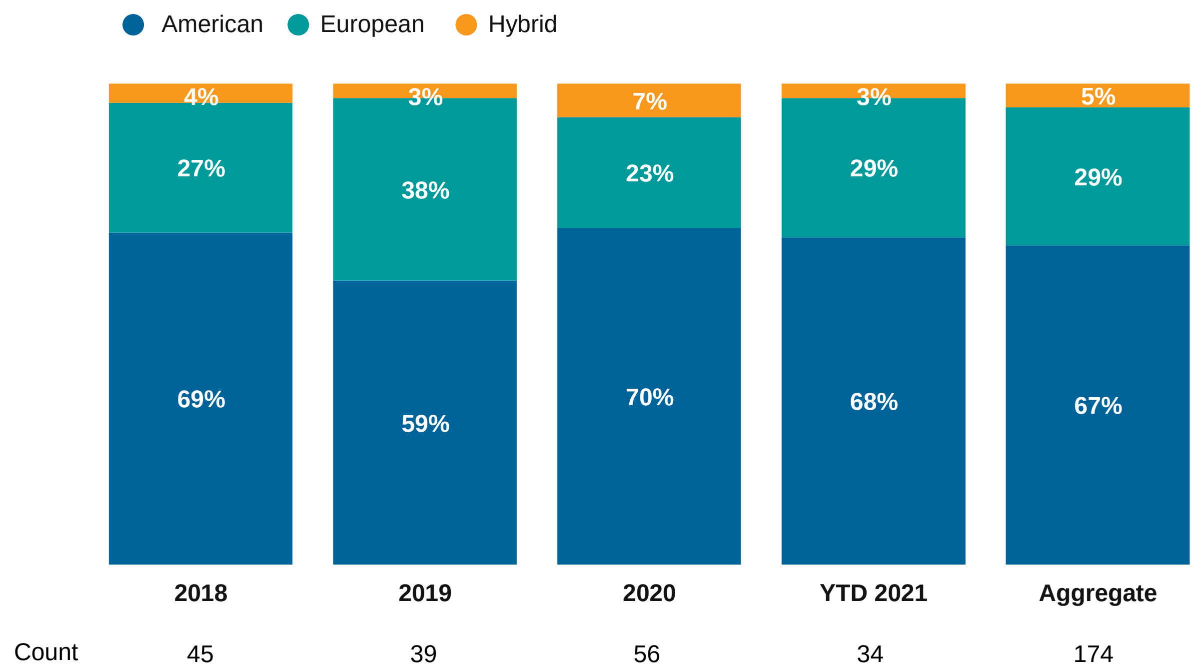
Definitions

Waterfall: refers to the distribution of gains to the limited partners and general partner

American waterfall: carried interest calculated on a deal-by-deal basis, which benefits the GP

European waterfall: carried interest calculated on a fund-as-a-whole basis, benefiting the LP

Waterfall Type



Vast Majority of Funds Charge a 20% Carry

The most common carried interest percentage by far was 20%, with 86% of funds at this level.

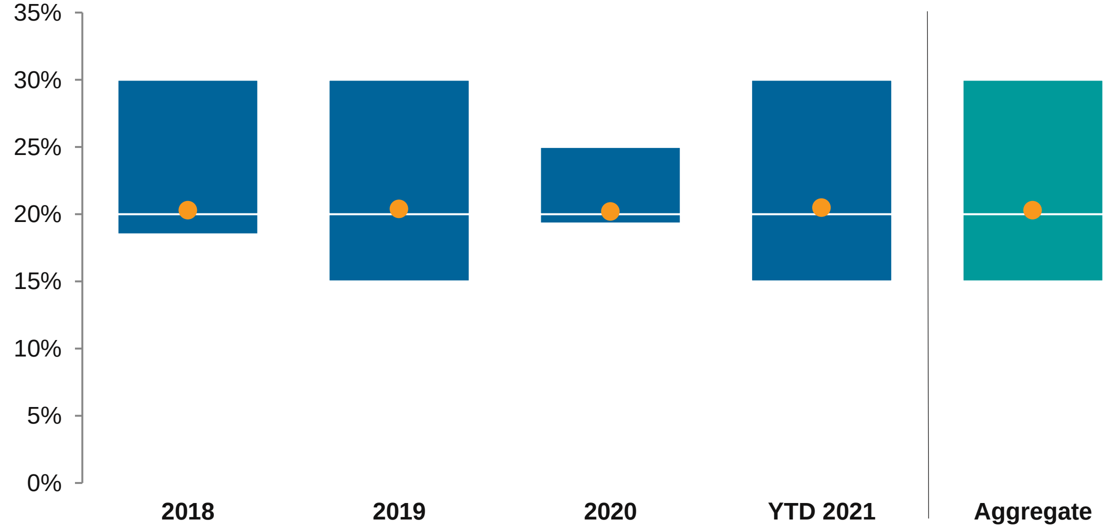
Some funds, typically venture capital funds, charged carried interest as high as 25% or 30%, particularly those funds in high demand. For 2020 and 2021 funds, we also started collecting data on tiered fee structures, meaning funds that charge a higher carried interest percentage once the fund reaches a certain threshold. For example, once a fund returns a 3.0x net DPI (Distributions to Paid-In Capital) to investors, the carried interest would increase from 20% to 30%. Only 9% of the dataset had a tiered carried interest structure, but within venture capital, over 50% of funds had this tiered structure.

For funds that charge higher carried interest, it is important for investors to determine the impact on net returns and ensure the general partner is able to offset those higher fees through strong performance.

Definitions

Carried Interest: percentage of realized profits paid to the general partner as an incentive/performance fee

Carried Interest (%)



	2018	2019	2020	YTD 2021	Aggregate
Count	45	45	56	38	184
Max	30.0%	30.0%	25.0%	30.0%	30.0%
Median	**20.0%**	**20.0%**	**20.0%**	**20.0%**	**20.0%**
Min	18.5%	15.0%	19.3%	15.0%	15.0%
Average ●	20.3%	20.4%	20.2%	20.5%	20.3%

Preferred Return Stays at 8%

Similar to the carried interest percentage, the median preferred return has consistently been 8%. None of the funds analyzed had a higher preferred return. Many, principally venture capital and growth equity funds, did not have any kind of a preferred return.

The vast majority of partnerships used a compounded calculation for the preferred return.

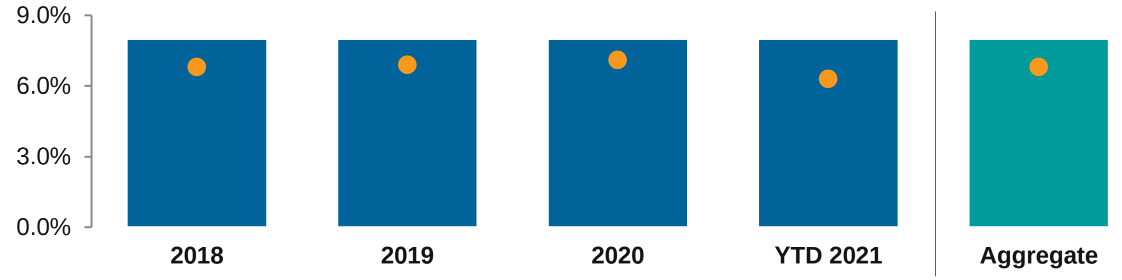
We added the GP catch-up to this study for partnerships reviewed in 2020 and 2021. 87% of those partnerships had a 100% GP catch-up. A small number had a lower GP catch-up of 80% or 85%, meaning it takes longer for the GP to catch up to its 20% carried interest.

Definitions

Preferred Return: the threshold the GP must achieve prior to realizing any carried interest; can be a simple or compounded return calculation

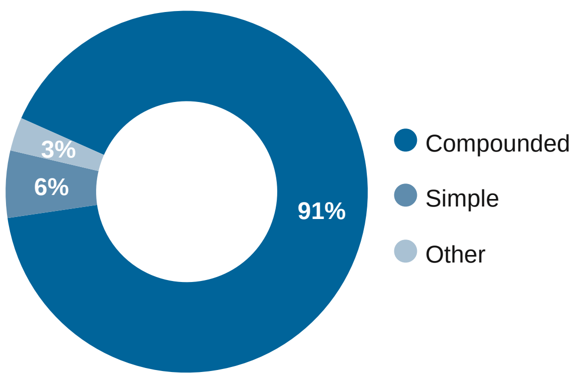
GP Catch-Up: after the preferred return has been met, the distribution of profits to GPs until they "catch up" to their full portion of cumulative carried interest

Preferred Return (%)

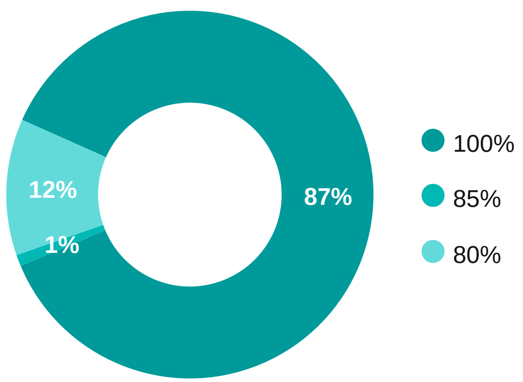


	2018	2019	2020	YTD 2021	Aggregate
Count	43	41	54	34	172
Max	8.0%	8.0%	8.0%	8.0%	8.0%
Median	**8.0%**	**8.0%**	**8.0%**	**8.0%**	**8.0%**
Min	0.0%	0.0%	0.0%	0.0%	0.0%
Average ●	6.8%	6.9%	7.1%	6.3%	6.8%

Preferred Return Calculation
2018-YTD 2021



GP Catch-Up
2020-YTD 2021



Conclusion

Pandemic does not slow demand

Despite the COVID-19 pandemic, partnership terms continued to remain predominantly GP-friendly. Some GPs offered management fee discounts in 2020, often for first closers to incentivize LPs to commit more quickly. However, we did not see a large power shift toward the LP in partnership terms.

Larger dataset

Each year this study is conducted, the growing size of the dataset become more representative of the broader private equity industry. Although this year's study was still largely dominated by North American and global buyout funds, the dataset has become increasingly diverse. The number of small buyout and venture capital funds increased, and correspondingly the number of large buyout funds decreased, which had a large impact on the results.

How this study compares

While we saw changes in some terms, principally as a result of a growing and varying dataset, other terms remained consistent over time. While this study has shown management fees increasing both during and post the investment period, this shift is principally the result of the specific funds included each year, rather than any fundamental changes in the industry. This effect should diminish as the dataset grows. Waterfall structures and carried interest percentages have remained relatively consistent over the past four years, as have GP commitments and minimum LP commitments.

About the Author

Ashley DeLuce, CAIA, is a vice president in Callan's Private Equity group. She joined the group in 2017, and her role includes research, client servicing, strategic planning, portfolio reviews, manager evaluations, and overseeing private equity performance reporting. Ashley joined Callan in 2015 and previously worked in Callan's Client Report Services group preparing quarterly and monthly performance measurement reports. She is a shareholder of the firm.

Ashley earned a BA in history and medieval/renaissance studies from the College of William and Mary. She has earned the right to use the Chartered Alternative Investment Analyst designation.

Disclosure

About Callan

Callan was founded as an employee-owned investment consulting firm in 1973. Ever since, we have empowered institutional clients with creative, customized investment solutions that are backed by proprietary research, exclusive data, and ongoing education. Today, Callan advises on more than $3 trillion in total fund sponsor assets, which makes it among the largest independently owned investment consulting firms in the U.S. Callan uses a client-focused consulting model to serve pension and defined contribution plan sponsors, endowments, foundations, independent investment advisers, investment managers, and other asset owners. Callan has six offices throughout the U.S. For more information, please visit www.callan.com.

About the Callan Institute

The Callan Institute, established in 1980, is a source of continuing education for those in the institutional investment community. The Institute conducts conferences and workshops and provides published research, surveys, and newsletters. The Institute strives to present the most timely and relevant research and education available so our clients and our associates stay abreast of important trends in the investments industry.

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