SCERS
Sacramento County Employees' Retirement System

Board of Retirement Regular Meeting

Sacramento County Employees' Retirement System

Agenda Item 17

MEETING DATE: **April 16, 2025**

SUBJECT: **Education: Later-Life Private Equity Funds**

SUBMITTED FOR: **___ Action** **_X_ Information**

RECOMMENDATION

Receive and file presentation on exit considerations for later-life private equity funds, as presented by Staff and Cliffwater.

PURPOSE

This item supports the Strategic Management Plan objectives to manage a diverse investment portfolio and ensure effective oversight of the investment program.

DISCUSSION

This memorandum provides an overview of later-life considerations within private market funds. Historically, private market investments have a ten-year life, with the possibility of a few limited extension periods. However, the growth of continuation vehicles (CVs) and the slowdown of the exit market over the last four years has complicated this narrative. CVs involve the sale of an asset (or assets) from one fund to another, both of which are managed by the same General Partner (GP). CVs have various structures, including single-asset, multi-asset (within the same fund), multi-asset (comprising certain investments that can span different funds), and end-of-life restructuring.

There are more private-market-backed companies (comprising a more significant share of total GP portfolios) awaiting exit than ever before. According to McKinsey, companies in private equity ownership (excluding add-ons) that have been held for more than four years comprise 61% of all buyout-backed assets, up from 55% in 2023 and the ten-year average of 53%. With liquidity remaining a pressing issue for Limited Partners (LPs), and exits still backlogged, the secondary market has increasingly become a critical source of liquidity for LPs. In 2024, secondary transaction value rose 45% to an all-time high of $162 billion last year, according to Jefferies' market review. More than half of this total comprised LP-led deals, reflecting how limited partners found a way to monetize their investments. There are more private-market-backed companies (comprising a more significant share of total GP portfolios) awaiting exit, which is greater now than at any point since 2005.

SCERS' private markets portfolio is maturing, with the number of mature investments increasing. For example, 21 of the 27 private equity commitments made between 2006 and 2014 remain active. Four of the six liquidated funds were sales in the 2022 secondary sale of legacy fund of funds. The demands of post-commitment can be particularly challenging during even the best exit markets, including handling LP agreements, fund life extensions, cross-fund investments, and CVs, among others. The slowdown in the exit market over the last few years has exacerbated holding periods, an issue facing LPs, who are seeing growth in their legacy portfolios. At the same time, GPs are facing challenges from LPs, some of which are demanding liquidity and cash flows while others want to wait for optimal exit timing.

CVs are a popular tool for GPs to create alternative forms of liquidity. Historically, GPs' ability to generate distributions have involved exiting a company to another GP, a trade buyer, or the public markets. However, the advent of the CV has created an alternative avenue for liquidity. Ideally, a CV, whether single-asset or multi-asset, involves an intermediary collaborating with the GP to optimize pricing, including third-party pricing. This process may take months and falls beyond the purview of most LPs. When a formal offer is presented to LPs, they typically have less than one month to decide whether to sell or underwrite a new fund commitment.

GPs are raising more capital by offloading their strongest assets, which tend to sell more easily. Meanwhile, other assets may hold high valuations but aren't as likely to sell at today's prices. At the same time, GPs are realizing that when they sell a top-performing asset to another GP for 3x their cost, that new GP often turns around and makes 3x as well—highlighting that the original GP could have made 9x by holding on. The growth of continuation vehicles has opened a path for GPs and participating LPs to capture more upside by effectively selling the company to themselves. However, the rise of continuation vehicles also complicates decision-making for many LPs, who are often not set up to make informed decisions within tight timelines—typically around 20 days.

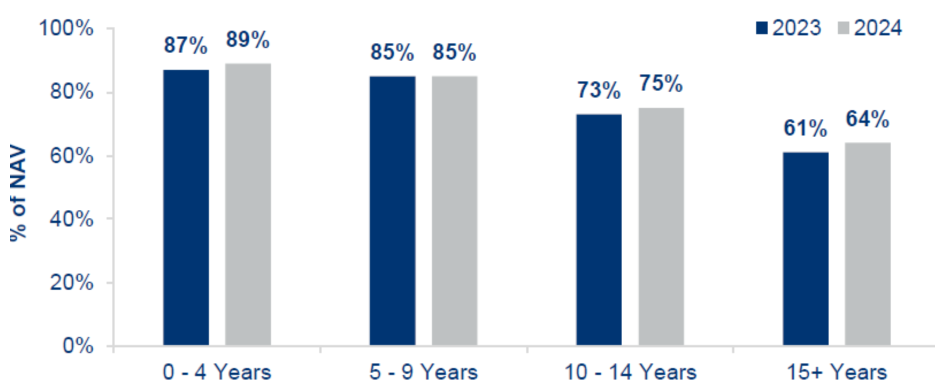

Figure 1 Source: Elm Capital

In addition to later life fund considerations Staff continues to evaluate secondary options for the portfolio, including the potential sale of newer vintage funds and positions with high-demand GPs to maximize pricing. While valuation discounts remain common in the secondary market (*See Figure 1*), LPs looking to sell must accept that some level of discount is likely. Without other avenues to generate liquidity within the underlying portfolio, selling a fund position often becomes the only practical way to rebalance. Though the process is time-intensive for LPs, it remains a widely used strategy. Staff does not expect any significant changes to the SCERS' Mater Investment Policy Statement (IPS) regarding secondaries.

SCERS' EXPERIENCE

Staff has been assessing and implementing later-life fund decisions such as whether to sell and take liquidity versus rolling into a GP-led secondary/CV under the delegated authority within the private markets/alternative assets implementation protocols within the Master IPS, while providing the Board with reporting from Staff and SCERS' investment consultant prior to taking action. CVs typically have a short window of time to make a decision. If an LP chooses to roll into the CV, the process typically involves reviewing the transaction, performing legal due diligence, and executing documentation, in an expedited timeframe.

To date, SCERS has experienced seven GP-led secondaries/CV decision points and elected to take liquidity (sell) in each case. If SCERS were to consider rolling into a GP-led secondary, implementation using the existing private markets/alternative assets protocol is important given the compressed timelines associated with these transactions. The current implementation protocols were written to address initial/primary fund commitments, as well as LP led secondary transitions, as they were created when SCERS' private markets portfolio was less mature and before SCERS was facing later-life fund decisions. Staff plans on coming back to the Board with recommended language to the implementation protocols within the Master IPS to include later-life fund decisions. Transparency and reporting to the Board would remain a foundation of the process and protocols.

As SCERS' private markets portfolio continues to mature, navigating the complexities of later-life fund dynamics has become increasingly important. The rise of CVs, prolonged exit timelines, and evolving secondary market activity all reflect broader structural shifts within private equity. These changes present both opportunities and challenges for limited partners, particularly in terms of liquidity management and decision-making under compressed timelines.

ATTACHMENTS

- Board Order
- Cliffwater's Considerations for Later-Life Private Equities Funds presentation

Prepared by:

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Retirement Board Order

Sacramento County Employees' Retirement System

Before the Board of Retirement
April 16, 2025

AGENDA ITEM:

Education: Later-Life Private Equity Funds

THE BOARD OF RETIREMENT hereby approves Staff's recommendation to receive and file presentation on exit considerations for later-life private equity funds, as presented by Staff and Cliffwater.

I HEREBY CERTIFY that the above order was passed and adopted on April 16, 2025 by the following vote of the Board of Retirement, to wit:

AYES:

NOES:

ABSENT:

ABSTAIN:

ALTERNATES:
(Present but not voting)

James Diepenbrock
Board President

Eric Stern
Chief Executive Officer and
Board Secretary

CLIFFWATER LLC

Los Angeles • New York

Sacramento County Employees' Retirement System

Board Educational Presentation

Considerations for Later-Life Private Equity Funds

April 2025

Overview

The recent slowdown in private equity activity has extended the timeline for holding portfolio investments and pushed more fund value into later years of a fund's life

- The slowdown has been most apparent in reduced portfolio exit activity

Investors in private equity funds have likewise seen a slowdown in portfolio distributions and an increase in hold times for private equity funds and investments

- Some investors are facing allocation constraints or limits to new commitment activity

Continued evolutions in private markets, combined with investors' need for increased distributions, have begun to create new liquidity considerations for investors

- More considerations for actions at the end of the fund's stated life
- Seeing increasing number of "mid-life" options for liquidity solutions as well
- Expect many of these to remain as mainstream options though changes in market environment could lessen frequency or urgency of need

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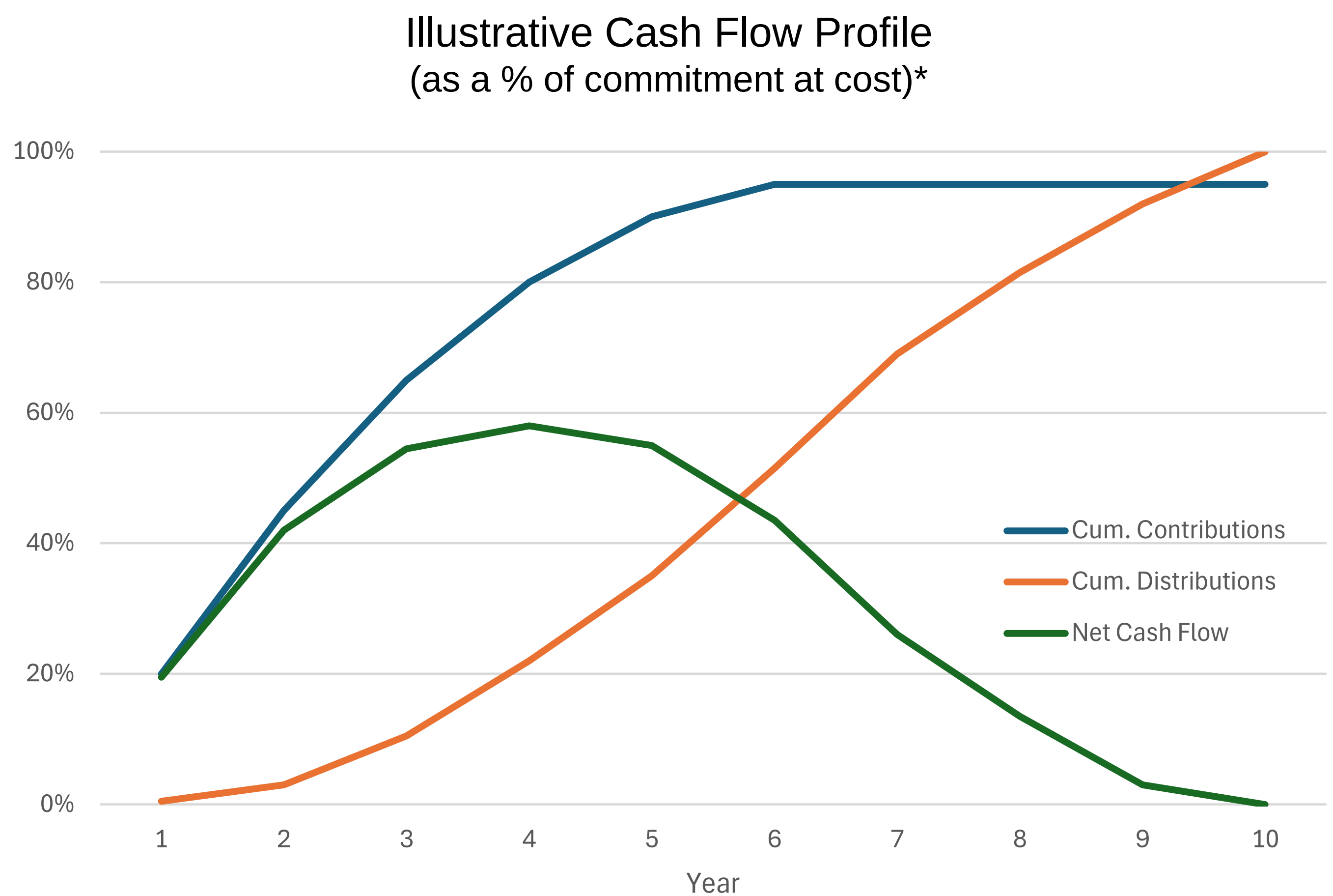
Private Equity Fund Typical Cash Flow Profile



Private equity funds often return the majority of invested capital by year 7-8

*The example above shown on a cost basis, ignoring any benefit from appreciation of fund investments

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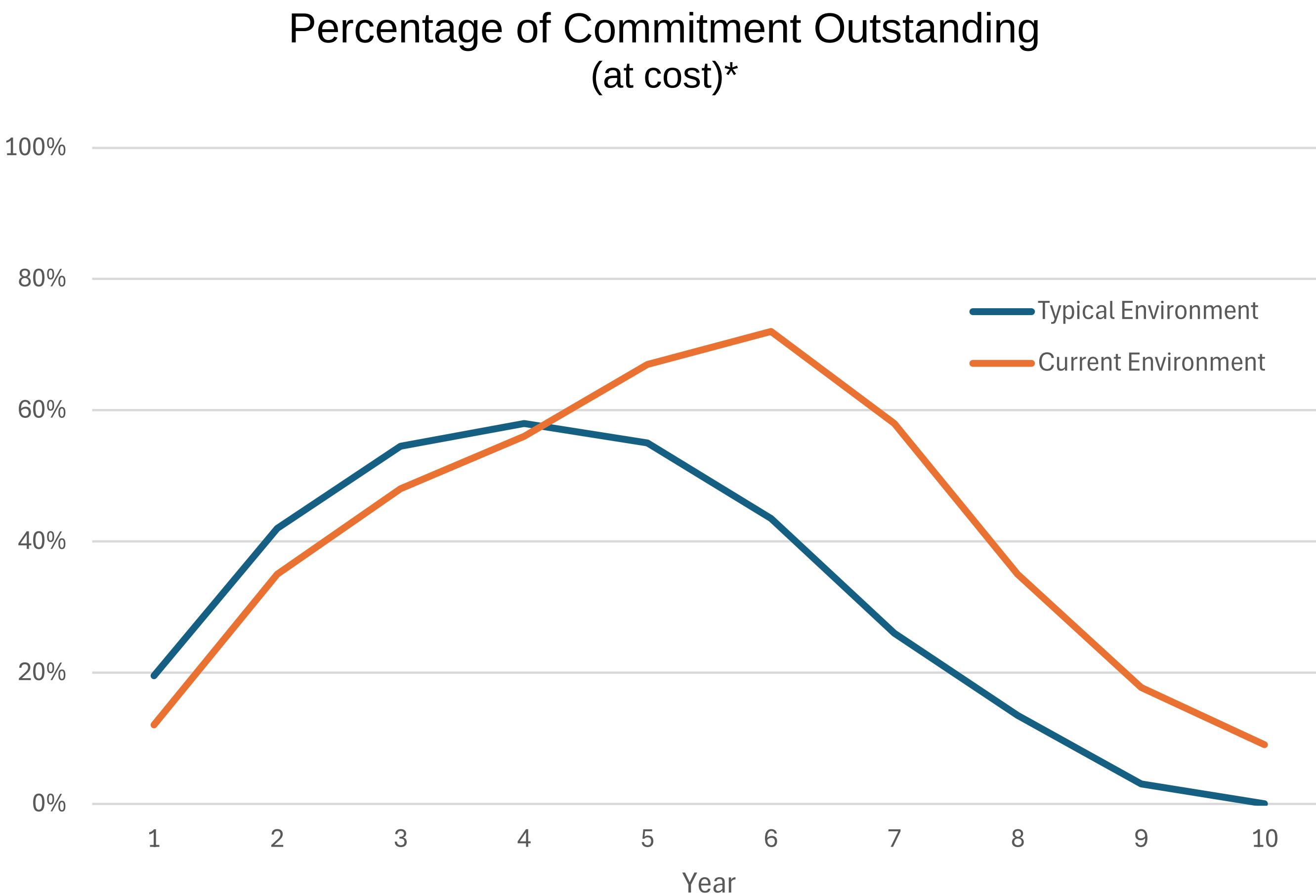
Changes in Private Equity Fund Lifecycle



The current environment has slowed activity and extended the lifecycle for many funds

*The example above shown on a cost basis, ignoring any benefit from appreciation of fund investments

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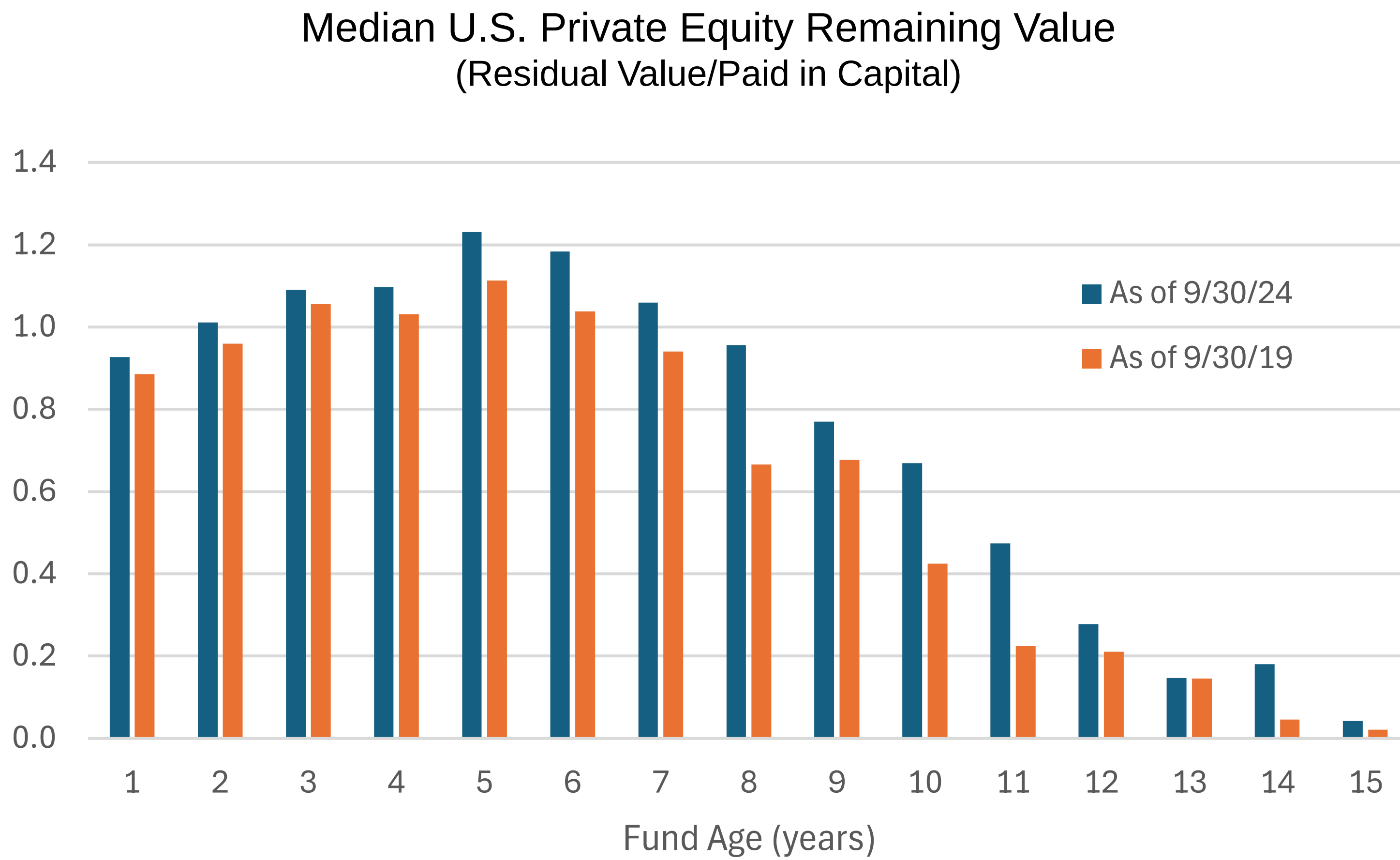
Seeing More Fund Value Remaining Later in Fund Life

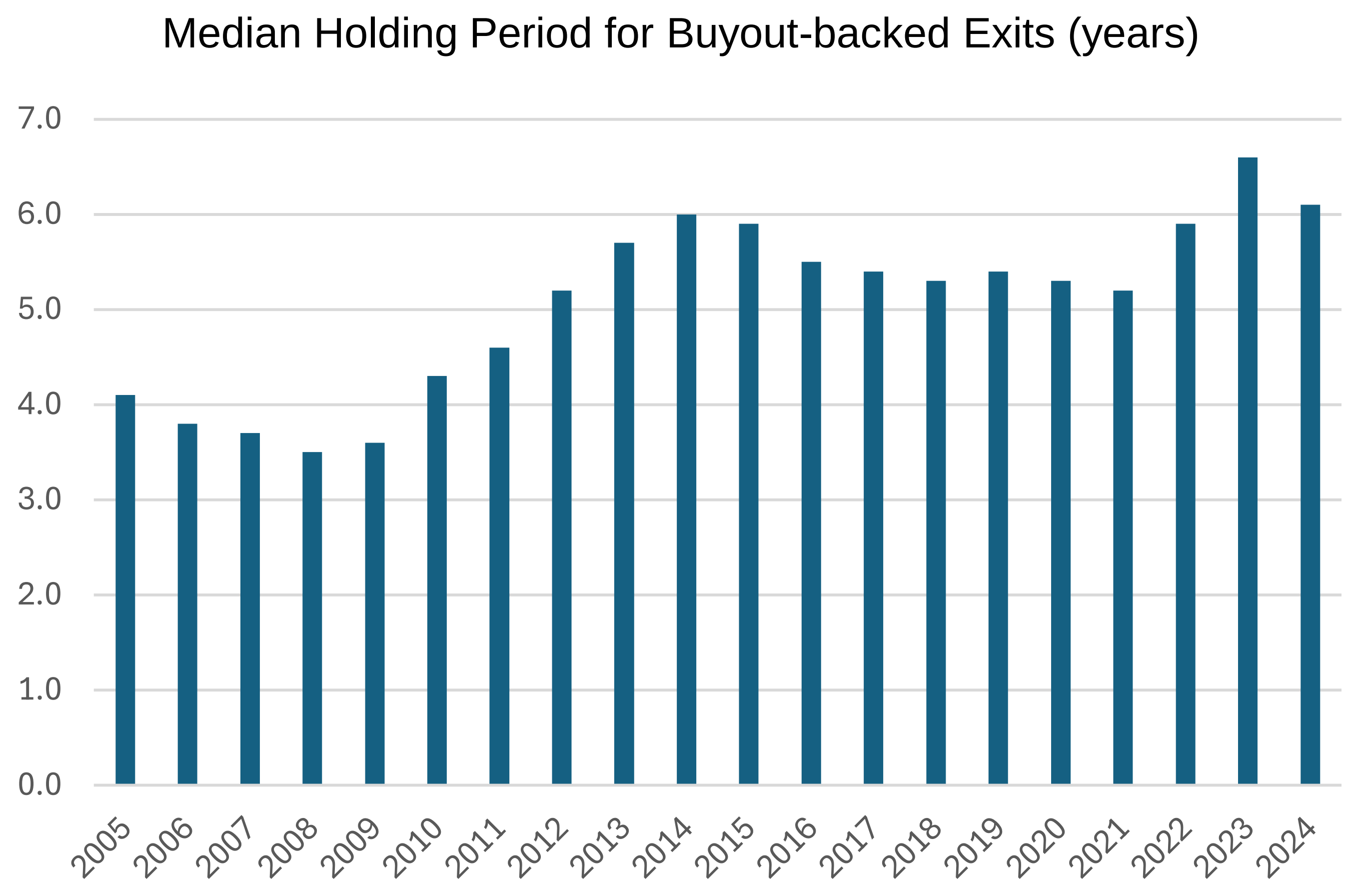


Extended horizons accompanied by an increasing proportion of later-life fund value

– Seeing more than the typical "tail end" or "clean up" portfolio holdings in later years

Source: Cambridge Associates

PE Funds Holding Portfolio Companies for Longer



While the median holding period for exited investments has remained above 6 years, nearly 20% of current U.S. PE-backed companies have been held for more than 7 years

Source: PitchBook, Preqin

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Impact of Recent Market Dynamics

- Slowing distributions to Limited Partners
  - Liquidity lagging expectations of Limited Partners
    - Private equity portfolios more sizeable for longer

All of the above are leading to new fund election and liquidity provision considerations for limited partners of private equity funds

Private Equity Terms

Fund Term

- The allowable duration of a fund
- Typical term for private equity (buyout) funds is 10 years

Fund Term Extensions

- Preset parameters to extend a fund's stated term
- Typical provisions provide for a 1-year extension at the General Partner's (investment manager's) discretion
  - Up to 2 additional 1-year extensions are often available with the consent of a fund's Advisory Board (comprised of select Limited Partners)

Investment Period

- The period of time within which a fund may make investments
- Investment periods are typically 5 or 6 years for private equity (buyout) funds
  - Funds often include provisions for a portion of committed capital to be invested beyond the investment period as needed for follow-on investments, subject to additional restrictions

While the current environment has lengthened the investment horizon for many private equity investments, these basic terms have remained largely unchanged

- Has led to more actions requested of, or options offered to, limited partners recently

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Options Offered to Limited Partners

Fund Term Extensions

- Limited Partners ("LPs") being asked more frequently to extend fund terms
  - Portfolios often have more value than the previously typical "end of life" portfolios
- Extension requests evaluated case-by-case, often in tandem with discussions around fund fees and exit plans

"Traditional" Secondary Sales

- Sales of interests in private funds sold from one LP to another in a privately negotiated transaction
- Market continues to expand in breadth and depth of potential buyers and sellers

"GP-Led" Secondaries

- Secondary sale opportunities created by fund General Partners
- Can involve an entire fund interest, preselected group of fund assets, or a single asset
- Existing fund LPs typically have the option to maintain their interest ("roll") or take liquidity ("sell")
  - Rolling an interest could also require an additional capital commitment from the LP
- GP-led secondaries are now frequently offered through "Continuation Vehicles" ("CVs")
  - Special purpose vehicles created to hold the offered secondary assets in a fund structure for subscribing investors
- GP-led secondaries can be "mid-life" options, not only considered at the end of a fund's life

Evaluating GP-Led Secondary Offerings

Evaluate each GP-led secondaries offering on an individualized basis

Quality of GP:

- ✓ Consistent track record with a history of outperformance
- ✓ Transparent, documented process with existing fund LPs
- ✓ Resources to support the company's strategic growth

'Trophy Asset' type characteristics:

- ✓ Defensible business model with compelling growth plans
- ✓ Strong historical financial performance
- ✓ Clear path to liquidity

Alignment with GP:

- ✓ Maximize return for LPs in the selling fund
- ✓ GP economic incentive focused on go-forward performance
- ✓ Strategic rationale to own the company for longer

Additional LP Considerations for GP-Led Secondaries

Timing
* Some offerings have short windows for evaluation and execution

Legal Work
* Potential cost and resource strain

Allocation Size
* Small sizing, as compared to primary fund commitments, could reduce appeal

Blind Pool Risk
* Could additional new investments be made alongside existing assets?

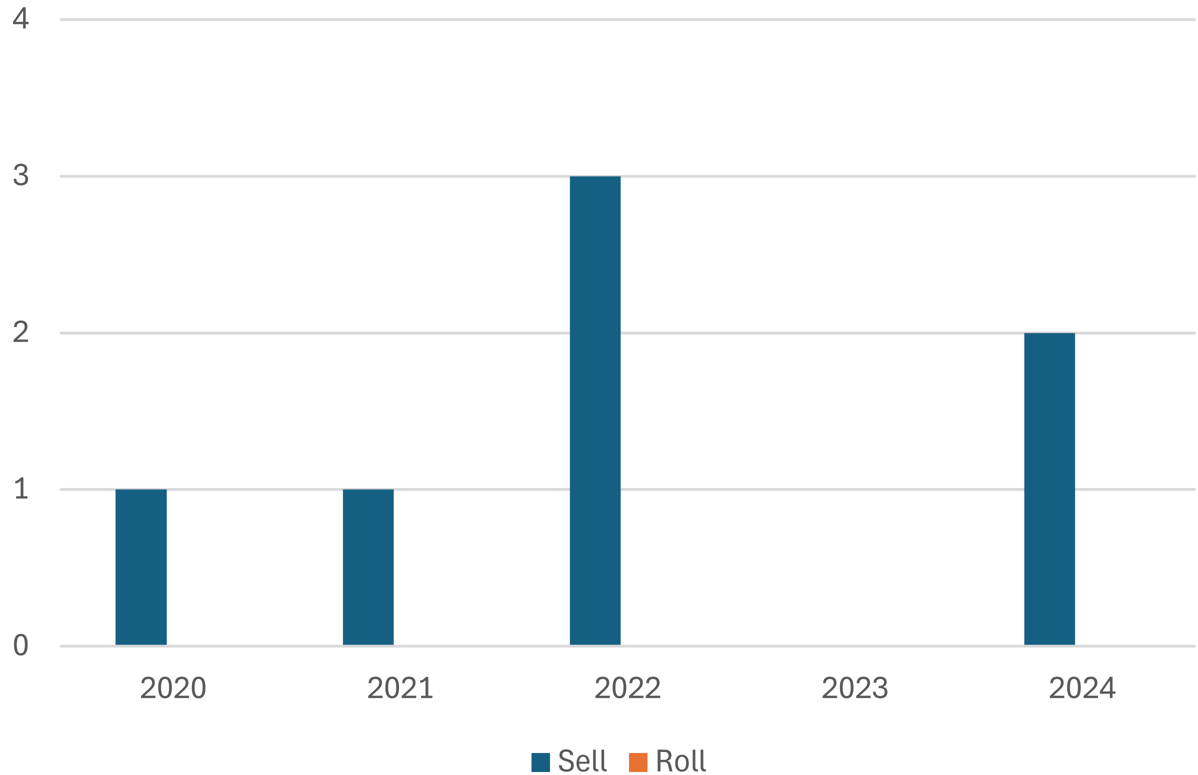
Governance Process
* Does the LP have the ability to execute on the offering

LPs have additional considerations for Roll v. Sell even after evaluating the quality of the GP-Led secondaries offering

SCERS' Experience with GP-Led Secondaries

SCERS has thus far evaluated 7 GP-Led secondaries offerings of its PE funds

- SCERS elected to take liquidity (sell) in each case
  - Broad industry experience has similarly seen LPs overwhelmingly taking liquidity thus far



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SCERS Current Process

Fund Term Extensions

- Handled by Staff, General Counsel, and when needed, outside counsel
- Turnaround time is typically 30 days

"Traditional" Secondaries

- Process initiated by Staff and Consultant; requires Board approvals throughout process
- Involves various outside parties, including an advisor and outside counsel
  - Typically, a multi-month process, with delays impacting pricing
- Pricing can be highly variable, but often prices offered are at a discount to the reported valuation
- Handled under established delegated authority in the Master IPS with reporting to the Board on each step of the process

"GP-Led" Secondaries/CVs

- Typically, have 20 business days to complete
- As previously shown, Staff has reviewed several of these transactions and recommended taking liquidity; Staff has reported to the Board during each process
- If rolling into a new transaction, Staff and Consultants need to underwrite as if it is a new investment; with the portfolio in place, a transaction is based on business plans and expected exit timing
- Rolling into a new transaction (fund) would often result in a pro-rata allocation well below current commitment sizing; the ability to upsize to a full allocation is often limited
- Current IPS governance protocols do not address decision-making authority and timing of CVs

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Governance

Current implementation protocols focus mostly on primary investments – silent on mid- and later-life decisions

- Staff and Consultants have historically evaluated GP-Led secondaries/CVs under the delegation within the protocols
    - Staff provides reporting and transparency to the Board as part of the process

Mid- and later-life decisions may have short timelines in which to respond

- Most LPs have chosen liquidity when offered the option with CVs
- CVs by design require a re-underwriting
    - Essentially a new fund commitment, though not blind pool
    - Can have long expected terms (8+ years)
    - Limited ability to negotiate side letters, including requiring GPs to disclose certain information as required by law

All SCERS CV decisions to date have been to sell, based on sizing, future return expectations, and timelines

- Decisions to roll in the future would need to occur under delegation model due to short timelines

Staff plans on presenting revised implementation protocols within the IPS to include mid- and later-life decisions, based on comfort from the Board

- Transparency and reporting to the Board would remain a foundation of the process and protocols
- No change to primary commitment or secondary sale process

General Disclosures

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