Preferred equity – addressing the market gap

The secondaries market has witnessed significant growth since the global financial crisis. However, it is no longer the only way for investors to unlock liquidity.

Alternatives, such as preferred equity, have been welcomed by investors looking to access funding without selling their portfolio upside, according to Pierre-Antoine de Selancy, managing partner and co-founder of London-based 17Capital.

Investors continue to see the secondaries market as a useful way to reshape their private equity portfolios.

According to the AltAssets Activity & Pricing in the Private Equity Secondary Market survey released early last year, portfolio rebalancing was the main motive for sellers, with 56 per cent referring to it.

It also revealed that 27 per cent sold to reduce the number of GP relationships, and 22 per cent were motivated due to liquidity requirements.

While the secondaries market has long been a tool for investors to achieve early liquidity, 17Capital's preferred equity funding provides an alternative for investors.

In 2008, the firm introduced a unique strategy to a busy private equity market. Preferred equity is a source of capital for investors to optimise the management of their private equity portfolios.

Limited partners (LPs) invested in high-quality portfolios can generate liquidity to meet obligations such as debt repayments and capital calls, or reduce their private equity exposure.

This could be an LP looking to manage the strategy and asset allocation of its private equity portfolio, or a fund-of-funds manager accelerating distributions to meet upcoming capital calls.

"We worked with a fund-of-funds manager and a family office to accelerate liquidity so they could meet their obligations. With each transaction, a secondaries sale was initially considered. However, with significant upside remaining in the portfolios, 17Capital was preferable to a sale. Investors benefit from maintaining ownership of their portfolios and the upside," says de Selancy.

17Capital managing partners Augustin Duhamel (left) and Pierre-Antoine de Selancy

In recent years, GP-led deals have represented an increasing share of the secondaries market. "A number of funds raised in 2006-2008 are starting to approach the end of their lives", according to de Selancy.

17Capital offers GPs and their investors a competitive funding option.

"We have completed a large number of transactions with GPs. Our capital allows strongly-performing GPs to accelerate distributions to their investors. Investors can unlock liquidity while preserving the high upside remaining in the portfolios," says de Selancy.

17Capital has also worked with GPs that have healthy portfolios and want to increase investment capacity, or GP teams looking to raise capital to fund their GP commitments.

"GPs like to work with us as we offer more flexible funding than bank debt. We don't have repayment dates or covenant guarantees, and investors keep control and ownership of their private equity portfolios," says de Selancy.

The secondaries market is still growing, albeit at a slower pace than in recent years. In August, the Setter Capital Volume report found the booming global secondaries market stuttered in the first half of 2015, with completed transactions dropping more than five per cent year on year.

However, despite that overall fall, private equity secondaries grew 1.9 per cent in the same period, reaching a total of $16.2bn.

Growth in the secondaries market is a natural consequence of a booming primary market.

"Last year, there were record distributions: over $500bn was sent back to investors. We will probably see a similar amount returned in 2015. Investors therefore have plenty to invest. It's a good time to be raising a fund," says de Selancy.

In December 2014, 17Capital closed its third fund in six years at the €500m hard cap. The vehicle was more than twice the size of its predecessor and 95 per cent of its investors from previous funds participated.