Preqin Research Report
Survey of Family Offices Investing in Private Equity

March 2010

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Family offices are typically viewed as being somewhat of an enigma. They are, by nature, a reclusive and private set of investors, which can result in fund managers failing to understand or fully appreciate their specific investment needs. Family offices represent a key – at times underappreciated – source of capital for private equity fund managers, however. This is particularly true for firms managing funds at the smaller end of the scale, for whom the building and maintenance of family office relationships can be crucial, but it has also become the case for all private equity firms as the difficult fundraising climate persists.

Preqin recently contacted 34 of the family offices, multi-family offices and wealth managers on our Investor Intelligence database in order to gain a better understanding of family offices as investors in private equity. We specifically looked to shed light on the private equity plans of family offices for the next year, their needs as an investor type, and their perceptions and requirements of fund managers at the start of what many anticipate will be a difficult 12 months of fundraising.

Survey Participants

As Fig. 1 shows, the experience of investing in private equity funds varied considerably across survey participants. While 28% of respondents have been active in the asset class for at least 20 years, almost one-third have entered since 2000. This suggests that, as with many institutional investor types, the experience and investment expertise of family offices varies significantly. It also lends weight to the comments of one respondent at a multi-family office based on the east coast of the US, who said that “there are differing levels of sophistication across family offices, so this is a challenge for GPs to overcome.”

Fig. 2 depicts the geographic breakdown of respondents to the survey. More than half of the participants are based in Europe, with a number located close to centres of finance and wealth such as London, Zurich and Geneva. Just under one-third of respondents are located in North America, with the remaining 15% based in other regions around the world.

Current Position, Expectations and Plans

In order to get an idea of the current position of family offices in relation to their overall private equity plans, we asked participants if they had a target allocation and, if so, whether they were above, below or at their target. Fig. 3 indicates that a number of family offices operate opportunistically when investing in the asset class, with 36% of respondents declaring that they have no specific target allocation to private equity. This is in contrast to many other institutional investors whose

Fig. 1:

Year of First Investment in Private Equity

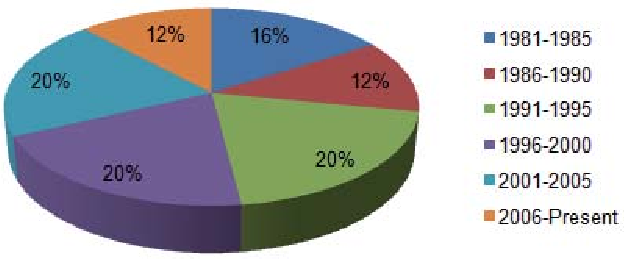
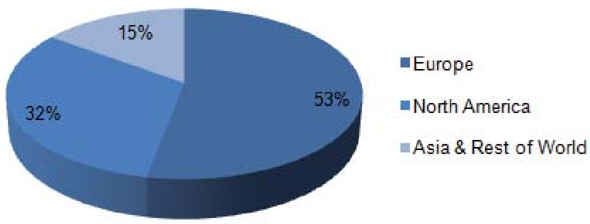


Fig. 2:

Location of Survey Participants



investments are often required to fit within strict boundaries. As one respondent pointed out, “Pension funds, insurance companies etc. have parameters and targets they have to stick to; family offices can be more flexible.”

Fig. 3 also shows that a considerable proportion (28%) of family offices are currently over their target allocation, with 36% of respondents revealing they are currently at or below their target to private equity. To an extent, this reinforces the notion that family offices are more flexible than other investor groups, which often do not enjoy the freedom to overallocate capital to a particular asset class as it becomes comparatively more appealing.

Fig. 4 shows that, for the most part, private equity has met the expectations of family office investors, with 65% declaring this to be the case. A further 19% of respondents believe that their expectations of the asset class have been exceeded. While some participants noted the difficult conditions faced by private equity in the last year, Fig. 4 indicates that family offices are committed to the asset class in the long term, with one East Asian investor commenting, “[Whether expectations have been met] depends on the vintage, with some good and some bad. Currently it’s not so great but we’re still satisfied overall.”

With many fund managers expecting the difficult fundraising climate of the past 18 months to continue throughout 2010, the search for new sources of capital is likely to intensify. Private equity firms, both large and small, have found it necessary to look beyond long-established relationships for investors with capital to commit and family

Fig. 3:

Current Level of Private Equity Allocations Compared to Target Allocations

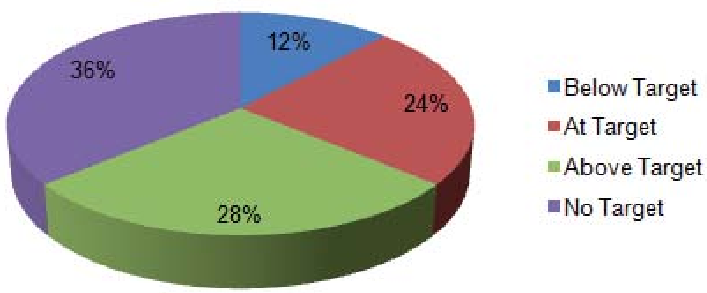
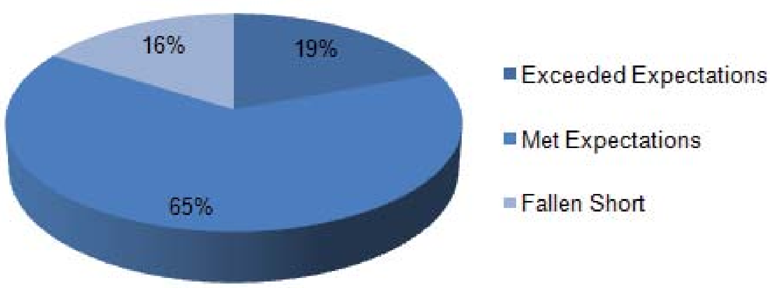


Fig. 4:

Family Offices’ Views of How Their Private Equity Investments Have Lived up to Expectations



offices are one investor group that are likely to receive greater attention.

But are family offices seeking new general partners? Fig. 5 suggests that, in the short term at least, family offices are generally open to forming new relationships with fund managers. Approximately 69% told us that, in the next 12 months, they would consider investing with managers they had not previously committed capital to.

This compares favourably to the plans of private equity investors in general. A December 2009 survey of all LP types in Preqin's 2010 Global Private Equity Report found that, of those investing in the next 12 months, 41% would be looking to invest exclusively with managers they have previously invested with. Of those family offices seeking to invest in the next 12 months, however, this figure was less than 5%, indicating that family offices are more receptive to new GP relationships than other private equity investors.

Fig. 5 also reveals that 28% of family offices that responded to the survey do not intend to make new commitments to the asset class in the next year, which can be seen as a consequence of a similar proportion of investors being overweighted to private equity (see Fig. 3).

Fulfilment of Needs

In contrast to other investors, Fig. 6 indicates that more family offices are satisfied than dissatisfied with the alignment of GP and LP interests, with 56% agreeing that there is alignment and 44% disagreeing. The December survey of all investor types, however, shows that 57% of private equity investors do not feel that GP and LP interests are properly aligned.

It should be noted that a number of family offices commented that the alignment of interests varies from manager to manager. One group based in the United Arab Emirates, for example, agreed that interests are aligned, but recognised that the degree of alignment is dependent on individual GPs. Another family office based in the Middle East, agreed that there is variation, with some GPs more conducive to LP interests than others, but did not believe that there was alignment within the industry as a whole.

Several other family offices noted that there has been an improvement in this area of GP-LP relationships. According to an Illinois-based family office, "the alignment is much better than it used to be because GPs have realised they need to meet LP interests," while another US group, located on the west coast, believes that recent improvements, particularly to fees charged, have occurred "because big pension funds and

Fig. 5:

Proportion of Family Offices Considering Establishing New Relationships with GPs in the Next Year

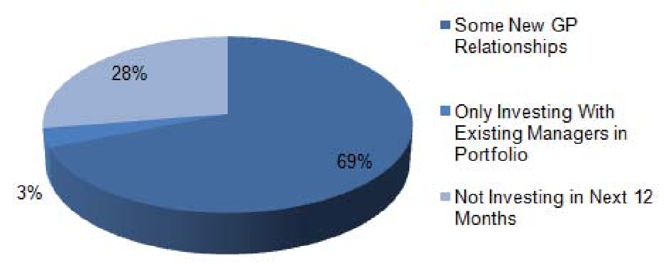
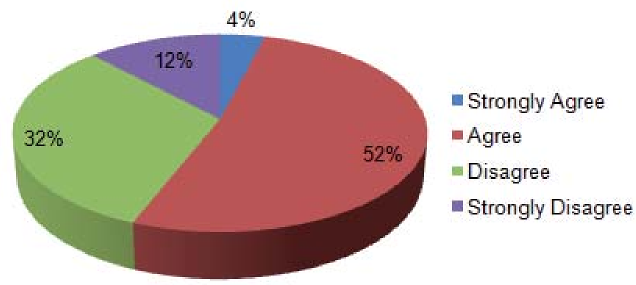


Fig. 6:

Extent to Which Family Offices Agree That GP and LP Interests are Properly Aligned



other investors have been pushing for these changes. Family offices aren't big enough and don't have the capacity to push for these changes." As Fig. 7 indicates, however, management fees remain a point of contention for family offices, with 59% of respondents citing this as an area in which improvements can still be made.

Upon asking participants which areas they believed could be addressed to more effectively align interests between fund managers and family offices as limited partners, over one-quarter referred to each of three areas: deal-related fees, carried interest, and the size of commitments made by GPs. A New York-based multi-family office asserted, "The major improvement would be to remove deal fees," while one Canadian family office declared that it would prefer all managers to calculate carry on the whole fund, rather than on a deal-by-deal basis. A European family office that believes managers tend not to commit as much as they should to their own funds, further commented, "GPs that offer more value creation capabilities typically commit more to their own funds, which is good from our point of view."

Approximately 45% of respondents referred to other elements of the alignment of interests. Some of the responses falling into the category of 'Other' include:

- "Fewer professionals should be included in key man clauses. (There should also be greater transparency of other investors in the fund)."
- "GPs using non-recourse loans from banks for their commitment is not right – cash is king".
- "Clearer explanations and transparency of fees are needed."
- "[There should be] more evaluation on the performance of the fund every quarter."
- "GPs should be less greedy and stop charging expenses!"

Fig. 7:

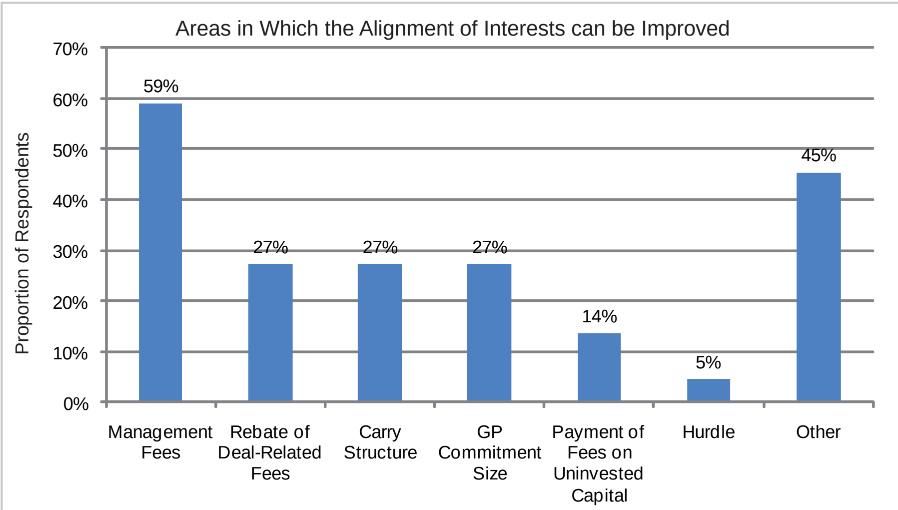
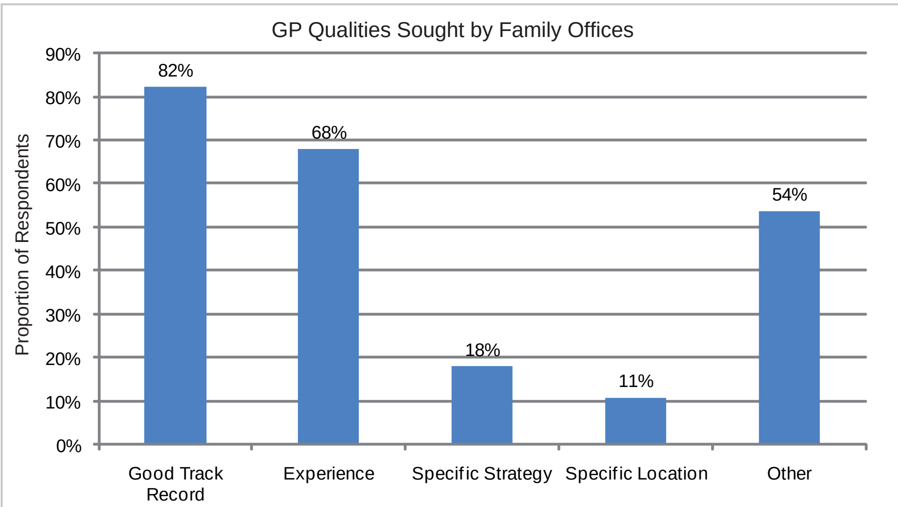


Fig. 8:



GP Qualities Sought

We asked survey participants what it is that they look for in private equity fund managers. As Fig. 8 shows, the majority of family offices asked indicated a greater interest in the history of private equity firms than the actual strategies employed by those firms or their location. Approximately 82% told us that they look for managers to have a good record in the private equity market, while 69% said that they value the amount of experience firms have in the asset class.

As well as indicating that family offices might not be receptive to first-time and emerging managers, this also underlines the need for family offices to have access to information about the history and past performance of management teams. A Chicago-based family office explained that it seeks GPs that are transparent and can communicate effectively so that, as an investor, it can enjoy a high level of comfort in the relationship.

Of the 54% of respondents falling into the 'Other' category in Fig. 8, one-third referred to the need for GPs to have more than just financial skills. A multi-family office located in the New England region of the US explained that it typically targets small- to mid-size private equity fund investments because "you are able to see the transformational value that you can't necessarily see with larger investments." Several other family offices echoed this sentiment and commented that the ability to add value is an important trait that they look for in GPs. A family office based in Germany told us that it believed a lot of private equity houses "are too finance-oriented" and for GPs to secure commitments they should have "operational know-how", while a New York-based group said that it avoided firms that rely too heavily on "financially engineered transactions to generate returns."

Further comments about what family offices look for in a GP include:

- "We usually go for smaller firms and newer firms, although we like to see a track record so it's about achieving a balance"
- "Stability of the team."
- "They must have the ability to replicate what they would have done in the past…mostly look for things performance related."
- "Quality of deal flow."
- "GPs should have low fluctuation/high stability of their team."
- "Different, unique, stand-out investment strategy."

Needs of Family Offices as Private Equity Investors

The reclusive nature and core purpose – private wealth protection – of many family offices means that they present challenges for private equity firms that are not necessarily faced with other, more public, investors. For fund managers looking to secure commitments from family offices then, an understanding of the investor group is vital.

We asked survey participants what they believe the unique needs of family offices as private equity investors to be, and to highlight the differences between family offices and other investors in the asset class. More than one-quarter (27%) of respondents referred to the need for family offices to have a close relationship and good communication with fund managers. One family office located in Saudi Arabia explained that improved communication between GPs and LPs is more of a key issue for family offices than other investors because "the assets are more personal and more information is needed to see if the investments have lived up to expectations." Other participants spoke of family offices requiring "a more personalised service" than most investors while one North Carolina-based respondent said that family offices need more "hand-holding."

The greater degree of flexibility was also highlighted by a number of respondents as something that differentiates family offices from other private equity investors. One German family office pointed out that they avoid considerable external barriers as they face "no constraints by regulators", while a Swiss group was one of several participants to allude to the lack of internal parameters and targets: "family offices can enter new investments faster as they do not need the approval of a board of trustees."

Several survey participants, including a Singapore-based multi-family office, iterated a belief that family offices have a longer-term perspective than some investor types, which "aligns well with private equity." Reasons for this include the capital preservation aim of family offices and their lack of a need for current income, with one suggesting that the long-term mindset means that private equity is a more important asset class for family offices than other investor groups.

It should be noted that almost one-fifth (19%) of respondents did not perceive family offices to have unique needs. An Austrian family office, for example, doubted that there was much difference across private equity investors, commenting that "we're all investing in the same asset class and we're all looking to outperform public markets." This serves to emphasise that, as with other investor types, there is a degree of variation across family offices.

Looking Forwards

With uncertainty surrounding investor appetite in the short term, the managers of private equity funds of all sizes are likely to need to broaden their scope and establish new relationships in order to secure commitments. Family offices, as an investor group with a long-term outlook and, in many cases, capital to invest, may consequently see increased competition for their private equity allocations. This suggests that GPs will need to work hard to understand the various motivations and plans of individual family offices in order to secure commitments.

If you have any comments on this report, please contact: info@preqin.com

Preqin
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