



ILPA Insights

LP Perspectives on the Impact of COVID-19

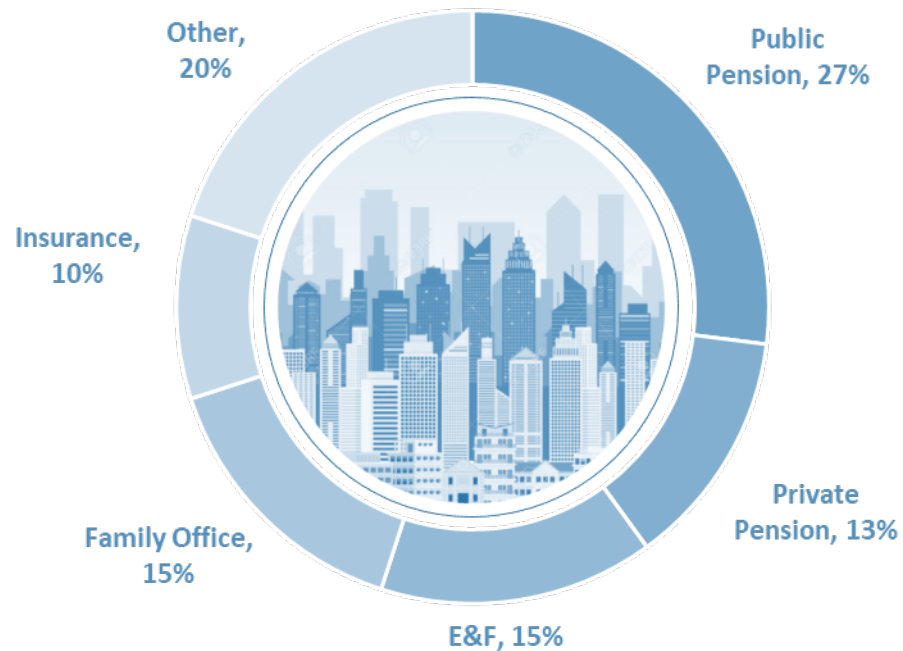
April 8, 2020

COVID-19 Impact on Private Equity

Source of ILPA Insights

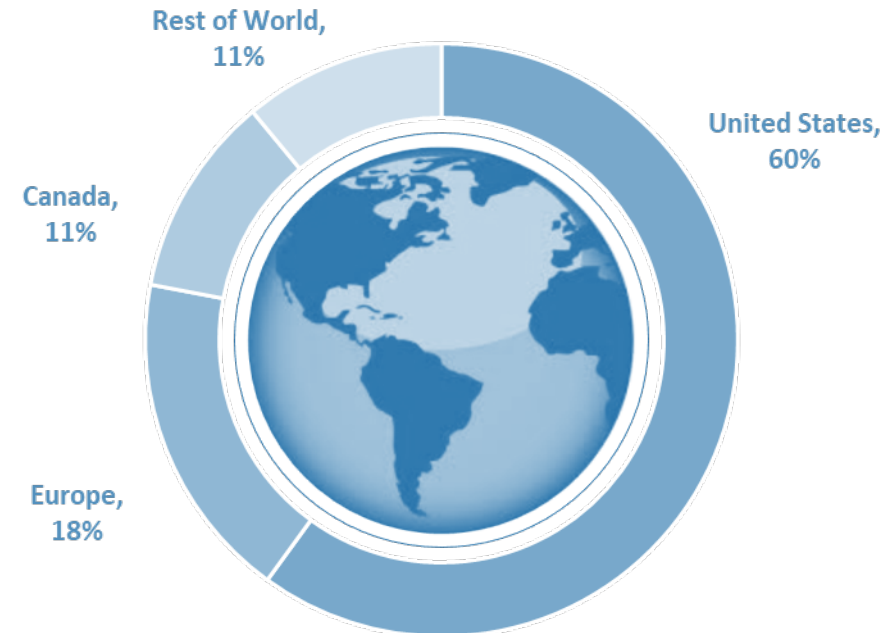
Member Type

> 570 LP Organizations



Member Location

> 50 Countries



COVID-19 Impact on Private Equity

Limited Partners Speak



On March 26, 2020, ILPA held an **interactive town hall with 583 participants from 192 organizations** to discuss the impact of COVID-19 on their programs, portfolios, and teams to date

On average, **~200 responses were received for each of the 5 polling questions** and over **200 additional questions were received**, indicating where members are addressing challenges and seeking insight

16 1-on-1 hour-long interviews with ILPA members since March 5 as part of ILPA's *LP Insights Program* have centered on COVID-19

ILPA spoke with **members in Asia** as they were transitioning to remote work and members in the US with **Asia-based investments** early in the crisis; subsequently, ILPA has interviewed a **regionally diverse** set of members

A **COVID-19 channel on ILPA Connect** - ILPA's members-only online discussion forum - gives LPs a place to raise concerns, ask questions, and share experiences as they navigate an uncertain market

Through a combination of polling questions and unprompted member posts, **~100 members** have shared their perspectives on COVID-19 and its impact on their programs, portfolios, and teams

Summary of Topics

What is Top of Mind for LPs

What ILPA Asked LPs

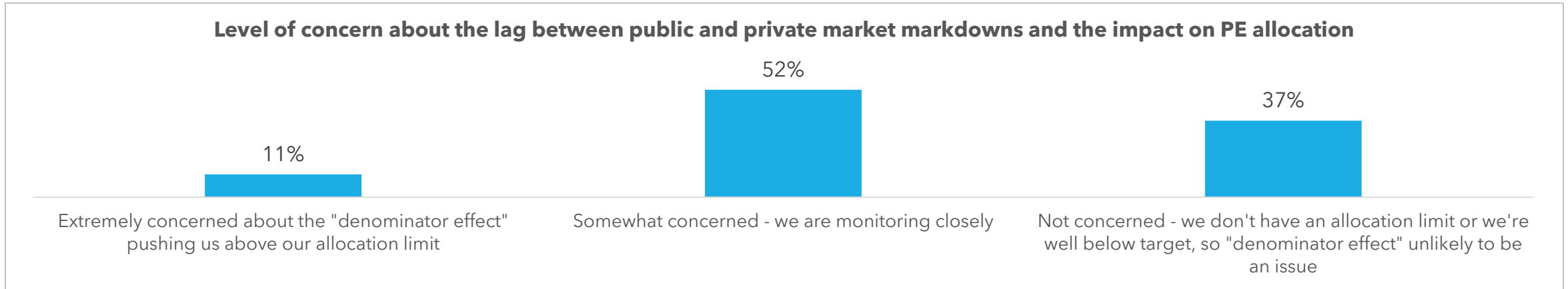
- LP Liquidity and the Denominator Effect
- Changed Pace of Capital Calls
- The Impact of Subscription Lines
- Outlook for Commitment Pacing
- GP Fundraising Activity
- Quality of GP Communications

What LPs are Asking ILPA

- Valuations
- Recycling Provisions
- Rescue Financing
- Legal Consideration in a New Market
- Transition to Remote Work

ILPA Asked LPs: LP Liquidity and the Denominator Effect

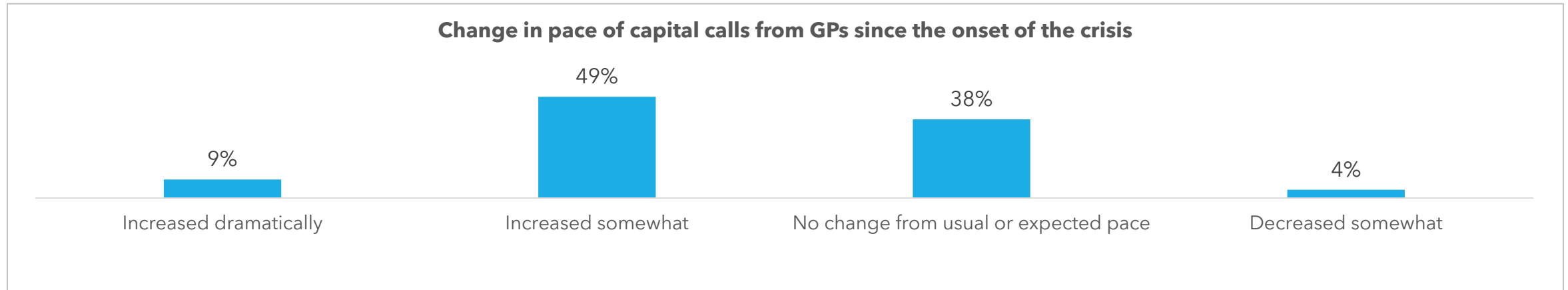
Level of Concern re: Liquidity and Allocations



- 63% of LPs are somewhat concerned (52%) or extremely concerned (11%) about exceeding their policy target/band to private equity: *"If 10 years ago this happened, it would have impacted us a little bit, but we had not met our allocation—we had room. We are more concerned today because we were at or slightly above our allocation before this occurred."*
- Institutions may liquidate public equities at a loss: *"It is hard to unwind current positions in PE. As public markets go down, we see a denominator effect. The last thing we want is to have a run on cash and have a large amount capital called to fund investments."*
- LPs are balancing strategies for their private portfolios with the needs of their public equities teams: *"We can't impact the ratio of public to private equity. We can improve overall equity allocation with an overlay program, but with a much higher PE ratio than we would normally have, and that is concerning to public equity folks selling down to fund liquidity needs."*

ILPA Asked LPs: Changed Pace of Capital Calls

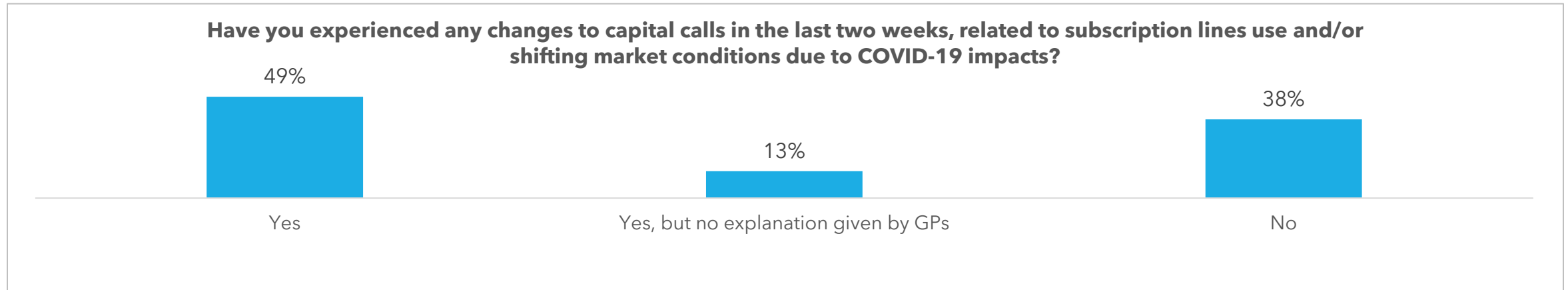
Over Half of LPs Report Capital Calls Have Increased



- GPs are engaging in anticipatory drawdowns to get headroom in the event of an LP liquidity crisis. However, LPs have poor visibility into what capital is being used for: *"Visibility is poor around subscription lines. I have heard of GPs calling capital with no obvious purpose—does that comply with the LPA?"*
- GPs are currently drawing down revolvers of cash to aid portfolio company liquidity: *"Most of the capital cushioning activity is taking place at the portfolio company level."*
- There are opportunities in this market to put capital to work and managers of certain strategies are calling capital: *"It really depends on the underlying funds' respective strategies. For opportunistic credit, special situations, distressed, and turnaround managers, we are seeing larger than normal capital calls; for all other strategies, less than normal."*

ILPA Asked LPs: Impact of Subscription Lines on Capital Calls

Some Capital Call Increase Attributed to Sub Lines



- GPs are bumping up against LPA limits on subscription lines and are being forced to drawdown: *"GPs will naturally be using calls to pay off earlier investments that are reaching LPA limits on how long they can be on the line."*
- However, GPs are taking varied approaches in how they handle subscription lines: *"Some GPs may be paying down credit facilities and calling money from LPs to make sure they have ability to borrow if need be. Other GPs are planning to max out the credit lines now while they still can."*

ILPA Asked LPs: Outlook for Commitment Pacing

LPs Slowing or More Selective with New Commitments

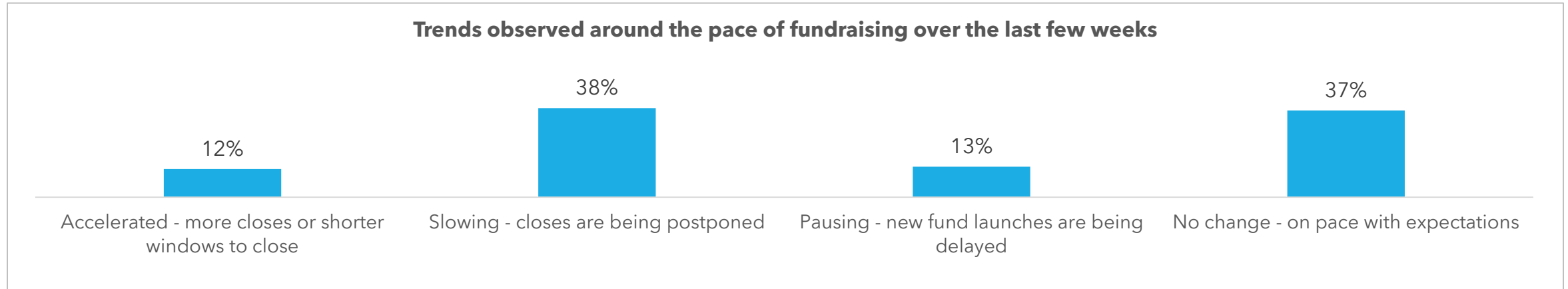
Expected impact on commitment pacing in 2020



- Some LPs believe the best plan is to stay the course: *"We will maintain our commitment levels. PE is a long-term asset class—it's all about timing."*
- Some LPs are open to changing strategies and want sufficient flexibility to take advantage of opportunistic vehicles: *"We do a lot of mapping for the year on re-ups ... we are looking at whether we should [make changes] to fund other more opportunistic distressed opportunities" ... "we will see a wave of these coming across our desks."*
- Valuations as of 3/31 will have a major impact on LP commitment pacing plans for 2020 and beyond, but LPs are concerned the reported numbers will be difficult to interpret: *"How much do we haircut NAVs? We have to look back at past dislocations"* and *"Using Q3 2019 NAVs in the upcoming Q1 2020 exposes how flawed the lagged method is."*

ILPA Asked LPs: GP Fundraising Activity

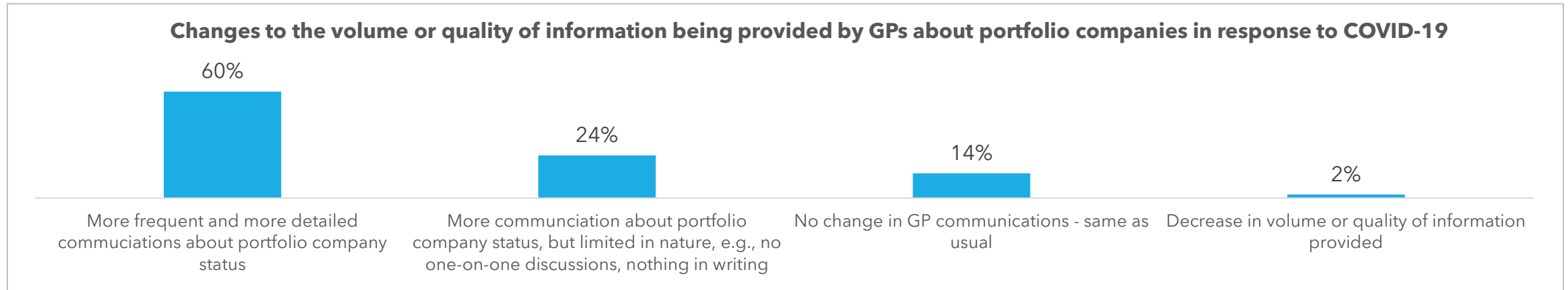
Final Closes Postponed and Fund Launches Delayed



- Some LPs expect a drop in fund sizes as managers cap their funds and close them early: *"First half of the year deal volume is going to go down and closings will be pushed."*
- Some LPs also expect fundraising timelines to be altered: *"Two things will happen: GPs will delay fundraising, and GPs that are fundraising will ask for extensions."*
- There is the potential for a widening gap between LP and GP expectations on fundraising: *"Managers are being bullish on fundraising, but it would be interesting to see if that was the LP view. If LPs have capital, are they committing on a normal basis?"*

ILPA Asked LPs: Quality of GP Communications

GPs Providing More Frequent and Detailed Updates



- LPs are being careful not to overload GPs with requests in order to let them focus on portfolio companies: *"We are surprised at the availability of our GPs. They have been responsive; they're looking to us for advice on what we need."*
- Many GPs are providing relevant information quickly: *"Most of my managers are using a stoplight approach at the portfolio company level to indicate which holdings are most at risk; from there they are letting us know how they are setting the companies up to make it through [the crisis]."*
- Other GPs are inundating LPs with information that lacks real insight: *"GPs have been providing updates, but every story is the same: 'The portfolio is impacted but it is too hard to measure, we are focused on liquidity, we do not have a view on the impact today.'"*

LPs Asked of ILPA: Valuations

How to Factor Declining Valuations into Outlook

LP Insights

- How will valuations affect deal flow: *"Given the significant drop in expected valuations, there's been a dramatic drop in [new] deal activity and the pipeline of expected deals. [Deals that were previously in the] pipeline are less attractive due to the potential to overpay."*
- What will the impact be on the secondaries market: *"Near term, there are likely to be fewer secondary deals - not too many who want to sell in this environment unless they have to."*
- How should LPs independently confirm / get comfortable with reported valuations from managers: *"We know there will be a lagging effect and we can't say what the impact will be; we're asking the same questions to our managers and back office to try to understand the impact on our program."*

Actions to Take

- Continue to ask GPs for updates on how they are managing in the current environment; expect that 3/31 marks will be less affected than 6/30 marks
- When interpreting marks, ask GPs the questions you need to get comfortable with the approach used and underlying assumptions

LPs Asked of ILPA: Recycling Provisions

What Does Responsible Recycling Look Like

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- LPs are willing to consider recycling provisions to support portfolio companies; however, some LPs think potential limits should be placed on such activity
 - *"We are seeing several of our GPs request LPA amendments to liberalize recycling provisions."*
 - *"There should be triggers based on how much committed capital has been drawn, so that GPs don't abuse recycling provisions."*
- LPs should also consider the impact of recycling clauses on the expected curve of distributions
- Experiences from the Global Financial Crisis are likely to impact LPs' judgement on the use of these provisions

Actions to Take

- Educate yourself: Review Limited Partnership Agreements to understand how individual fund recycling provisions work
- If a GP is looking to move on recycling provisions, ask them the questions you need to get comfortable the capital is being put to work in the most responsible way possible

LPs Asked of ILPA: Rescue Financing

How to Respond to Rescue Financing Requests

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- Few LPs have been approached to provide financing; LPs are considering how to respond in the event of such a request
- LPs have different opinions on the risk of rescue financing:
 - *"We're considering the merits of deploying capital at potentially better returns with the assets and the GPs we already know."*
 - *"We are tracking the potential rise of conflicts; tough times lead to spikes in alignment issues—rescue financing would be an indicator."*
 - *"Some of our GPs are talking to us about opportunities to provide rescue financing, e.g., in the form of convertible notes that would put us higher up the capital structure ... least attractive is where there is potential for covenant breaches and we need to provide an equity cure."*

Actions to Take

- To the extent possible, establish your organization's position on rescue financing before a GP approaches you so that requests can be evaluated against a consistent set of criteria
- Any rescue financing arrangement should have clear and mutually agreed legal terms

LPs Asked of ILPA: Other Legal Considerations

Where to Focus Attention re: LPA Terms

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- LPs are unclear what provisions they should be considering in the short-term to protect themselves: *"What terms should LPs pay extra attention to in LPAs for funds that are being closed in the next 60-90 days?"*
- Some LPs anticipate increased negotiating leverage coming through the cycle: *"The pendulum might swing in LPs' favor. We are preparing terms that are a priority for us."*

Actions to Take

- Fund governance, through proactive engagement by LPs, will be paramount in subverting potential alignment and legal issues in the current environment
- ILPA's Fund Terms survey results will be released in Q2; the report intends to establish a baseline against which current and future trends can be measured
- ILPA's Model LPA serves as a reference for optimally constructed and balanced terms

LPs Asked of ILPA: Transition to Remote Work

How to Manage Your Program and Teams, Remotely

LP Insights

- LPs are relying on technology to maintain daily activities: *"In today's day and age everyone needs to have a business continuity plan. We are able to connect to our systems remotely to continue to support our portfolio."*
- LPs are considering ways to leverage technology to sustain oversight and industry relationships: *"We are converting meetings to calls; where before we might have had an onsite, we are having a teleconference."*
- Some are beginning to think about the extent to which the crisis may change the future of work: *"Working from home is new. It has opened a new aspect of how individuals can work together. In terms of business building, it is difficult to start new relationships and initiate conversations virtually."*

Actions to Take

- ILPA will be hosting a Town Hall to share recommendations from LPs and to collect and share insights on the key questions that LPs have on:
 - How to transition their programs to a virtual process
 - How to stay connected to and supportive of team members



INSTITUTIONAL
LIMITED PARTNERS
ASSOCIATION

INSTITUTIONAL LIMITED PARTNERS ASSOCIATION

1800 M Street N.W., Suite 825-S
Washington, D.C., USA
20036

Phone: 416-941-9393

Web: www.ilpa.org

Email: info@ilpa.org

Twitter: [@ilpaorg](https://twitter.com/ilpaorg)