Private equity

Private equity stakes unloaded at a discount as investors seek exits

Pensions and endowments turn to secondary market to cut exposure and raise needed cash

Big investors sold 99% of their private equity holdings at or below their net asset value on the secondary market last year © FT montage/Getty Images

Sun Yu in New York 10 HOURS AGO

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US institutional investors are selling more of their private equity holdings at a discount as they cut exposure to the illiquid asset class.

Led by pension funds and endowments, big investors sold 99 per cent of their private equity holdings at or below their net asset value on the secondary market last year, according to Jefferies, the most since the investment bank began tracking the figure in 2017. The figures were 95 per cent in 2022 and 73 per cent in 2021.

Investors have been forced to increase their use of the secondary market as stock listings and mergers and acquisitions — traditional avenues for private equity investors to exit businesses — have recently been subdued.

Many pension plans are also obliged to make payouts to their beneficiaries, forcing them to resort to the secondary market to raise cash more quickly.

"Public pension funds have for many years poured money into private equity on the premise that it was high return and low risk while illiquidity was deemed not to be an issue," said Richard Ennis, co-founder of EnnisKnupp, a consultancy that works with pension plans. "They are now discovering that PE is no magic bullet and liquidity does matter for investors with a sizeable payout requirement."

Public pension funds in North America allocated an average of 11 per cent of their assets to private equity last year, up from 8 per cent three years ago, according to Preqin, a financial data provider.

"By and large, many institutional investors are overallocated to private equity when benchmarked by their target portfolio allocation strategy," said Christine Patrinos, a Boston-based partner at Monument Group, a private equity placement agency.

Secondary sales have been booming as investors seek to reduce their exposure. According to Jefferies, the global private equity secondary market reported $112bn in transactions last year, the second highest since the bank's records began in 2017.

Higher interest rates have undermined the value of private equity portfolios as investors flock to fixed-income assets with improved yields, contributing to the secondary market discounts.

"For a lot of LPs that are overallocated to private equity or having liquidity issues, getting cash at hand through secondary sales is a sure thing," said an executive at a public fund, referring to institutional investors known as limited partners.

One example is the $137bn New York State Teachers' Retirement System, which sold 34 private equity holdings with $3.5bn in total commitments on the secondary market at the end of last year.

The pension plan said the transaction served as a "rebalance measure" to cut its private equity allocations to its 9 per cent target, from 12 per cent last September.

The increasing prevalence of discounts on secondary markets stands in contrast to previous years when low interest rates boosted the values of private equity-owned companies, giving sellers more bargaining power.

"You have a buyer community saying, 'Wait a minute, interest rates are much higher. I am not willing to still pay the same multiple,'" said Todd Miller, global co-head of private capital advisory at Jefferies, referring to a company's price in relation to its earnings.

As the Federal Reserve has stopped raising interest rates and suggested the possibility of lowering them, the size of discounts on the private equity secondary market has shrunk in recent months.

“There are enough things in LPs’ portfolios that they can price at a smaller discount today and that makes them feel better,” Miller said. “There are actually a lot of secondary transactions getting done.”

Many sellers had little choice but to accept lower prices as they were keen to get rid of illiquid assets. An executive at a second public fund said he sold private equity portfolios on the secondary market last year at a “bigger than expected” discount after the plan’s board became “uncomfortable” with its cash flow.

“We could have charged more had we not been in such a rush,” he said.

Additional reporting by Antoine Gara in New York

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