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Family Offices Show Strong Appetite for Private Funds

By Tom Stabile

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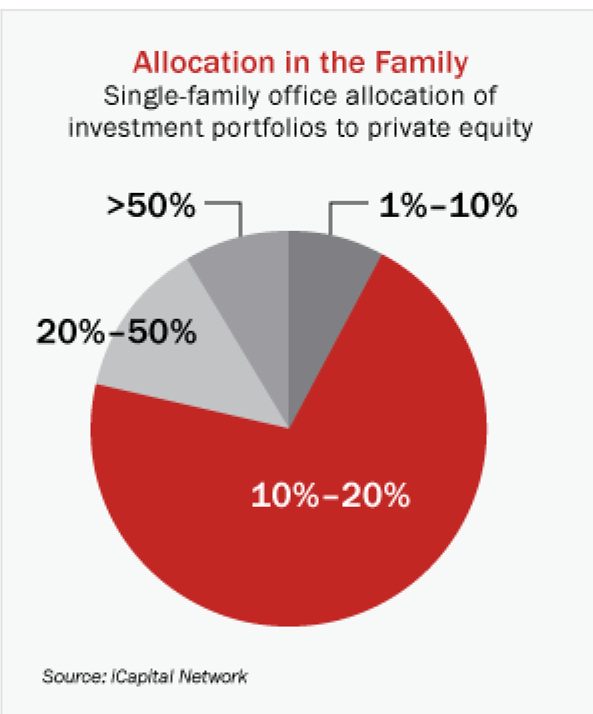
Single-family offices have developed a healthy tilt toward private equity – much of that into funds – and more than half of them plan to increase their allocations next year, according to a new survey from **iCapital Network**. But market watchers also say a subset of single-family offices appears more eager than ever to tap into private equity through their own direct deals, and that the shift could come at the expense of commingled funds.

More than 90% of single-family offices in the iCapital survey that invest in private equity reported allocating 10% or more of their investment portfolios into funds or direct investments. Most of them – nearly 71% – put 10% to 20% into private equity, but nearly 13% allocated a larger 20% to 50% slice of their portfolios, and even 8.4% set aside more than half of the portfolio to such investments.

“The magnitude of the allocation is what we found most surprising,” says Lawrence Calcano, managing partner of iCapital, an online platform that delivers private equity funds to wealth management firms and high-net-worth investors.

The survey, which polled 162 single-family offices with average investable assets of $406.6 million, found that of the 62% of respondents allocating to private equity, 93.9% use funds and 40.1% invest directly. And it found pockets of potential growth, with 56.4% of respondents that have existing private equity portfolios planning to expand their allocations, and more than a quarter of those not yet invested saying they are primed to put capital in funds or direct deals in the next two years.



Those results match another recent survey, which found a 20% average allocation by single-family offices to private equity and more than a third planning to boost that share in 2016, says Marco Wulff, partner at Switzerland-based Montana Capital Partners, a secondaries investing specialist, which did the survey with Private Equity International. Most of the activity in the survey described investment in funds.

“Family offices are moving in this direction of higher allocations,” Wulff says.

A recent report on single-family offices from Campden Wealth and UBS also found an average allocation of 22% to private equity – the largest share of the typical firm’s portfolio.

It is hard to establish more detailed patterns in the single-family office market, with every possible mixture of staffing, resources, sophistication, appetite for external providers, and investment philosophy, Calcano says. But at a broad level, these investors act more like foundations and endowments than a typical high-net-worth investor using a financial advisor.

“The biggest difference is their greater comfort around illiquidity,” he says.

There also is a distinct subset of experienced players among single-family offices that are shifting away over time from accessing private equity via commingled funds, says Katharine Hill Ritchie, CEO of PEX Global, a consultant to single-family offices.

“Many of them want to get into deals directly right now,” she says. “Some of them are seeing all of these venture-backed companies coming out with high valuations and saying, ‘I want to get in that game.’”

That hunger for direct deals has been building since the 2008 financial crisis, when some single-family offices began to sour on funds because of the comparative lack of transparency and higher fees, says Robert Casey, senior managing director for research at the Family Wealth Alliance, a network of family office firms. Many single-family offices grew in the first place from a desire to have more control over investments and tap into the family’s intellectual capital, he says.

“Going out and buying and running a firm may be daunting to some, but that’s how many of these families made their money in the first place,” he adds. “Getting involved in running another business can be a vehicle to keep the family’s entrepreneurial spirit going and develop talent in the family.”

It may take a full investment cycle for many of these single-family offices to determine how those direct deals turned out, Ritchie says. “And the families don’t have to tell you either way how they performed,” she adds.

And there are times when this subset still will work with fund managers, Ritchie says. Some have become very interested in plucking secondary stakes in existing funds from other limited partners, while others are looking at more customized structures, she says.

“If I just talk about a fund, they’re not as interested, but maybe listen more if we bring in co-investments or a fund-of-one structure,” she says.

Single-family offices appear very willing to explore the co-investment structure where they are investing in deals alongside a fund, says Christian Diller, partner and co-founder at Montana Capital.

“Some of the larger family offices are looking more and more for co-investments,” he says.

While there is generally a preference to co-invest with managers they already know or have invested with in the past, some smaller single-family offices are willing to work with newer firms as well, Montana’s Wulff says.

That co-investing interest has a direct angle as well, with many single-family firms partnering with “fundless” sponsors or with peers in club-style deals, says Ritchie. But managers that offer co-investing still can position themselves to build up trust with single-family offices and make it more likely they will invest in funds in the future, she adds. “It’s a long game,” she says.

Among single-family offices that already invest in funds, buyout strategies and real estate are staples, Calcano says. Several other areas seem to be in favor today, including credit strategies, energy themes, and distressed investing. And venture capital’s run of high-profile valuations “has caught people’s attention,” he says.

There also is a slant toward funds that pursue middle-market opportunities, Diller says.

“They see the large end of the market as very competitive, and they want to look at deals where it’s less crowded and there is more chance for operational value creation,” he says. “Anything a little bit out of the mainstream is of interest. They do not want to be last to the big investors’ party.”