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Family offices and private capital

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Introduction

Family offices (private wealth firms that serve specific high-net-worth individuals and their families) vary in shape, size and investment outlook. But in a tighter fundraising market, where GPs are seeking to diversify their investor base, family offices are becoming a more important LP constituency.

This note explores the trend in family offices increasing allocations to private capital funds, what is driving this trend and how GPs can best position themselves to benefit from the increased activity of family offices.

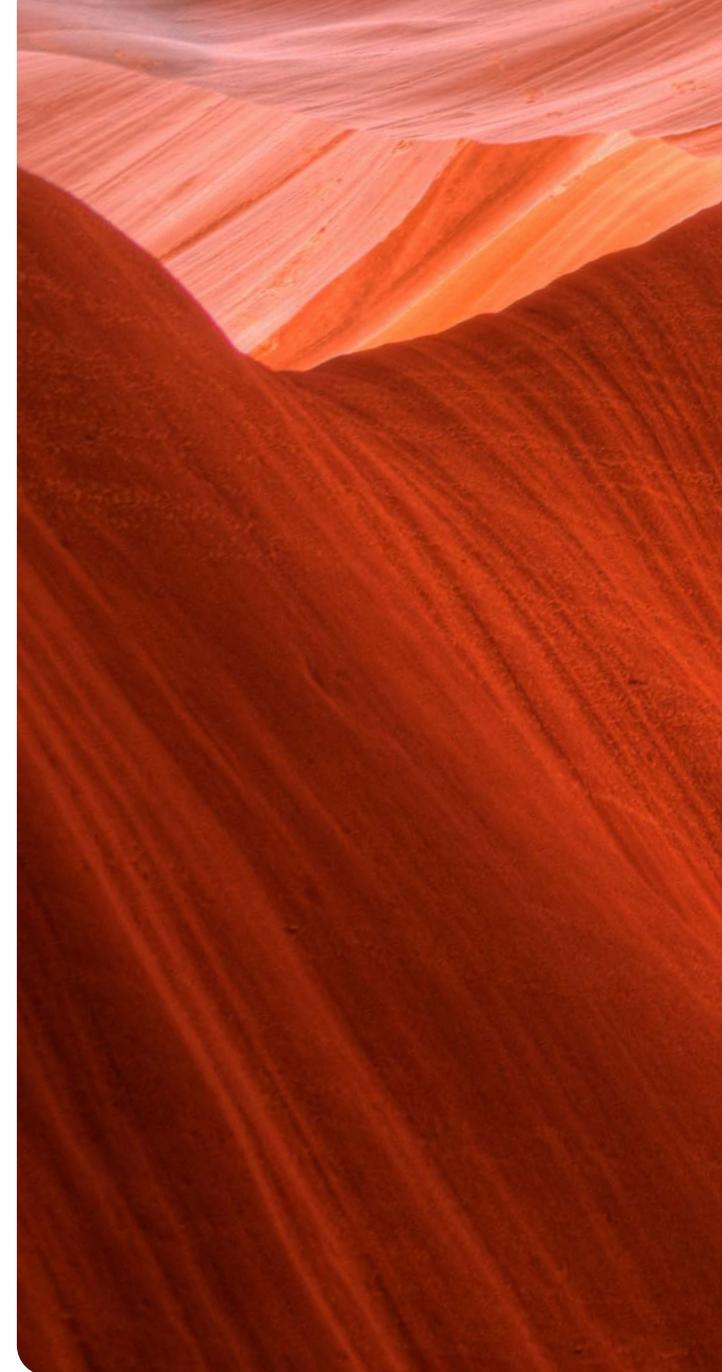
“When you know one family office you know... one family office”

- Whilst family offices are hugely varied, there are a few things that GPs should always bear in mind if they want to raise capital from this type of investor. Family offices are by their nature long term allocators of capital. They are focussed on preserving and building wealth for the family and future generations. Their time horizon may therefore be significantly more elastic than some other institutional investors and without their own funding timing constraints (which may make them a better partner for some strategies).
- Family offices are by their nature private and confidential; but family offices do and can collaborate, work together, and share ideas and experiences of private fund managers. Word of mouth recommendations (or otherwise) can be very powerful.
- It is critical for the GP to understand the nature of the family office, and how the family or original principal is still involved in decision making. For example, some offices are led by particular family members that continue to work within the original business, as well as sitting on the investment committee for the family office. These decision makers can often have a disproportionate impact on manager selection.
- GPs should check whether the family office still owns an operating business or has specific sector interests. This is important for a number of reasons.
 - If a family office still runs an operating business then it is unlikely to be interested in investment opportunities in the same sector or adjacent sectors: their investment exposure to that area is well-served already. For example, a family office whose wealth is derived from pharmaceuticals may not be that interested in life-science investment opportunities.
 - However if the family office has now sold out of the company/sector, then the principals/family office may have specific sector expertise and may therefore want to use it to their advantage by investing in a fund that invests in that area. Historic sources of wealth may also encourage a particular ESG outlook. We have come across family offices which have originally built their wealth in (for example) carbon-intensive industries (such as heavy manufacturing or long-distance haulage) and which therefore have very strict ESG criteria on decarbonisation when selecting managers. These criteria are non-negotiable for the family office.

Challenges for family offices and GPs in coming together

Whilst it is a benign environment for investors at the moment, there are still a number of challenges for family offices looking to ramp up (or start) their allocation to private capital and for GPs seeking to find and win such investors.

- Family offices can often be light on internal resource in comparison to larger, more institutional investors. A lot of screening of potential GPs has to take place so that focus can be devoted to a smaller subset. Family offices are more likely to look to the fund manager and ask them to share bespoke due diligence materials to assist with decision making.
- Transparency and access is often critical for family offices. They will need time with key decision makers at the GP in order to get comfortable with how the family wealth is being invested; this is a very personal decision. Managers that are fully transparent and can shine a light on their processes are more likely to be successful. Managers who obfuscate or appear unwilling to share information are likely to drop out of screening processes at an early stage.
- Private capital investments are operationally complex for family offices particularly if there are multiple investment vehicles to choose from and the investment documentation is comparatively lengthy. Here it is helpful if the GP and their advisors can assist with interpretation of partnership agreements and completion of subscription agreements.
- It can also be difficult to keep on top of liquidity management with drawdown requests which can be issued at any time during the life of the fund – investors need to always have dry powder available to manage these capital calls. There are private funds which can offer solutions to this challenge by providing financing products which offset the unpredictability of the drawdown approach.
- Family offices care about the same terms and legal provisions as other institutional investors. But reputation and privacy are of paramount importance to family offices. Anything around a GP which suggests problems with either issue, may well be terminal for the relationship. Family offices are more likely than other institutional investors, for example, to look carefully at “cause” triggers around poor behaviour which does not necessarily trigger an economic loss to the fund, and diligence cyber security policies for both the GP and its service providers, and information sharing with third parties.



What are the benefits for private funds of having family offices in their LP base?

- Family offices in the LP base can provide a competitive advantage to a private fund manager. Family offices generally aren't tied to the same complex processes as more institutional investors and so they can move quickly if an interesting investment opportunity arises: they are particularly well suited to act as co-investment partners alongside flagship funds. Additionally, they can provide invaluable input on fund advisory committees if particular sector knowledge is required on a portfolio issue, which matches their expertise.
- One family office investment manager has said that to close a family office into your fund you have to be “lucky with the timing and long term with the relationship”. But family offices do view these arrangements as genuine partnerships and long term – GPs who look after their family office investors can expect long-standing support and engagement.
- As noted above, family offices do confer and talk with one another surprisingly frequently. If a GP has the goodwill of one family office, it may find that other investing groups come forward to seek it out.

Conclusion

The increasing size and sophistication of family offices is an encouraging development in the market at a time when private capital GPs are working very hard to unlock new sources of long term, supportive capital.

Family offices by their nature are in many ways an obvious partner to private capital GPs, but managers must do their homework and apply old fashioned principles of “understanding your client” to get the relationship right. Family offices are looking for a long term relationship: GPs that can show they safeguard their reputation and take confidentiality very seriously are well placed to secure capital from these groups.

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