Co-investments May Offer a Powerful Way to Drive Down Fees in Private Market Investing

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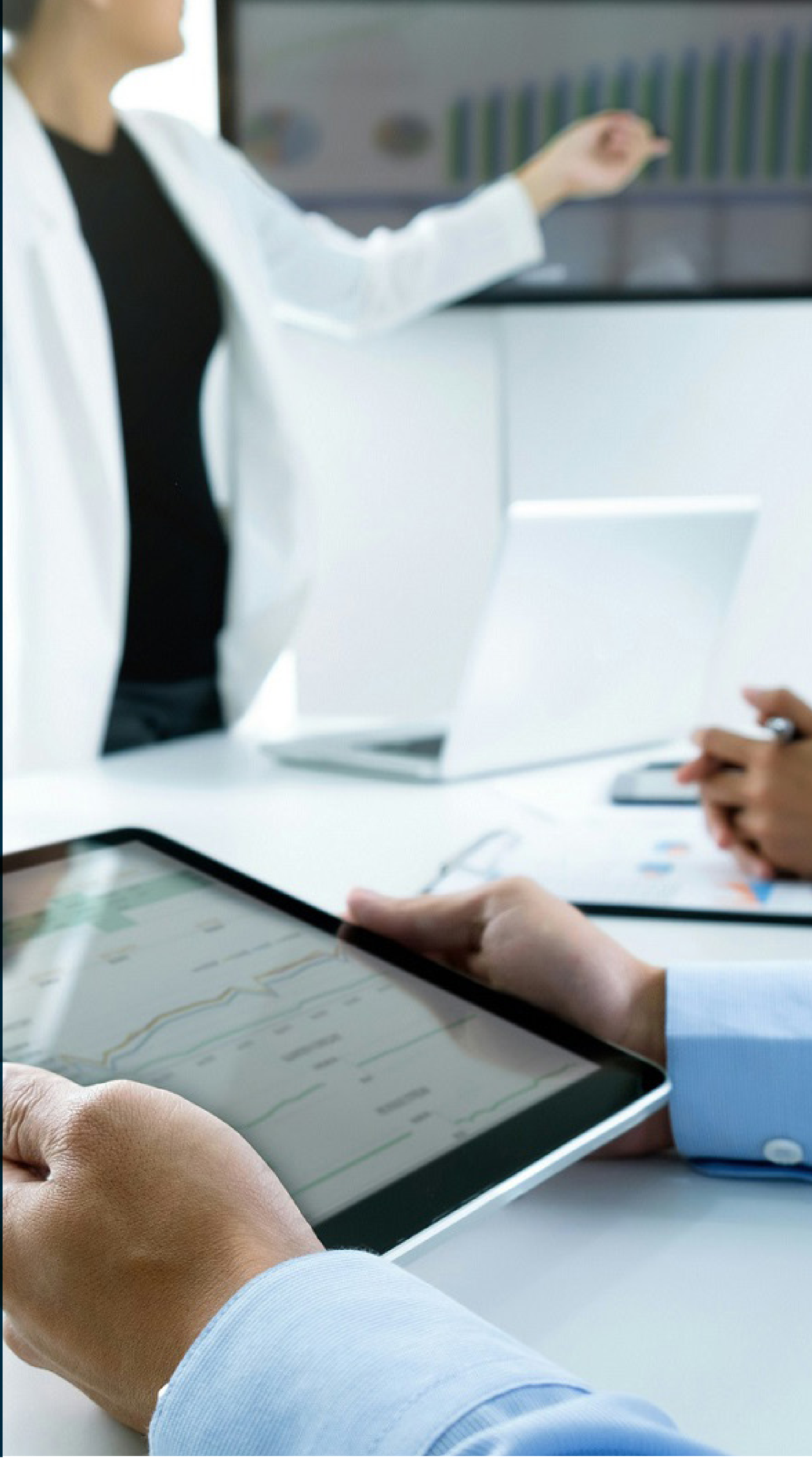
Key Takeaways

- Private wealth access to private market investments has improved significantly thanks to the rise in investor-friendly vehicles — in particular, evergreen funds.
- To optimize net performance outcomes, advisors and their clients must understand the fees tied to evergreen fund structure, including the stated and hidden fees related to the underlying investments within the evergreen structure.
- A large or dedicated allocation to co-investments in the underlying structure is a highly effective approach within an evergreen fund to help mitigate or even eliminate altogether the management fee and carried interest fee, resulting in investors keeping more the expected gross investment returns.
- By potentially reducing the fees typically associated with private market investing, evergreen funds that focus on direct co-investments can offer a more favorable experience for clients — especially those new to private markets.



Greater and Better Access to Private Markets Than Ever Before

For several decades, investing in private markets (mainly private equity, private credit, private infrastructure/real assets, and private real estate) has largely been the domain of global institutional investors, such as public pensions, sovereign wealth funds, endowments, foundations, and corporate pensions.

Many private wealth investors and even some ultra high-net-worth individuals have had little to no access to these private asset classes, thereby missing out on the potential to improve portfolio performance, lower risk, and introduce additional diversification benefits. The lack of access was mainly due to high investment minimums, extensive due diligence requirements, lack of liquidity, and complex documentation.

However, private wealth access to private market investing has improved significantly in recent years. This shift stems generally not from changes in private markets themselves, but from the rise in investor-friendly vehicles — in particular, evergreen funds.

Unlike traditional private equity drawdown funds with a fixed lifespan (typically 10+ years), evergreen funds are investment vehicles that allow investors to invest in private companies with no fixed end or termination date, offering ongoing capital access for general partners and the potential for client redemption opportunities. These evergreen funds continuously accept new investors and capital, allowing for ongoing investment opportunities. Investors can typically redeem their capital at regular intervals, subject to the fund's liquidity and terms. Evergreen funds typically invest in a diversified portfolio of private companies, offering investors exposure to a range of opportunities.

In essence, these investment structures often offer lower minimums, a measure of liquidity, simpler tax reporting, and streamlined documentation. They include interval funds, tender offer funds, business development companies (BDCs), and non-traded REITs.

To optimize portfolio outcomes, advisors and their clients should understand the fees tied to each evergreen fund structure, including the stated and hidden fees related to the underlying investments within the evergreen structure. This knowledge is essential to determine whether they're gaining the right kind of investment exposure while potentially maximizing net returns. With many investors new to private markets, it's especially important that their early experiences are positive – anchored in strong net performance.

Comparing Tender Offer Funds and Interval Funds

Generally, tender offer and interval fund structures are similar and may invest in the same types of underlying private market assets.

Unlike open-ended mutual funds, **tender offer funds** have a fixed number of shares outstanding, and they are not typically listed on a stock exchange. Tender offer funds may, but are not required, to offer investors the opportunity to sell their shares back to the fund at a predetermined price (NAV) through periodic tender offers, but this is at the discretion of the Fund Board. The tender offer structure potentially provides a degree of liquidity for investors, allowing them to exit their investment at a specific price.

Similarly, **interval funds** are closed end, meaning they don't trade on an exchange and don't offer daily redemption. The crucial difference is that interval funds have a pre-determined redemption schedule such as monthly or quarterly, and often for a minimum amount such as 5% of the net asset value (NAV) of the fund’s assets. When an investor chooses to redeem their shares during a repurchase period, they receive the fund's net asset value per share on a specified date, as outlined in the fund's prospectus.

Generally, the availability of evergreen fund vehicles is a tremendous positive as it allows a greater number of individual investors to access private market investments, like private equity. However, when comparing different types of fund structures like tender offer funds and interval funds, it’s important to understand the effects that fees have on the expected return of the underlying portfolio (the biggest contributors to the difference between gross and net returns).

The Fee Framework in Traditional Private Market Investments

Traditional institutional access to private markets has come in the form of closed-end drawdown vehicles for which the general partner (GP) is compensated for its role in managing a fund through two primary mechanisms: a management fee and a performance-based fee. The management fee is typically calculated as a percentage of the fund's assets under management and is intended to cover operational expenses. The performance-based fee, commonly referred to as "carried interest," represents a share of the fund's profits and serves as an incentive for strong investment performance.

A standard compensation structure is the "2 and 20" model, whereby the GP receives a 2% annual management fee on assets and 20% of the profits, subject to certain conditions. This arrangement aligns the interests of the GP with those of the investors, as the GP's financial upside is directly tied to the fund's success—providing the GP with "skin in the game."

Carried interest typically begins to accrue as fund assets are realized, but distributions to the GP are generally deferred until investors have received their capital back along with a minimum required return, known as the "hurdle rate." Once this threshold is met, the GP becomes eligible to receive carried interest in accordance with the terms outlined in the fund's investment agreement.

Because fund-level profits cannot be fully determined until all investments are liquidated, carried interest fluctuates over time and is ultimately finalized upon the fund's conclusion.

Limited partners (investors) commit an investment to the fund which is drawn down over time (an investment period which can range from 4 to 8 years including extensions, depending on the asset class) during which the GP makes investments. Then there is a harvest period during which the fund hopefully is able to exit its investment profitably and in a timely manner. This harvest period may last for up to 10 years after the commitment period ends. It's important to understand that generally, the management fee is charged on committed capital during the investment period and then on invested capital during the harvest period.

For the majority of US-based strategies, the carried interest is an American-style waterfall which means it is assessed on the performance of each individual deal rather than a European-style waterfall structure for which it is assessed based on the entire fund performance. There is almost always a hurdle rate, or preferred return, before the GP can assess the carried interest, but 8% is a typical hurdle rate.

There are other potential fees in the drawdown structure such as organizational expenses, advisory fees, and transaction fees, but the management fee and carried interest are, by a significant margin, the largest contributors to the potential fee drag. Please refer to an excellent 2018 paper from the Journal of Financial Economics for a detailed analysis of these portfolio company fees.[1]

Fees and Evergreen Funds

Evergreen funds can gain their private market exposure through a variety of underlying investments including direct investment in closed-end drawdown vehicles, making secondary investments in LP or GP led vehicles (or both), investing in other interval funds, or investing directly in co-investments or other co-investment funds. There may even be different combinations of these underlying strategies.

A simple rule of thumb is that any holding that is not a "no management fee, no carried interest" direct co-investment will have some degree of underlying management fees and likely carried interest, therefore introducing fee drag into the portfolio.

To understand the impact of fees on a traditional evergreen fund, consider a private equity investment that includes a conservative 1.5% management fee and 20% carried interest (see Figure 1). In this example, the management fee is charged on committed capital for the first six years of the fund and then on invested capital thereafter for a total fund term of 12 years.

The step chart clearly demonstrates significant fee drag on the portfolio even at lower levels of absolute return (left-hand side). At a 20% gross return, the fee drag would mean that the net return flowing up to the evergreen fund vehicle from its underlying investments is only 14%, or a 6% loss to fees. That is before the evergreen fund charges its management fees and in some cases incentive fees (evergreen version of carried interest). In addition, as returns get larger, the percentage of the fee drag due to the carried interest increases substantially (right-hand side). A key point for advisors to consider is that most evergreen funds do not disclose the carried interest paid on the underlying portfolio of investments, even though it is the largest component, and hence we refer to this as a hidden fee.

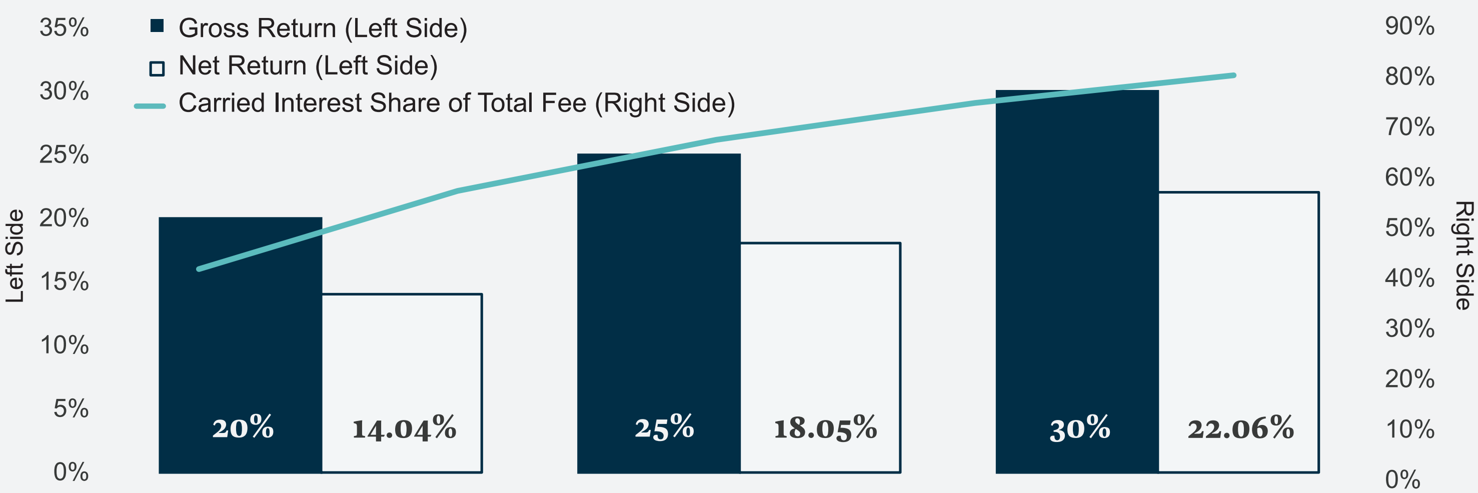
Avoiding These Fees with a Co-Investment Structure

As demonstrated, when investing in private investments, the typical "2 and 20" fees can have a significant impact on portfolio performance. To minimize or eliminate these fees, advisors and their clients may want to focus on investment structures with co-investments.

Co-investments become available when General Partners, seeking to raise additional capital, invite select Limited Partners to invest directly alongside them in a private company. The co-investment is generally structured so that Limited Partners acquire equity in the company directly or through a special purpose vehicle set up by the General Partner.

Figure 1

Fee Drag of Private Equity Closed End, Drawdown Fund



Source: Meketa, 2025.
Note: Hypothetical example only – not representative of any actual investment.

Typically, co-investments are offered to Limited Partners on a no management fee, no carried interest basis. So, investors typically don't pay the "2 and 20" fees, which reduces performance drag, and enables investors to keep more potential returns for themselves (see Figure 2).

In the context of management fees and carried interest, if the gross return on the co-investment portfolio is 20%, then the evergreen fund will recognize 20%. If 30%, then the net return is 30%. An evergreen fund with 100% of its allocation in traditional closed-end private equity funds or LP /GP led secondary stakes would need to generate a gross return of 26% to 28% to match the 20% net return of a portfolio that's 100% allocated to co-investments.

By avoiding the extra fund-level management fees and carry, co-investments can also mitigate the J-curve effect, which is the period where investors initially experience losses due to fees and expenses before seeing positive returns.

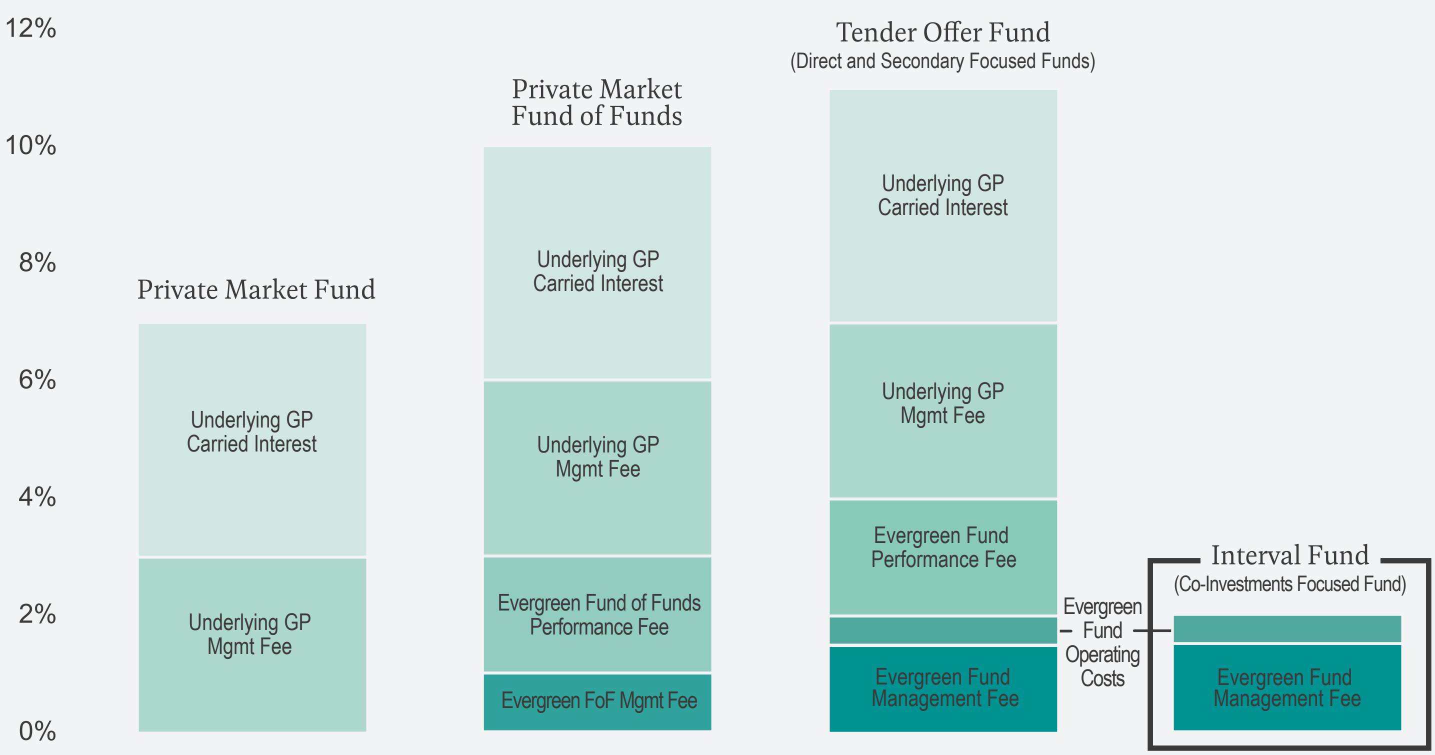
Avoiding these traditional private market investing fees translates into enhanced net returns for investors and may have a significant impact on overall performance when a fund has a meaningful allocation to co-investments.

> An evergreen fund with all of its allocation in traditional closed-end private equity funds or LP / GP led secondary stakes would need to generate a gross return of 26%-28% to match the 20% net return of a portfolio 100% allocated to co-investments.

Figure 2

Significant Variability of Fees Among Private Market Investment Vehicles

Source: Meketa Capital, 2025.



Due Diligence Steps for Advisors

Investing in private markets comes with higher levels of fees and expenses relative to public markets and carried interest tends to be the biggest culprit.

To better understand the fee-drag dynamics, advisors may want to consider these due diligence steps:

1 Dig deeper into the underlying investments.

Most evergreen funds have a 10%-20% allocation to publicly traded and/or highly liquid securities to address the redemption requirements of the evergreen fund structure. Therefore, the focus is on the remaining 80%-90% of private equity investments. The prospectus will spell out the type of underlying investments the fund can make, and the marketing materials can provide a current snapshot. However, the advisors should ask for historical allocations and the expected allocation going forward. For example, two interval funds may both claim to invest in LP- and GP-led secondaries and co-investments, but the actual and expected allocation to each will play a meaningful role in potential size of the fee drag and should be well understood.

2 Understand the acquired fund fees and expenses (AFFE).

Every prospectus has a Summary of Fund Expenses section that is a key element for the advisor to review and understand. Although we have established the importance of carried interest in the fee-drag calculation, we are unaware of any prospectus that actually provides or models out this figure. Indeed, we compared the language in the prospectuses[2] of four well established private equity interval funds and the language in each as it pertains to the carried interest of the underlying funds was almost identical across each of them,

> "The 'Acquired Fund Fees and Expenses' disclosed above, however, <u>do not reflect any performance-based fees</u> or allocations paid by the Portfolio Funds that are calculated solely on the realization and/or distribution of gains, or on the sum of such gains and unrealized appreciation of assets distributed in kind, as such fees and allocations for a particular period may be unrelated to the cost of investing in the Portfolio Funds."

Arguably the most important component of the fee issue has been relegated to a footnote. We would recommend that advisors ask any evergreen fund to provide an estimate of the effect of the underlying carried interest on the overall fund performance historically and what it might look like going forward based on the expected return of the evergreen fund and the underlying investment allocation.

The greater the allocation to no fee, no carry direct co-investments, the lower the effect of the carried interest will be.

3 Determine if the fund has access to top-tier managers.

The key to allocating to private markets, especially from a fee perspective, ostensibly has two components: the benefits of the asset class as a whole and access to top-tier managers. Using benchmark data, we see that over the long-term even the median private equity fund outperforms public equity in most time periods. It also has a lower standard deviation of returns, offering a diversification benefit within mean variance optimization and a diversification benefit in terms of differentiated strategy and manager exposure.

The second component is getting access to top tier managers. The performance spread between the top quartile and median managers in private equity is much larger than public markets. The average performance interquartile spread (between 25th and 75th percentile) for buyouts across vintage years was 13.6%.[3] Access to top quartile managers should provide the performance compensation needed for a high level of fee drag. If an evergreen fund is only offering "beta" type access through a high number of underlying investments, paying a lot in carried interest is harder to justify. Using the most recent 2025 factsheets, we noted some private equity interval funds may hold over 1,200 or in another example, over 3,000 underlying portfolio companies! It is challenging to reconcile a 3,000-company portfolio with having access to top tier managers. As in public markets, the greater the number of holdings, the more a portfolio becomes a beta play and makes the underlying high fees harder to justify. A portfolio of 20-80 direct co-investments from a diversified source of general partners provides the opportunity for selective access to top-tier general partners on a no fee, no carry basis.

4 Find out if the fund charges carried interest at the interval fund level.

Although we did not explicitly model out the fee drag to include fees at the evergreen fund vehicle level, we have found that the management fee and operational expenses tend to be in a similar range across the entire evergreen fund landscape per asset class. However, several funds charge a form of carried interest called an incentive fee or performance fee, although at lower amounts than the 20% on underlying investments. Nevertheless, we have documented how damaging carried interest can be on net returns to the investor, and therefore we would recommend an advisor be highly skeptical/critical of evergreen funds that charge any sort of incentive or performance fee at the vehicle level, regardless of what the underlying investments are.

Creating the Best Private Markets Experience for Your Clients

Understanding management fees and carried interest can help optimize portfolio returns. Today's market has experienced a significant increase in the breadth and use of evergreen fund vehicles. For the private wealth channel, these vehicles provide semi-liquid, less complex access to private markets, allowing everyday investors to gain exposure to the same return and diversification opportunity set that have benefited global institutional portfolios for decades.

However, there are a variety of underlying investments that an evergreen fund may use to gain this exposure, many of which have high levels of management fees and carried interest, which in the case of the latter may not be quantified in any prospectus or presentation material.

Fees have always been a staple of investing, and advisors are under pressure from their clients to mitigate the impact. The benefits of an interval fund which only invests in no fee, no carry, direct co-investments are significant and should result in a much better experience for the end client, especially if they are relatively new to private markets in their portfolio.

Important Information

Past performance is no guarantee of future results, and the opinions presented cannot be viewed as an indicator of future performance. Private market investments are complex, speculative investment vehicles and are not suitable for all investors. An investment in a private market investment entails a high degree of risk and no assurance can be given that any private market investment objectives will be achieved or that investors will receive a return of their capital.

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Meketa Capital is an investment advisor registered with the US Securities and Exchange Commission. Additional information about Meketa Capital LLC is available at https://adviserinfo.sec.gov.

Notes

[1] Source: Phalippou, Rauch, and Umber, Private Equity Portfolio Company Fees. September 2018 Journal of Financial Economics.

[2] Source: 2024 Prospectus for the Hamilton Lane Private Assets Fund, the Cascade Private Capital Fund, Stepstone Private Markets, and the Primark Meketa Private Equity Investments Fund.

[3] Source: Data sourced from Cambridge Associates via IHS Markit, annual Pooled IRR quartiles by vintage year as of December 31, 2023 with data pulled in May 2024. eVestment data as of December 31, 2023 with data pulled in January 2024. Private markets funds raised Vintage Year 2012 to 2021 (2022 and 2023 are excluded as they are too recent). Indices: Cambridge Venture Capital Composite, Cambridge Growth Equity Composite, Cambridge Buyouts Composite. Private market performance presented in this chart is net of fees. There is no complete and reliable data set for private investments. The information is extremely limited, and most data is compiled from funds that elect to self-report and tend to be biased toward higher performing funds. Losses are underreported. Funds included in these measures lack commonality and transparency. Over time, components of the data may change. Funds may begin or cease to be represented based on these factors, thereby creating a "survivorship bias" that may additionally impact the data reported.