Welcome to Alston & Bird's second quarterly update on the secondaries market. In this issue, we share insights on real estate secondaries, GP consent trends, current market updates (courtesy of $M_2$0 for this issue), and news about our practice.

INSIGHTS – REAL ESTATE SECONDARIES

Since the first transaction in the mid-1990s, the real estate secondary market has experienced considerable growth as investors have increasingly sought opportunities to actively manage their real estate portfolios. In a similar trend to private equity secondaries, GP-led transactions have become increasingly popular, with GP-leds widely reported to represent over 50% of real estate secondaries transactions last year, as GPs look to generate liquidity, whether that be via recapitalisations or tender offers.

Although the real estate market currently has a relatively small buyer pool (and, in evolutionary terms, is widely considered 10 years behind the traditional PE secondaries market), historic growth trends are likely to continue into the future. Austin Charles and Amie Benedetto from Alston & Bird's Real Estate Finance & Investment Group note that, like many sectors, the real estate investment landscape experienced drastic shifts during the pandemic. Seeing the enormous demand for deliverables, many real estate investors began to raise and deploy capital in the logistics space. Industrial warehouses and logistics sites remain in high demand as the pre-existing trend towards at-home delivery continues to rise. Funds focusing on sectors hit hard by the pandemic, such as hospitality, retail, and office, attracted the attention of certain secondary investors seeking lower prices on assets that they believe will recover over time. As with any marketplace, investors are hoping to capitalise on trends. Time will tell if the upward trend in logistics and anticipated rebound in hospitality will materialise over time and whether real estate will become a sector of focus for secondary players more generally.

Pricing

Tradition Private Markets conduct a number of transactions in illiquid financial assets across the alternative investment spectrum, with teams specialising for over 10 years in private equity, real estate, and non-traditional secondaries. They shared their insights with us on pricing in the real estate secondaries market (correct through 13 September 2021):

- Secondary market volumes across real estate funds have been buoyant, with roughly $500 million of NAV coming to market seeking liquidity in Q3 so far.
- As buyers seek to put money to work in the UK after several years of headwinds, discounts to NAV are rarer (although retail sectors and office funds continue to be priced at a discount). In Q2, balanced funds saw capital value growth exceed 2% and other specialist funds (industrial) exceed 8%, and secondary trading levels in the UK reflected this positivity; balanced funds largely traded between bid price and NAV+2.0%, single-sector funds for industrial, health care, and residential funds at a premium, and even laboured sectors (retail and leisure) saw discounts narrow.
- In Europe, Q2 2021 total return was 2.6%, with capital growth and distributed income return being 1.8% and 0.75%, respectively. Secondary market pricing remained stable in these areas with sought-after balanced funds trading at small premiums to NAV, industrial funds at strong premiums, and funds with redemption queues at a discount.
- In other areas, a selection of investors believe that the U.S. & Asia will outperform Europe in 2021. Q2 saw large allocations to ODCE funds and specialist single-sector funds, medical office, and life sciences. Investors will pay premiums to jump primary queues.

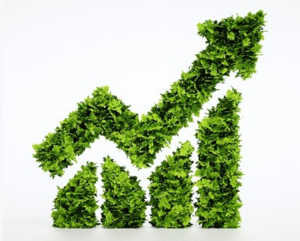
GP ACTIVISM IN LP-LED SECONDARIES

As LP-led secondaries gained in popularity over the last decade, GPs have increasingly used these transactions to their advantage. A key component of an LP-led secondaries transaction is the requirement to obtain the consent of the GP of the fund that such interest is being transferred in. This is typically given in the GP's sole and absolute discretion (with the obligation not to act unreasonably being reserved for affiliate transfers). Today, it is not unusual for GPs to exert their control over proceedings more generally, either through controlling to whom interests may be transferred (i.e., effectively withholding consent for any reason if their discretion so permits) or, as we have seen more recently, insisting on the right to participate in the sale, either through entrenched rights of first offer or by imposing this as a condition on transfer. In some instances, we have also seen GPs require a primary commitment to be made to its next fund-raising, a so-called staple.

ALSTON & BIRD **Secondaries Update – Q3 2021**

MARKET SNAPSHOT

This quarter's market snapshot is provided courtesy of M2O Private Fund Advisors LLC*:



- Many secondaries buyers are increasing their deployment in 2021 to compensate for insufficient deal flow in 2020. Capital deployed in H2 is expected to be split equally between LP-stake portfolios and GP-led transactions.
- LP demand for secondary funds has led buyers to raise larger funds than expected – in which they are dedicating significant capital to traditional LP deals.
- A meaningful number of secondary buyers have lowered their return targets in order to underwrite deals more aggressively.
- Undersupply, high levels of dry powder ($160+ billion), and increased competition for LP portfolios means LP deals have typically **exceeded pre-marketing price expectations by an average of 5–10%**.
- As a result of robust post-COVID market conditions, pricing has rebounded to peak levels, resulting in a seller's market which offers **attractive opportunities for LPs to rebalance portfolios at full prices**.

** M2O are happy to share the results of their semi-annual secondary market survey (based on responses from 38 reputable secondary firms), summarising key trends and activities in the first half of 2021.*

OPEN FORUM

We are excited to announce a new Alston & Bird podcast, *Open Forum*, produced by Alston & Bird's EU Women's Initiative, which shares stories, insights, and advice from women in business. This month, Megan Lau spoke with Sunaina Sinha, Global Head, Private Capital Advisory, Cebile, Raymond James. Sunaina explained her top 3 challenges facing the secondaries market:

1. **Ensuring that there is enough talent in the secondaries industry.** The industry has grown tremendously over the last 3–4 years, and its growth in volume has far outpaced the talent pool that can deliver that volume from an execution perspective.
2. **How to deal with the incredible influx of GP-led single-asset deals.** Secondaries funds today are not generally set up for single-asset deals, which have a very different duration, different return, and different risk profile associated with it. In response to this challenge (and opportunity), a number of secondaries investors are putting together standalone funds or standalone pockets of capital to invest in single assets, and this is expected to increase.
3. **Conscious choices on diversity.** Because the secondaries industry is relatively new (with its big growth coming in the last 5–6 years), we all are responsible for making conscious decisions to bring change. If the secondaries industry doesn't do better itself on diversity, we cannot mandate GPs to do more.

To listen to Sunaina's *Open Forum* podcast, click here. Sunaina and Megan talk about what it takes to succeed in business, how to make a real difference in diversity in the alternative assets industry, the importance of mentors, and how to reset your mental balance.

Click here to enjoy our July episode in this series with Saloni and Alston & Bird senior associate Sherry Scrivens discussing managing work and family, thriving in a competitive industry, and pondering the road not taken.

Secondaries Update is produced by Alston & Bird's Financial Services & Products Group and is edited by Saloni Joshi, Megan Lau and Rob Davidson.