

## PRIVATE PARTNERSHIP INVESTMENT PRINCIPLES

The purpose of this document is to formulate a general view that institutional investors should seek when making private equity and real estate partnership investments. Private market partnership terms and conditions that have gradually evolved should receive renewed attention in order to better align interests between general partners and limited partners, enhance fund governance, and provide greater transparency to investors. Below is a summary of the issues that we believe will lead to the modification and improvement of specific terms and best practices for new commitments. While there is no panacea for optimal contract terms, these principles should be considered as a guide, and not as absolutes, recognizing that partnership agreements and terms are complex, and must be considered in whole.

### Areas for Improvement in Private Partnerships

#### Alignment of Interests

- The 80/20 profit split in commingled funds works well to align interests, but tighter distribution provisions should become the norm to avoid clawback situations or other forms of “leakage” that allow general partners to earn more than 20% of profits due to the timing of distributions or creative drafting of the partnership agreements.
  - The carry should be on net profits generated after taxes, management fees, transaction costs, and all other ancillary expenses, rather than on gross profits.
  - The carry should only be in effect after 100% of capital, net of all fees and expenses, has been returned to the investor who has provided the vast majority of risk capital. However, interim tax distributions can be paid to cover the general partner’s tax liabilities. These distributions should be considered advances to the general partner.
  - Each time a carried interest payment is proposed to be made to the general partner or any GP affiliate, the books and records of the partnership shall be audited at partnership expense to confirm the amount of such payment.
  - If clawbacks are required; they should be fully and timely repaid.

- Management fees are intended to cover reasonable operating costs and should not be a material profit-center, or a funding source for staff bonuses or business expansion for the firm. Fees should be reduced for all but the most modest funds with larger funds taking larger reductions in “standard” fees, acknowledging economies of scale.
  - Larger investors in a fund should receive fee or carry concessions, particularly when the general partner has multiple funds or follow-on funds in the market at the same time.
- The general partner should avoid charging transaction, monitoring fees, and other fees to a deal or portfolio company/investment entity in the fund. In addition, all fees earned by the general partner should offset management fees and partnership expenses during the life of the fund and at the end of the life of the fund. Any remainder should be distributed as profit pursuant to the distribution provisions.
  - Transaction, monitoring and other fees, if charged, should be escrowed against future management fees.
- In no event shall the partnership be required to bear, directly or indirectly expenses of the general partner or manager for entertainment, publicity, fund raising, office space, information technology, employment, personnel or other matters that are generally considered to be corporate overhead. All partnership expenses shall be limited to those third party out-of-pocket expenses reasonably incurred directly in connection with the partnership business.
- The general partner’s capital commitment to the fund should reflect a substantial amount of the net worth of the principals making up the general partner and a high percentage of the amount should be contributed in cash.
- Changes in tax law that personally impact members of a general partner should not be passed on to investors in the fund.

### Governance

- Recent scandals have again highlighted the need for and the importance of an independent auditor who should be firmly focused on the best interests of the partnership and its limited partners, rather than the interests of the general partner.
  - The auditor should be an independent, nationally recognized firm and should provide no other services to the general partner, unless explicitly approved by the Advisory Board.

- Because partnership terms are long (10-15 years) and withdrawal rights are virtually nonexistent, a majority of outstanding limited partnership ownership interests should be able to effectuate the following, without cause:
  - Suspend the commitment period
  - Terminate the commitment period
  - Remove the general partner
  - Dissolve the fund
- General partners should reinforce their duty of care. The “gross negligence, fraud, and willful misconduct” indemnification and exculpation standard should be a minimum in terms of what is agreed to by limited partners. Recent efforts by the general partner to: (1) reduce all duties to the fullest extent of the law; (2) demand the waiver of broad categories of conflicts of interests; and (3) allow it to act in its sole discretion, even where a conflict exists, should be strongly resisted.
- General partners should be required to seek approval of the limited partners to change the investment strategy promoted when the fund was raised.
- Advisory Board meeting processes and procedures should be adopted and standardized across the industry to allow this sub-body of the limited partners to more effectively serve its role.
  - All limited partners should receive a list of the names and contact details of Advisory Board members.
  - The Advisory Board should be able to call for a meeting with the general partner at any time.
  - The Advisory Board should be allowed “private time” with the auditor, on at least an annual basis.
  - The Advisory Board should not be asked to approve specific investments and will serve the limited partnership investors best by reviewing audit results, portfolio holdings updates (including valuation methods), and addressing issues relating to potential conflicts-of-interest.
  - Any significant transaction between multiple funds of the same general partner should be subject to Advisory Board approval. The Advisory Board shall have the right to put particular matters to a vote of all limited partners.

## Transparency

- Fee, carry and all other ancillary fee calculations should be transparent and subject to limited partner and independent auditor review in a standardized form.
- All placement agent and fundraising fees should be fully disclosed. The scope of work provided by placement agents should be disclosed. Campaign contributions or other payments made to individuals that may influence the decision-making process should be disclosed.
- Accurate disclosure around uses of leverage at both the fund and the investment entity levels should be provided.
- All limited partners should be notified when/if the general partner receives any SEC inquiries or meaningful legal actions.

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