Evergreen funds: Strategic benefits in private credit

Investors want more flexible access to their returns and capital, while fund managers need to attract a broader range of investors as difficult macroeconomic conditions continue to hamper fundraising. Evergreen funds are able to deliver for both investors and managers. Francesca Raffa and Gabriele Avellino explore their strategic role in private credit.

The number of semi-liquid and evergreen funds is increasing. According to a Preqin report, evergreen funds conservatively represent around $350 billion in global assets and they are expected to grow significantly in the next few years (with an already impressive growth of 30% over the last two years), a fact that is especially true in the private credit sector.

Evergreen funds have become more prominent in private credit because they are open-ended and the investment criteria are easier for retail investors to meet. Unlike fixed-term private equity funds, evergreen funds allow continuous investments and reinvestment of returns, attracting both investors and fund managers alike. In addition, the typical ticket sizes are in the tens of thousands, rather than the millions needed to invest in conventional private capital funds. This article examines the benefits, challenges, and strategic role of evergreen funds in private credit.

The Architecture of evergreen funds

Evergreen funds – a term which includes Business Development Companies (BDC), European Long Term Investment Funds (ELTIF), Long Term Asset Funds (LTAF), non-traded REITS, Interval Funds and Tender Offers – operate in perpetuity without a set termination date. This structure permits them to accept fresh capital at regular intervals and reinvest proceeds from maturities or exits into new ventures. Unlike the finite lifespan of traditional closed-ended funds, which typically span 10 to 15 years, evergreen funds can, in theory, function indefinitely, provided they adeptly manage inflows and outflows.

This type of fund – whilst well established in the U.S. market – is now more commonplace in the European market because of the advantages it offers investors. In particular, the increased popularity of these open-ended funds is connected to the slowdown in liquidity within the private equity and private credit sectors. This has meant investors have had to be more innovative in managing their financial positions and what their needs are to invest most effectively. Along with evergreen funds' liquidity advantages is their flexibility, as they allow capital to be continuously available and ready to be invested in new opportunities.

For example, investors can commit funds continuously, enabling fund managers to deploy capital more strategically. This steady stream of capital can be particularly beneficial in the private credit arena, where market conditions and investment opportunities can vary significantly. For example, if there is a chance to invest in a leveraged buy-out (LBO) of a mid-sized company, the fund manager can quickly gather the needed funds from investors to take advantage of this opportunity, something that might not be possible with traditional funds. The ongoing investment structure also allows for profits to be reinvested, fostering growth as the returns are put back into the fund. This continuous flow of capital provides a strategic edge, helping fund managers maintain dynamic portfolios and adapt to changing market needs.

Also, the investment strategy for evergreen funds in private credit broadly aims to generate steady, predictable returns through investments in debt instruments, such as senior secured loans, mezzanine financing, or distressed debt. The perpetual nature of these funds allows managers to adopt a longer-term perspective and pursue strategies that may not be feasible in a closed-ended structure. This can include sustaining investments through multiple market cycles and leveraging long-term growth trends.

What makes these structures attractive

There are three main areas where evergreen funds offer both investors and fund managers advantages which can facilitate better returns in a tough macroeconomic environment.

1. Liquidity and adaptability

Liquidity, mentioned above, is worth repeating as it is the key benefit of these types of funds, offering a solution to unstick capital and provide a more flexible way for it to flow in and out of investments. Investors can typically redeem their investment at regular intervals, offering a level of flexibility not available in traditional private equity or closed-ended funds. This liquidity can be particularly appealing for investors seeking to manage their cash flow needs or adjust their portfolios in response to market changes.

2. Alignment of interests

The perpetual nature of evergreen funds can also foster a better alignment of interests between fund managers and investors. Without a fixed end date, fund managers are motivated to focus on long-term performance and sustainable returns, rather than pursuing quick exits to meet the deadlines of a closed-ended fund. This long-term alignment can result in more prudent investment decisions and enhanced overall fund performance.

3. Reduced fundraising strain

For fund managers, the ongoing capital raising model of evergreen funds can alleviate the pressure associated with traditional fundraising cycles. Instead of periodically raising new funds, managers can concentrate on growing and managing a single evergreen fund, allowing them to devote more time and resources to identifying and executing investment opportunities. In addition to these benefits, evergreen funds also generate cost efficiencies, especially as they do not trigger the need for setting up a new structure, rather it requires that existing legal documentation is refreshed on a periodic basis.

Challenges and considerations

As with all things, while there are clear benefits, there are also unique challenges that must be carefully managed.

1.Valuation and pricing

Unlike publicly traded securities, private credit investments can be illiquid and difficult to value. Fund managers must establish robust valuation methods to ensure that the net asset value (NAV) of the fund accurately reflects the underlying investments. This can be particularly challenging during periods of market volatility or economic uncertainty.

2. Liquidity management

While the continuous inflow of capital provides flexibility, it also requires meticulous planning to ensure that the fund can meet redemption requests without compromising its investment strategy. Fund managers must balance maintaining sufficient liquidity to meet investor redemptions with the need to deploy capital into attractive investment opportunities.

3. Regulatory and compliance challenges

Depending on the jurisdiction, these funds may be subject to different regulatory requirements than traditional closed-ended funds. Fund managers must navigate these regulatory landscapes to ensure compliance with relevant laws and regulations, which can vary widely between regions.

Evergreen funds' strategic role in private credit

The demand for evergreen funds in private credit has been growing, driven by investors seeking steady income streams and diversification. Institutional investors, in particular, have shown interest in these funds due to their potential for stable returns and their ability to provide exposure to private credit without the constraints of fixed-term commitments.

Evergreen funds can capitalise on a wide range of market opportunities, from direct lending and leveraged buyouts to special situations and distressed debt. Their perpetual structure allows them to leverage long-term trends and invest in opportunities that may not align with the fixed timelines of traditional funds. This flexibility can be a significant advantage in the competitive and evolving private credit landscape.

As the private credit market continues to evolve, evergreen funds are likely to play an increasingly important role in providing capital and facilitating growth. By partnering with an experienced fund administrator, fund managers can make the most of the advantages these funds offer and more expertly navigate the challenging market to deliver for their investors.

Aztec has extensive experience administering evergreen funds, as well as converting closed-ended funds into open-ended ones. If you'd like to know more please contact us below.

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