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DEALBOOK

Investment Indigestion at Stanford

[Stanford University](#) is holding a garage sale.

Not the desks-and-chairs kind. Instead, Stanford is selling stakes in funds run by the biggest names in [private equity](#) at deeply discounted prices.

While no one will confirm the names aloud, they are of the caliber of [Henry R. Kravis](#), [Stephen A. Schwarzman](#) and Leon D. Black.

During the boom times, Stanford Management, joined other endowments in a rush to plow increasingly large percentages of their funds into private equity, real estate and other illiquid investments — committing some \$12.6 billion of the university's endowment.

But then the market soured, and Stanford's endowment lost \$4.6 billion in value in its last fiscal year, a decline of 27 percent. So it now seems to be suffering from investor's remorse.

Its plan to sell part of its stakes in private equity firms — a bid to raise \$1 billion or more — appears to be an attempt to cut losses on current investments and a way to get out of committing more money to future deals.

In flush times, putting a for-sale sign on such assets would attract a crowd of potential buyers. But just about everybody is sitting on their own losses. And soon enough we may start seeing similar sales from other campuses around the nation.

[Harvard](#), whose endowment shrank 27.3 percent last year, looked to sell some assets earlier this year. But given the lukewarm response, it struggled in a bid to sell about \$1 billion of assets before pulling the sale. The [California Public Employees' Retirement System](#) has been looking to sell, too.

Stanford isn't planning to sell stakes in individual private equity deals. Rather, it wants to sell its place as an investor in private equity firms. (The funds, of course, won't just let endowments out of their commitments.)

One executive involved in the auction process, first reported last week by LBO Wire, a news service of [Dow Jones](#), called it "the biggest fire sale in private equity, ever." A potential buyer said, "For someone in our business, it's a rare chance to get a portfolio of this quality and of this size."

Even so, Stanford's decision will send a chill through the halls of endowment offices at other universities. By trying to sell such a large position all at once, Stanford will invariably depress prices for any institution considering a similar move.

Virtually nobody in the industry would talk on the record about Stanford's planned sale. Everyone contacted

was a buyer, adviser or consultant — or wanted to be — and considered this deal to be the third rail of the endowment industry.

Stanford is adamant that it does not need the money; it says it is not facing a liquidity squeeze.

And it did, in fact, already take out an expensive \$1 billion line of credit as a cushion in the event that it needed help keeping the lights on for students. Its decision, according to people who have been briefed on the university's thinking, is a strategic one — it wants to reduce its exposure to future private equity deals.

But taking this step suggests that Stanford wants to distance itself from other endowments like that of [Yale](#), led by David F. Swensen, who pioneered the push toward universities holding illiquid investments.

That strategy is often called the Swensen model. His fund has been decimated as well, falling \$5.6 billion, or 24.6 percent, in the last year. (The average large university endowment dropped 17.2 percent in that period, according to the Wilshire Trust Universe Comparison Service.) But unlike Stanford, Mr. Swensen is not changing course and selling assets — at least not yet.

When Stanford tries to sell its stakes in private equity portfolios, it will be entering a netherworld of secondary deals inhabited by a small cadre of investors looking to buy stakes on the cheap. They include AlpInvest Partners, Collier Capital, [Credit Suisse](#), HarbourVest Partners, [Goldman Sachs](#) and Lexington Partners.

NYPPEX, which tracks secondary deals, said that earlier this year such deals were made at 39.9 cents on the dollar, based on net asset value.

That number has moved up in recent months as confidence has returned to the markets, and NYPPEX's latest estimation indicates that recent deals have gone for an average of 51.58 percent of net asset value.

One question that has vexed the endowment industry is how to determine the value of portfolios. At the end of every quarter, private equity firms typically send out current valuations of their portfolios and the endowments accept them at face value.

But what happens if Stanford is able to sell its stake at only 50 cents on the dollar, for example, when K.K.R. is listing it at 80 cents? If other endowments hold similar stakes, what happens to their value?

This is still a hypothetical, because unlike investment banks, endowments don't have to mark to market. Instead, they value their assets on a hold-to-maturity basis, which means they should not have to reduce the value of those portfolios in the short term.

But if things get worse, will they have to?

Universities specialize in the art of big-picture questions. This probably isn't one they want to contemplate.