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The Fed’s Recent Interest Rate Cut: A Step in the Right Direction for PE Sponsors

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On 18 September 2024, the Federal Open Market Committee lowered the benchmark federal funds rate by 50 basis points to a target range of 4.75-5%. While this is welcome news on many levels, we expect that in the coming months it will have a real and positive impact on private equity sponsors, and particularly mid-sized and smaller sponsors.

Lower interest rates will improve portfolio company cash flows through reduced borrowing and refinancing costs. A lower rate environment will also provide potential portfolio company buyers with lower-cost debt financing for acquisitions. These factors combined can be expected to create a favorable environment for exits, something that private equity sponsors and limited partners alike have been eagerly seeking. And once exits start to accelerate, sponsors can turn to raising their next fund, and investors will have additional capital from current fund realizations to deploy into those funds.

We expect lower interest rates to have the greatest positive impact on mid-sized and smaller private equity sponsors, where the impact of cost of capital and the importance for exits and follow-on funds is greater than with the largest private equity sponsors. While it will take several months for the impact of lower rates to be seen, sponsors now have a more favorable environment as they look ahead to 2025 and lay the groundwork with investors for new fund launches.

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