



2026 Level 3 - Private Markets Pathway

Learning Modules	Page
Private Investments and Structures	2
General Partner and Investor Perspectives and the Investment Process	7
Private Equity	14
Private Debt	23
Private Special Situations	30
Private Real Estate Investments	44
Infrastructure	51

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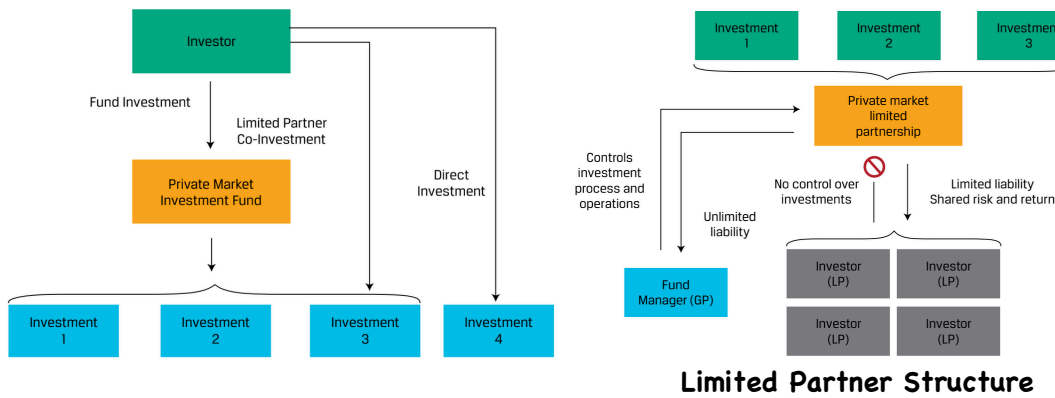
Private Investments and Structures

1. contrast the features of private and public investments, and discuss characteristics of private and public markets
2. discuss private investment methods and structures and their uses
3. discuss the difference between public and private market performance, and calculate, interpret, and discuss the use of performance metrics including distributed to paid-in, residual value to paid-in, and total value to paid-in
4. compare the risk and return of investing in private markets and public markets as part of a strategic asset allocation

Private Investments and Structures

	Public	Private	Page 1 LOS 1 - contrast - discuss
Asset Prices/	<ul style="list-style-type: none"> • exchange or OTC-listed • traded, observable → including benchmarks (current, historical) • intraday, daily 	<ul style="list-style-type: none"> • unlisted, negotiated, estimated <li style="padding-left: 20px;">- DCF, relative value, recent transactions • quarterly, monthly 	
Performance/	<ul style="list-style-type: none"> • periodic 	<ul style="list-style-type: none"> • compounded over a multi-year period (J-curve effect) 	
Liquidity/	<ul style="list-style-type: none"> • mostly liquid with few trading restrictions • low transaction costs 	<ul style="list-style-type: none"> • illiquid with sale prohibited or restricted 	
Investment Process/	<ul style="list-style-type: none"> • enter, exit anytime (open-ended) • passive holdings • minority debt or equity stakes 	<ul style="list-style-type: none"> • controlling or significant minority stakes • long holding periods • entry, exit limited (closed-ended) 	

	Public	Private	Page 2 LOS 1 - contrast - discuss
Manager Skills	<ul style="list-style-type: none"> • industry, company and financial analysis 	<ul style="list-style-type: none"> • industry, management, and technical experience and expertise • legal and financial analysis 	
Portfolio Diversification potential	<ul style="list-style-type: none"> • growth, maturity primarily • based on correlations of observed periodic returns 	<ul style="list-style-type: none"> • investments span the entire life cycle (early stage - VC, decline/turnaround - PE) + growth, + maturity • unique asset types 	



Limited Partner Structure

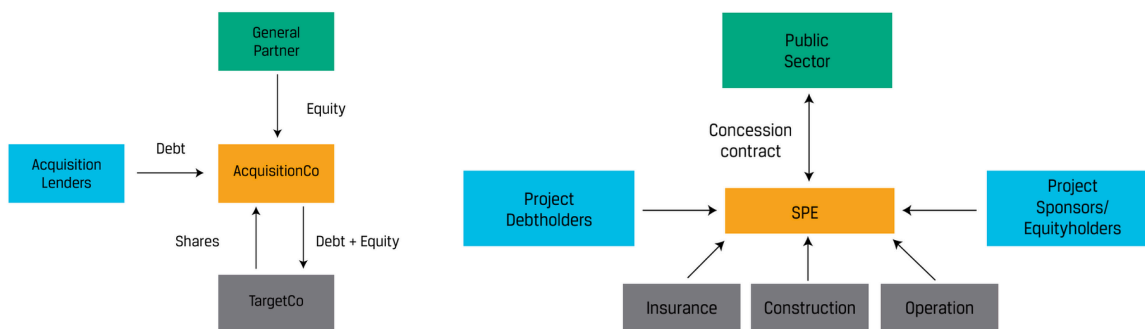
- **Direct Investment** - typically only for the largest asset owners
 - equity or debt investment **without** the use of an intermediary
 - **Direct Co-investment** - equity or debt **with** one or more partners **without** the use of an intermediary
 - lower investment size, added expertise of partners, no mgmt. fees
- } lower due diligence costs/partner

- **Indirect Investment** - through a fund (GP)
- **Indirect co-investment** - LP may be granted co-investment rights
 - allows LP to take a larger stake in specific targets alongside a more experienced manager
 - typically at reduced or no mgmt. and carry fees

Structures/ • new legal entities are created for specific uses

e.g./ take-private transaction

Infrastructure SPE

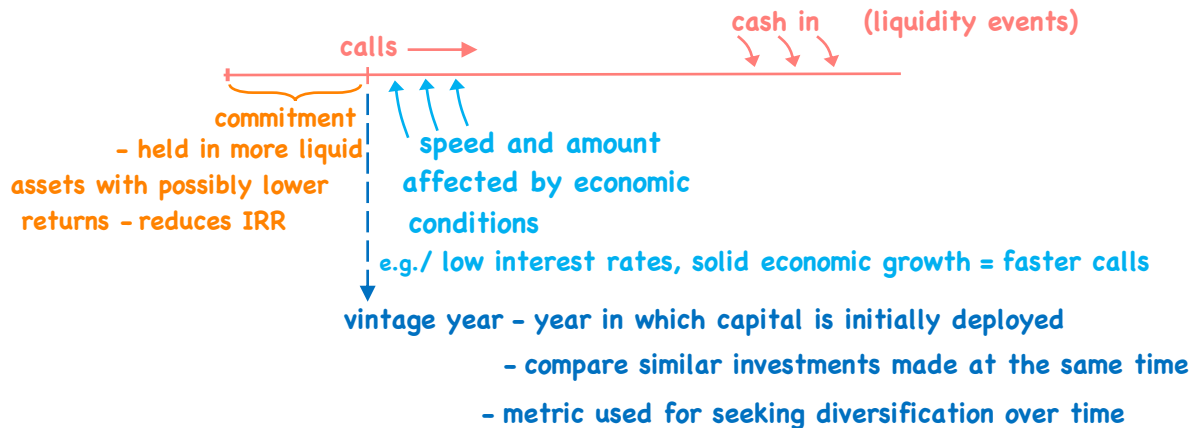


Page 5
LOS 3
- discuss
- calculate
- interpret

• **Performance** - best measured over a multi-year holding period

- common measures - IRR } cash-flow based
- ROI } performance measures

$\frac{\sum CF_{in}}{\sum CF_{out}}$] ignores TVM + holding period



• benchmarking private investment IRRs relative to public market returns
• public market equivalent methodologies

PME - replicate private market cash flows into and out of a public market index

choice important

Page 6
LOS 3
- discuss
- calculate
- interpret

• Private Market Fund Multiples/

Paid-in-Capital (PIC) = $\frac{\text{capital invested}}{\text{total capital committed}}$

• the degree to which the drawdown phase of the investment life cycle is complete

~ 75% may indicate GP may raise a new fund

Distributed to paid-in (DPI) = $\frac{\text{cumulative distributions}}{\text{total capital invested}}$

• realized return

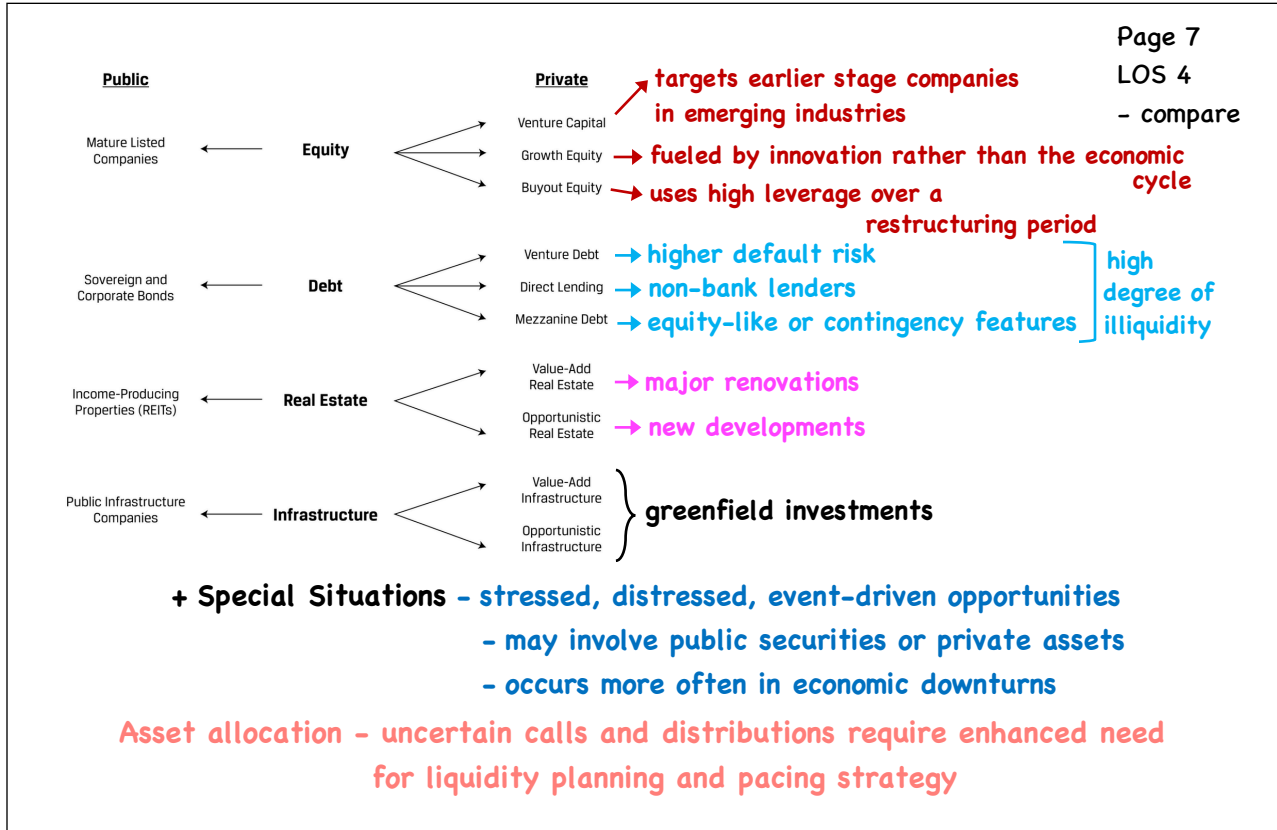
Residual value to paid-in (RVPI) = $\frac{\text{net asset value}}{\text{total capital invested}}$

• unrealized return

Total value to paid-in (TVPI) = DPI + RVPI

- gross of fees

• multiple of invested capital (MOiC) or multiple of money (MOM)



General Partner and Investor Perspectives and the Investment Process

1. discuss a general partner's roles and responsibilities in managing private investment funds
2. discuss how private investment firms align their interests with those of their investors, and calculate, interpret, and discuss private market fund performance from an investor perspective, including management fees and carried interest
3. discuss favorable characteristics of private investment targets and sources of value creation in private markets
4. discuss the role of conducting due diligence and establishing a business plan in the private investment process
5. discuss alternative exit routes in private investments and their impact on value

GP/LP Perspectives and the Investment Process

Page 1
LOS 1
- discuss

Pre-commitment: GPs establish an investment strategy reflecting the fund's focus
 specialized knowledge and expertise are the primary determinants of the investment strategy

Commitment: initiates capital calls from LPs (establishes vintage year)
 - identifies targets, initiates due diligence

Capital Deployment: finalizes DD, develops business and financial plan
 - negotiate purchase price and legal terms, establish an acquiring entity, arrange short term debt financing to complete the purchase of TargetCo.
 - merge AcquireCo. and TargetCo. → refinance s.t. debt with a combination of mid & long-term debt
 - mgmt. changes, spinning off non-strategic business divisions, realize synergies

- project-based → deployment phase contingent on meeting milestones
 - GPs provide periodic fund valuations to LPs

Page 2
LOS 1
- discuss

Capital Distribution and Exit: dividends + divestments → GP controlled (PE)
 • $i + p$ → private credit - issuer contingencies may determine distribution timing (e.g. PIK, pre-payability, callability)

- secondaries may be offered - allows LPs to buy or sell existing partnership stakes

wide	bid-offer	
	95% - 105%	PE - buyout
	80% - 120%	VC

• new investors - no commitment period
 • GP acts as intermediary

- sale of fund investments, return of capital to LPs

LOS 2
- discuss
- interpret
- calculate

Management Fee: paid annually

~ 1%	pr. debt
~ 2%	PE

} %'age of total capital committed

- during distributions → %'age of unreturned capital
 100% - (cost basis of exits)%

Page 3
LOS 2
- discuss
- interpret
- calculate

Management Fee: • on committed capital

- compensates GP for significant upfront costs of DD
- reduces incentive to deploy capital as quickly as possible in less attractive environments
- reduces conflict of interest regarding valuations (if %'age was based on NAV)

- some cases, additional transaction fees are paid to the GP for advisory services that benefit the fund

Carried Interest: applied to fund returns above some hurdle rate (HR)

~ 15% to 20% share of returns above the HR

- hard hurdle - fees only on returns above the HR - suitable when returns follow a steady path over the HP or are all paid at the end

carried int. → $r_{GP} = \max[0, p(r - r_h)]$

/ return
%'age

hurdle rate

- soft hurdle - fees on all the return if HR is exceeded (suitable when returns are volatile or paid over several years)

Page 4
LOS 2
- discuss
- interpret
- calculate

Carried Interest: soft hurdle benefits the GP by ensuring their performance compensation 'catches up'

(i.e. catch up clause)

e.g./ $r_h = 8\%$ GP earns 100% of return from 8% to 10%, after
 $p = 20\%$ which it is 20/80

$r_{GP} = \max[0, r_{cu} + p(r - r_h - r_{cu})]$

catch-up return

e.g./ $r_{sh} = 9\%$ committed capital = 300m
 $p = 10\%$ total return = 660m
 10yrs.

LPs get \$0 to $.09(300m)(10)$ first
 (0 - 270m)

GP gets 100% of 270m - 300m next

LP gets 90% of $(360m - 300m) = 54m$

GP gets 10% of $(360m - 300m) = 6m$

660m
 - 300m
 360m
 × 10%
 36m

100% of LP capital commonly paid when 100% of committed capital has been returned

<ul style="list-style-type: none"> • High water mark - the fund's maximum value as of a performance fee date (net of fees) <ul style="list-style-type: none"> - typically applicable when funds mark-to-market for purposes of calculating fees (not common with private funds) • Clawback provisions - the return of GP performance fees to LPs in cases where returns from successful transactions earlier in a fund's life are offset by weaker returns later • tax treatment of CI - in US, treated as a long-term capital gain <ul style="list-style-type: none"> - deferred until end of investment period - CI is typically structured so that the GP receives performance fees years before the end of the fund's life (provided that committed capital has been distributed in full) • Returns - gross of fees, net of fees → gross IRR, net IRR 	<p>Page 5 LOS 2</p> <ul style="list-style-type: none"> - discuss - interpret - calculate
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<ul style="list-style-type: none"> • PE - targets a controlling stake or significant minority position to drive value creation <ul style="list-style-type: none"> <div style="border-top: 1px solid black; width: 100%; margin: 5px 0;"></div> this potential must exist vc/ <ul style="list-style-type: none"> - start-up firms with high growth potential in new or emerging industries - firms with potential to disrupt established industries with new products/services or business models - patents, IP, industry expertise, track-record <div style="border-top: 1px solid black; width: 100%; margin: 5px 0;"></div> sought after qualities - typically non-financial milestones <ul style="list-style-type: none"> < new product prototypes < first significant customer • growth - existing product, customer base & business model <ul style="list-style-type: none"> - potential for above trend growth - well managed young firms with initial success but resource constrained 	<p>Page 6 LOS 3</p> <ul style="list-style-type: none"> - discuss
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