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INVESTOR WATCH: ASTARTE SOWS SEEDS OF CHANGE FOR INFRA LPS

03 January 2020 | 14:26UTC

Emerging fund managers are taking new fee structures to LPs bored with vanilla propositions and fully allocated to established funds. Can Astarte's innovative platform approach to seeding co-GPs pave a safe path into 'future-core' infra? Katherine Steiner-Dicks reports

Europe

Sector:	Environment Social Infrastructure Other
Country:	United Kingdom USA
Published:	03 January 2020
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According to the Pythagoreans, the number eight, or 'Ogdoad', symbolized something holy, harmonious, balanced and all powerful. Somehow, centuries later in 2020, that number has sustained as an aspirational – albeit fairly standard – hurdle rate for LPs and their infrastructure fund investments, regardless of a current environment of compressed returns, low interest rates and occasionally questionable fundamentals.

Finding innovative ways to provide investors higher returns, even at zero or below market standard management fees, is a tale of wizardry in an ever-competitive fundraising market.

Continuing the spirit of all things eight, had Stavros Siokos and Teresa Farmaki, founders of co-investment platform Astarte Capital Partners, picked up a fortune-telling Magic 8 Ball in 2017 and asked the bubbling perspex clairvoyant 'Will seeding operational and emerging GPs in the infrastructure space be something LPs can get on board with?', with a glimpse of foresight, the response would have been: "*Signs point to Yes*".

But not before experiencing a few trials along the way.

Seeds of change

Farmaki was the former CIO and co-leader of private equity at Athens-headquartered Piraeus Group, where she worked alongside Siokos, who was head of asset management.

With an impressive combined rolodex, the duo and a growing team of hedge fund, asset management and infrastructure executives, started to raise capital for a USD 200m Alternative Assets Specialist Fund, which by September 2017 was halfway towards reaching the total and sizing up infrastructure assets and luxury retirement homes, with a focus on London, Switzerland and Barcelona.

Two months later, Astarte hired Ireland-based DMS for alternative investment fund manager and distribution services, preparing for the 1Q18 launch of the USD 200m fund. Just a day after the DMS link-up was announced, Astarte was shortlisted in the category of "Most Innovative Manager" at the Institutional Asset Management Awards 2017 in New York.

That fund did not pan out as planned, for reasons not explained. Could it have been the fee model? The skill set with the team at the time? Or were LPs looking for something less vanilla? Keeping persistent, Astarte's original team, which also included former headline grabbing hedge fund trader Spiros Skordos, went back to the drawing board to come up with something a little more unique: Astarte Special Opportunities Platform (ASOP).

The platform would allow Astarte to place and grow operational teams, effectively creating a new generation of GPs in the real assets and infrastructure space. The partners would bring their specialist know-how, offering under-the-radar investment opportunities, and Astarte would bring their institutional LP contacts, related reporting standards, fundraising and discretionary fund investment experience.

One of the only challenges potentially faced here, according to a legal source familiar with the fundraising environment of the time, was non-commercial – such as procedural Known Your Customer (KYC) checks, which can derail or delay a deal for an LP to participate.

But according to Farmaki, Astarte's large database of investors also comes with a pre-existing understanding of which investors are investing in what, giving the platform "a targeted process."

At the time of writing, the discretionary GP seed fund (ASOP) is days away from reaching a hard cap of between USD 200m and USD 250m.

Over the next three years, Astarte wants to seed three or more co-GPs via ASOP. Astarte will be a co-GP with each partnership and take part in the fundraising. Each fund is targeting approximately USD 400m fundraising.

For each new fund raised, 10% of ASOP's AUM will be allocated to a co-GP partnership. The remaining capital raised will be positioned in a co-investment vehicle to be invested in between eight and 10 portfolio investments led by the co-LP partnership.

In a recent interview with *Inframation*, Siokos said Astarte is targeting a net IRR return of 20% and a net multiple on invested capital of 2.6x for investors.

The sweetener? Those investing in the co-GP seed discretionary ASOP will pay no management fees.

"The other unique element is how we compensate," says Farmaki.

"On the discretionary side, we give LPs discretionary fund ownership of the GP stakes we structure whereby the JV is under the fund, not outside as the manager."

"The GP economics they make, including the management fees, carried interest, anything that comes with this, including goodwill – as there is a big market for GP stakes – all of that is owned by the fund and the investors reap the benefits. This in addition to returns they intend to make on the asset side," she adds.

For those LPs not yet internally prepared for a co-GP commitment, they are welcome to co-invest alongside them in one or even several to-be-launched co-investment funds targeting natural resources (a South American forestry fund is soon to be launched), transport, and future core infrastructure. Co-investors not invested in the discretionary co-GP vehicle will, however, pay fees typical of private equity models – such as 1.5%-2% and 20%, benchmarked to the asset class.

Future-core infra

Astarte's first co-GP partnership under ASOP was launched in April 2019 with real estate partner Yoo Capital. Astarte made a seed investment of just under 10% of the target GBP 400m for the real estate fund: Yoo Capital Fund II, a closed-end structure. Weil Gotshal advised on the ASOP real estate fund structure, and Schulte Roth & Zabel advised on the corporate side. DMS was been retained for distribution services.

The fund will look to invest in between eight and 10 deals in what Astarte calls "transforming" prime infill and edge-of-prime real estate that can be turned into institutional-quality "future core" real estate assets such as university housing, EV charging stations, and multi-purpose communities, predominantly across Greater London and major UK cities.

The emerging fund manager is led by: Chairman John Hitchcox, a developer perhaps best known for his work on the Manhattan Loft Corporation in London and Paris, the latter of which he collaborated with Philippe

Starck; and Lloyd Lee, Managing Partner, who oversees the firm's investment strategy as well as for originating and negotiating its major transactions.

The official relationship started two years ago, when a mutually known investment advisor suggested they connect, given their like-minded future real asset strategies.

Farmaki says she and Siokos were impressed with what the Yoo team was doing with its first fund – a 2016 vintage GBP 200m pledge fund in collaboration with Deutsche Finance International. The first fund includes the GBP 304m acquisition and development plan of Olympia Exhibition Centre, a mixed-use regeneration project, bought from London-listed from Capco.

Lee says real asset deals, such as Olympia, create communities of mixed-use space, from university labs and incubators to theatres and offices that can often provide an enterprise value greater than their parts.

The new fund with Astarte is attracting LPs that are already seasoned real estate and infrastructure fund investors, he says.

A new infra fund

Astarte has confirmed to *Inframation* that it wants to partner with a European co-GP and launch a European infrastructure fund through the ASOP platform in the second half of 2020, with a final close around the end of the second quarter of 2021.

This fund will be within the USD 400m target total size and as with the first real estate/future core fund, 10% of funds will come from the ASOP co-GP discretionary fund, whereby those LPs invested will pay no management fees. The hurdle rate is expected to be at standard market level for infrastructure funds. The co-GP partnership will be incentivised through performance-based compensation not disclosed.

Astarte will be eyeing opportunities in Western Europe and also North America for future funds within energy transition, waste-to-energy, energy storage, telco infrastructure and urban transport.

These plans for an infrastructure fund could be due in part to the talent now at work at the firm.

Earlier this year, six new hires joined the now 20-strong team, which is spread across the London headquarters, North America, Europe, and Australia. Hires joined from AMP Capital, Santander Project Finance, Royal Bank of Canada (London), Citigroup, and hedge funds and family offices out of the US and Europe.

What works in PE...

"We are a very specialist player with a very novel product," says Farmaki. "Both of these aspects make raising capital, trying to get the attention, understanding and right comfort level of LPs not only time consuming, but very difficult."

She says that when they first launched the concept of the ASOP, they did not see anything comparable to their co-GP seed funding and fee model in the infrastructure space.

"Yet, interestingly, we have seen the seeding early-stage GPs concept developing within the private equity sectors, which is our biggest validation in a way," she says.

Offering institutional quality emerging co-GP partnerships for LPs to invest with no management fees remains a novel concept for the infrastructure sector, according to legal fund structuring and financial advisory sources spoken to for this article.

A seasoned legal partner specializing in fund structures, including infrastructure, says that he has not come across a similar structure or fee model in the European infrastructure asset class.

Fee structures continue to be fairly consistent in infrastructure. The ultimate structure or fee model for an LP in the asset class comes down to the relative bargaining strengths of the parties involved in the fundraising, the legal source says.

"We are not seeing signs of attrition on established GPs, but new ones can find it more challenging and negotiations can become more protracted or heavy-going."

The fund structuring specialist also says that having a history with an LP will give a manager a much better indication if an investment is suitable for co-investment or the time that it may take for them to get a deal done.

"When working with an LP for the first time it is often a shot in the dark, unless perhaps they are a very well-known and established brand that is reputed to be doing a lot of co-investments and will have the capacity to execute deals efficiently or in a set time frame," says the legal source.

Farmaki says not all of their investors on the discretionary side will co-invest with them in certain opportunities, not because they do not understand the opportunity, but rather because it does not match their asset allocation or they do not have additional capacity.

She admits that their ASOP model may not be for everybody.

"We are not in the market to try to meet requirements on co-allocations or on more widely used strategies. For this reason, we have a targeted audience. I would not say we have something revolutionary, but in terms of the deal flow and the investors that do invest with us, they want to get exposure to these less traditional areas of real assets. They are not happy with a vanilla proposition because they could have done that directly with someone else," says Farmaki.

Jonathan Koerner, a US-based partner that specializes in implementation including fee negotiations at alternative asset advisory firm Albourne Partners, says that emerging fund managers with a bespoke infrastructure offering are taking the lead in non-core infra because the larger established funds "have a good hold on the deal flow and can fund those larger capacity core deals."

Koerner, perhaps best known in the alternative asset class as one of the architects of the "1-or-30" fee structure developed initially for Teacher Retirement System of Texas back in 2016, says that Albourne is seeing core infrastructure GPs offer new strategies alongside their core vintage, but within a separate business and opportunity given the higher risk.

Victim of own success?

Since Astarte set up shop, completed a fund model rethink, and backed its first GP, the fundamentals for infrastructure investment have experienced an evolution cum revolution, of sorts.

Among LPs, change has been brewing over fees in the alternative assets space, and infrastructure is also in the line of fire. In many ways, infrastructure, for all its popularity, might now be a victim of its own success.

The search for stable returns and recurring yield in a low interest rate environment has prompted investors over the past decade, and especially in the last three years, to steadily increase their allocations to the infrastructure asset class, with a record amount of USD 460bn in assets under management, around four times more than ten years ago, according to Partners Group's Outlook 2020 report.

According to Roberto Cagnati, Co-Head Portfolio Management at Partners Group, any deviation from the current mix of fundamentals, low discount rates and high valuations could lead to a "pronounced correction in asset prices."

Some LPs are now getting nervous about GPs even hitting hurdle rates.

A handful of better performing funds are managing to push down the hurdle rate from 8% down to 7% or even 6%, with the carry percentage less than 20%, says James Wardlaw, Vice-Chairman of Infrastructure at placement agent Campbell Lutyens.

And it does not help when financial reports of mega funds are recording significant increases in management fee revenues, while performance fee revenues are in some cases going in the opposite direction.

Timing could finally be on Astarte's side with its ASOP proposition on fees and projected higher returns in future core infra. Despite the challenges and growing pains it has overcome, and will undoubtedly endure as a specialised operator, there must be a shared sense of pride among the team knowing that they could be instrumental in creating a new way of thinking about infrastructure investment.