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King Customer wants co-investment

How Catalyst Capital reflects the changing face of European private equity real estate managers

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Through a prolonged downturn, retailers fare differently. Some manage to trade robustly and open up new shops without much difficulty. Some, unhappily, decide to shut stores. Others, meanwhile, take a good look at themselves, accept they will have to trade with reduced formats and reconfigure their offering to better suit customers accordingly.

It may not be a perfect metaphor, but in this regard European private equity real estate is beginning to resemble a high street.

Of course, there are some success stories around – Patron Capital and Perella Weinberg Partners may be the most-often cited of the pure-play Europe-focused firms. There also are some for whom the bell has tolled – Grove International Partners and Doughty Hanson Real Estate spring to mind for having closed their European operations or deciding against raising future funds. Still, both of those categories are at least matched in size by the third category. These are the firms that seem destined to downsize funds, or at least alter fund structures and accept lower fee arrangements.

Catalyst Capital, the London-based group, provides a working case study. **It has just launched Catalyst Capital European Property Fund II** and, unlike its €230 million predecessor of a 2007 vintage (which, by the way, made only one investment prior to late 2010), the follow-up is a hybrid model that puts co-investment at the heart of the strategy. Each investor's financial allocation will be split into two elements – a smaller commitment over which Catalyst will have discretion for an associated fee and a larger amount for co-investment over which each investor will retain the investment decision.

Catalyst is hoping to raise €150 million through a traditional blind-pool equity fund and the rest in co-investment capital, providing it with a total of €600 million to continue investing in opportunistic deals alongside partners such as The Blackstone Group and the Abu Dhabi Investment Authority. The idea is that the investor has to commit to the smaller fund, but it gets the option to put a bigger chunk into any given deal.

It is easy to see how this structure serves a useful purpose. It is a GP response to investors demanding 'optionality' and, at the same time, provides potential sellers with the confidence that the GP has the equity to complete a deal. The cynic might ask if it also is a response to performance but, in the case of Catalyst, that is not the case. At least, investors don't see it that way – one said the firm was an upper-quartile performer in its last vintage.

Moreover, by opting for this kind of hybrid structure, Catalyst provides a ready example of the kind of decisions that investment managers are taking after a great deal of thought. Moorfield Group, another London-based firm, also has co-investment capital as a more defined part of the structure for its new fund, for which it reached a first close earlier this month.

Both efforts are signs of the times. Given the choice, today's champions of the co-investment strategy might have preferred to raise larger blind pool funds the way they used to (and collect higher managements as a result). Apparently that isn't what the market wants them to do. To borrow from the retail world again, the best operators give customers what they want without becoming a charity. Indeed, they must.