Supporting act

Hodes Weill, which has helped to raise capital for some of the best known real estate investment managers over the years, is now seeking to provide capital to the managers themselves. By Evelyn Lee

Hodes Weill, the New York-based firm best known for its capital raising and advisory work on behalf of real estate investment management firms such as Clarion Partners and Cerberus Capital Management, is making a major move into principal investing with the launch of a new investment firm, Tunbridge Partners.

Tunbridge, which will buy minority stakes in midsized managers, will receive a total of approximately $500 million in initial backing, primarily from private equity firm Pine Brook, family office Soros Fund Management and two US pension plans. Hodes Weill co-founders David Hodes and Doug Weill and Tunbridge chairman Brian Finn, portfolio manager Sean Gallary and principal Keith Funston also are contributing equity equal to less than 5 percent of the initial capitalization. *PERE* last month spoke with Hodes, Weill and Gallary to discuss how the firm came together, the opportunity to provide capital for midsized managers and the potential conflicts that may arise with the new business.

Hodes and Weill: ramping up in principal investing

PERE: ***How did the idea for Tunbridge come about?***

Doug Weill: The seeds of the idea for Tunbridge really began in 2010, and it was borne out of discussions with our advisory clients. We were hearing from boutique managers that the challenge they were facing was evolving their business models to deliver a range of products to their client base, not just to raise fund after fund, but to enter the separate account business, the open-end fund business, raise co-investment capital.

We were also hearing from the managers how there was no capital available for some of their needs, and those needs could be for working capital, capital for expanding the business into new geographies and bring on new teams, launch new products, retiring partners and non-strategic shareholders that need to get bought out, lift-outs, spin-outs. As we started really looking at the market, and we were in discussions with managers and hearing about their capital needs, we realized that nobody was filling that need and that we could step in.

Sean Gallary: There are capital solutions out there for the hedge fund space and for private equity and traditional long only. There was no real solution focused on real estate and real assets.

DW: We were a relatively small team of people sitting in New York when we first started to conceptualize Tunbridge, and we were not built out enough in terms of our global manager outreach or institutional coverage. So we had a few preliminary discussions and then we put the idea essentially on the back burner. We built out our advisory business, opening up offices in London and Hong Kong in late 2011 and early 2012, and built the team out to what today is 26 professionals between New York, London and Hong Kong. Then we started to think about this business again, because the need we had identified was always there and it actually was becoming more apparent when the capital markets became a bit more fluid and managers were beginning to raise capital again for a range of strategies. The boutique managers were getting left behind by the big managers, who were getting more than their fair share of real estate allocations.

That's the point in time when we got back in touch with Brian Finn, who had been chairman and CEO of AMF [Asset Management Finance Corporation] to talk about potential backing. That led to Brian joining as chair and managing partner in early 2014 and putting some working capital into the company. Sean then joined us in the second quarter of 2014. And that was when we really drafted our business plan and really honed the strategy. So it was the summer of 2014 when we started to have real discussions with institutions, private equity backers, family office capital like Soros. We were able to pull the shareholder base together over the course of basically 12 months.

PERE: ***Can you talk about how all of you came to know each other?***

David Hodes: Brian had been at Credit Suisse (CS) from the 1980s to the late 90s. He had a very strong career at CS and then he left to join a private equity firm. John Mack became CEO in 2001, shortly after the CSFB acquisition of DLJ, and he brought Brian back to assist him in integrating the businesses.

DW: So when Brian came back to CS, he became head of what at the time was called the alternative investments division, where David and I were running the real estate private funds business. We directly reported into Brian for about four years, working closely with him as we grew that business. After Brian was the head of alternatives, he moved into AMF.

SG: CS owned just above 80 percent of AMF. It did the acquisition in August of 2008, and Brian moved in to run the business in January 2009. AMF is a firm that buys stakes in asset managers broadly defined: traditional long only, PE, hedge funds, timber, RE, so across the board asset managers, we bought minority stakes. I was there since 2006, and worked with Brian through 2012.

PERE: ***Investors generally don't like change, especially when it comes to ownership change. Have you had any thoughts about how that may be addressed with Tunbridge?***

DW: We think our investing in the business makes the business itself more stable in many respects from a capitalization standpoint, and it often accompanies succession planning, all things that we as a shareholder are going to be focused on and are good for the limited partner at the end of the day.

DH: We've thought about this a lot for all the obvious reasons. Capital partners that are coming in with a different strategic vision, for example, large institutions that invest in managers with a hope of getting better fee structures or preferred access to deal flow, can destabilize a platform and can unsettle the relationship between the manager and their LPs. We've been in the industry long enough to know that's exactly what you don't want to do. Tunbridge will not be getting involved in a company's governance or investment process.

PERE: ***Some of the firms that you're investing in through Tunbridge could be competing firms for your advisory clients. Couldn't that pose a potential conflict?***

DW: That is something that we've put a lot of thought to. We always are working with a number of clients that compete with each other in some respect. They compete for deals, they compete for clients. But we're very careful about not working with clients that have overlapping strategies at the same time. Our view is, if we're going to be investing in a specialized manager, we're making a deep commitment to that manager. Will it conflict us, potentially, out of business with someone that has the same specialization? Possibly, but only if that manager if has elected to work with Hodes Weill for distribution coverage. We think that will be the case some of the time, but not all the time. So we've recognized there may be conflicts, but we believe they are manageable.

PERE: ***There's also the concern that potential clients may disclose confidential information, and you may use that information in some way to advise the companies that you invest in through Tunbridge.***

DW: First of all, we're always under confidentiality. We have a long track record of being discreet in this industry. The information we'll be getting from a manager is not entirely dissimilar to what we get when we underwrite 200 managers a year. But more importantly, the reason we've set up Tunbridge as a separate business with a separate team in a separate physical space and under a registered investment advisor is to address some of those issues. So Sean and Keith will be doing the underwriting and that information will be essentially behind a wall relative to Hodes Weill, an actual wall and a compliance wall. That's one of the exact reasons why we set the business up like we did at the end of the day.

DH: You could say the same thing about any company that has more than one client, whether you're a fund manager or an intermediary, such as an investment bank or placement agent. You have to look beyond the question and just say, reputationally, do people act in a compliant and responsible manner, whether or not they're under a non-disclosure agreement? People want to draw their own conclusions, but I think they have to look at the long history and reputations of all the principals involved in these two businesses.

PERE: ***How does Tunbridge make money?***

SG: The simple answer is we're buying minority stakes into real estate and real asset managers that have fee streams. As the managers grow and develop new products, we're going to participate in the growth and the new products that they develop. And if their business shrinks and goes through a tougher time, our economics are going to shrink along with their economics.

PERE: ***Can you talk about how Hodes Weill's investment in Tunbridge is structured?***

DW: From a dollar's standpoint, we're not writing a massive check. The majority of the capital is coming from the institutional shareholders in the business. We have the ability to earn more equity in the business as it grows, and that's all incentive-based. But out of the gates, as a percentage, we're a smaller shareholder. The idea is we earn up over time.

PERE: ***Any thoughts on an ultimate exit for Tunbridge?***

DW: We will need to create liquidity for the founding shareholders, but not for five to 10 years from now. That could be via a listing of some sort, sale of additional shares in the company, a sale of the company to someone. But what's important to note is that the management team doesn't need an exit. Our capital in each manager is permanent equity and we will not look to sell individual interests for liquidity purposes.

SG: I don't believe that the only solution which people think of is that we have to take this portfolio of investments and sell it. There's plenty of ways to recap and inject new capital and have a solution for initial investors while just continuing to be Tunbridge and growing the business.

PERE: ***Do you have any companies that you're likely to be closing on soon?***

DW: We don't have anything that's imminent. What we're doing now is we're just in the communication phase, getting out to the market, telling people what we're all about, starting to tell them that there's this type of capital in the marketplace. We are hopeful that we'll transact in 2016, but if we don't, don't be surprised, because these investments take a long time. □

Tunbridge, Vermont: the company's namesake

What's in a name

Tunbridge refers to both the town of Tunbridge, Vermont and the state soil of Vermont. "The significance is two-fold, in that real estate starts with the dirt and a number of the partners at Hodes Weill – including David Hodes, Susan Swanezy and myself – have been skiing and vacationing in Vermont for years with our families," said Weill.

Each state has selected a state soil, which is a type of soil with specific characteristics and a special significance to a particular state. The Tunbridge series became the third official state soil in the country in March 1985.