News & Analysis

Exclusive: LPs push Blackstone to raise infra fund's hurdle rate at first close

One investor said the original rate was 'just not a standard hurdle', as we take a closer look at the $5bn first close, one of the industry's largest first closes for a debut fund.

By **Jordan Stutts** - 26 July 2018

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Blackstone raised the hurdle rate on its infrastructure fund before its recent $5 billion first close after investors expressed concern the vehicle's preferred return on investments was too low, according to two sources familiar with the matter.

The New York-based firm – which launched the open-ended Blackstone Infrastructure Partners last year, targeting $40 billion – increased the minimum return needed to collect carried interest from 5 to 6 percent, the sources told *Infrastructure Investor*. The sources added the increase was reflected in documents LPs signed in recent weeks before the fund's first close.

Originally marketed at 5 percent, BIP's new hurdle is the only term Blackstone has changed in more than 13 months of fundraising, both sources confirmed. One added there were "no economic changes" to BIP, which is targeting a 10 percent net internal rate of return (12 percent gross).

Asked whether the hurdle increase applied to all LPs, that person responded it was "a consistent adjustment".

Terms for the vehicle include a 1 percent management fee based on the net value of BIP's assets and 0.5 percent on uninvested capital; a two-year, 25 percent first-close fee discount; a 12.5 percent carry; and a six-year lock-up period, two sources told *Infrastructure Investor*, including a US LP that ultimately decided against investing in the fund.

Blackstone declined to comment.

'Not a standard hurdle'

A US-based institutional investor that committed to the fund before first close told *Infrastructure Investor* 5 percent is "just not a standard hurdle" and would have felt "much better" about 8 percent.

"These things get negotiated sometimes," the LP explained, saying the raised hurdle, which is still 2 percent shy of the more standard 8 percent, "brings us into alignment" with Blackstone.

Kelly DePonte, managing director at San Francisco-based placement agent Probitas Partners, agreed that fund terms sometimes change before a close is held. However, he told *Infrastructure Investor* it would be tough getting LPs to agree to that low a preferred return.

"Having a 5 percent hurdle is of course beneficial to any fund manager. That means they're in the carry earlier," he said. "On closed-ended funds, 8 percent is the hurdle. That really has been sticky across both private equity and infrastructure, and it's been hard to move [LPs] off that."

BIP's now 6 percent hurdle and 12.5 percent carry compare favourably to **IFM Investors**' Global Infrastructure Fund, one of the oldest open-ended infrastructure funds on the market, with $22.4 billion of assets under management. According to public pension documents from August 2017, IFM was charging a 0.77 percent management fee based on commitments of less than $300 million and 0.65 percent on commitments equal to or greater than $300 million. It set carry at 10 percent on a standard 8 percent hurdle rate.

Another open-ended fund, **JPMorgan Asset Management's Infrastructure Investment Fund**, which had a $6.1 billion NAV in August 2017, has a 7 percent hurdle and 15 percent carry, according to public pension documents. The vehicle charges a 1 percent management fee based on NAV for commitments less than

$100 million, 0.9 percent on capital between $100 million and $300 million and 0.8 percent on anything greater than $300 million.

On the closed-ended front, Stonepeak Infrastructure Fund III, which closed earlier this month on $7.2 billion, is charging a 1.5 percent management fee and a 20 percent carry (15 percent for first close investors) on an 8 percent hurdle, according to public pension documents.

In addition to a lower-than-normal hurdle, DePonte said NAV-based management fees may be unfamiliar to many LPs. He explained that NAV-based fees "act a bit like carried interest" because as asset values go up, so too does the amount of fees a firm collects.

"What looks off the bat as cheap may not be cheap," DePonte warned, adding: "If you're selling a fund like this to people who don't really take a look at a lot of infrastructure funds, and especially who don't take a look at a lot of open-ended funds, the people really may not be understanding what they're buying."

But the LP that committed to the fund said: "We believe the open-ended structure has expenses and other things that a closed-ended structure might not have to deal with, so we were able to get comfortable with the terms we ultimately signed off on."

He added the LP's investment board found the size of assets BIP is targeting, Blackstone's plan to invest in US infrastructure and the firm's reputation as one of the premier global fund managers as reasons to commit capital.

A record-breaking anchor commitment

Blackstone launched BIP in May 2017, as chief executive Stephen Schwarzman traveled with President Donald Trump and other US business leaders to Riyadh to drum up trade ties with Saudi Arabia.

That trip netted BIP a $20 billion anchor commitment from the Kingdom's Public Investment Fund, which agreed to match dollar-for-dollar third-party capital the firm raises. It's uncommon for one LP to effectively own 50 percent of a fund, especially one that could one day be worth $40 billion, but Blackstone has maintained Saudi Arabia's PIF will not influence investment decisions. Half of the $5 billion first close commitments came from the sovereign wealth fund.

A first close that large means it's almost certain there are numerous LPs committed to the fund. However, only a handful are publicly known, including the Pennsylvania Public School Employees' Retirement System, New Mexico State Investment Council, the Teacher Retirement System of Texas and Louisiana Parochial Employees' Retirement System.

According to US pension documents, Blackstone's plan is to invest 70 percent of BIP's $40 billion in North American infrastructure – a target the firm aims to reach "over the next decade or so", then-president Tony James said on a February earnings call. PSERS, which has committed $500 million to BIP, stated the firm is aiming to raise $7.5 billion by early next year, netting BIP a total of $15 billion, including PIF's commitment.

Blackstone has yet to make any investments from BIP, but with a first close behind it that could soon change. Pension documents state the firm will make investments of around $1 billion each, mostly in operating North American infrastructure, including energy, transportation, water and waste, and communications. Thirty percent of the fund is allocated for Western European assets, and a small portion will be invested in greenfield projects.

The team managing BIP is led by Sean Klimczak, who since 2005 has worked on the firm's energy and power investments. Former General Electric executive Stephen Bolze was hired in August to head infrastructure portfolio operations and asset management. Other senior team members include people already working at Blackstone and new hires from EIG Global Energy Capital and the infrastructure investment division of the Ontario Municipal Employees Retirement System.

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