

Alpha

Renting Rooms

Fully equipped "hotel" facilities beckon start-ups.

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For start-up hedge fund Outpost Investment Group, finding a place to anchor its new operation wasn't just about real estate. The New York-based firm needed data lines, networking, servers, desktops, laptops, software and the technical assistance to put it all together.

A few years ago Outpost probably would've turned to a prime broker that leased just the sort of space-plus-service package it sought. But brokers for some time have been pulling back from the so-called hedge fund hotel business, stung by complaints about conflicts of interest and reeling, too, from a multitude of unrelated headaches.

Demand for specialized office space persists, however. Funds like Outpost — preferring to focus their resources on portfolio management — are still in the market for office space that includes strong technical support. This presents an opening to financial technology services companies, hedge fund consultants and mini-prime brokers, all of which have begun offering leased space with tech extras to emerging hedge funds.

Outpost wound up signing a deal with Eze Castle Integration, a Boston-based tech service and consulting company that was founded in 1995. Eze opened an entire high-rise floor of hedge fund work space in midtown Manhattan in January. Outpost moved in on March 17 and is now raising capital. It expects to begin trading next month.

"We weren't equipped to do all of those things we needed to do as well as build out our tech infrastructure," says CEO Peter Forlenza, who left his job as global head of equities at Bank of America to launch Outpost. "That would have meant hiring computer support personnel. This is all sort of plug-and-play, so you can concentrate on raising assets and portfolio construction."

Dealing with the technical details of starting and running a hedge fund has never been appealing to most managers, who would just as soon let someone else string cable and install software. Prime brokers understood this and years ago began leasing blocks of space in their trophy buildings to hedge fund clients, bolstering their returns by including in such deals technology services drawn from their existing operations. The arrangement brought new hedge fund clients to prime brokers and gave nascent funds a way to cut through the tangle of getting a new operation up and running.

But then came the exodus of big hedge fund space providers. Bank of America bailed out and Bear, Stearns & Co. was sold under duress to JPMorgan Chase & Co., a firm that doesn't operate hedge hotels. Though UBS continues to provide office space and technology to hedge funds, it is being investigated by the state of Massachusetts over reports that it lured tenants with low rents and then overcharged for brokerage and other services. UBS says it has done nothing wrong, but the case has not been a good advertisement for broker-sponsored hedge fund space.

Larry Tabb, founder and CEO of research firm Tabb Group in Westborough, Massachusetts, says that the decline in prime-broker participation has been a setback for new funds.

"Typically, the folks who start up funds, particularly smaller funds, have the ability to trade or invest but generally don't have the ability to select technology or pick a portfolio-accounting system — or even want to," Tabb says. "They don't want to be underneath the desks connecting computers. To a certain extent these hedge fund hotels are

important for smaller players. Without them there would be fewer start-ups, and the start-ups would be more difficult."

Tabb says it's too early to tell how well companies like Eze Castle will fare. "The demand is there," insists Vinod Paul, an Eze Castle managing director of services who is in charge of the company's midtown Manhattan office suites. "We get three or four requests for space per week." (Eze won't say what it charges for space.) The company is considering opening hedge-fund-tailored offices in other cities, too, based on its success in New York — the 18,000 square feet it put up for lease in January was spoken for within 45 days (ten hedge funds currently operate out of the suites).

HedgeCo Networks, a West Palm Beach, Florida-based hedge fund consulting company, recently announced that it was converting 8,000 square feet of space in New York into hedge-fund-tailored offices. HedgeCo runs and creates hedge fund Web sites, sells hedge fund management software and provides start-up assistance to emerging managers. Shoreline Trading Group, a California- and New York-based mini-prime broker with an extensive technology arm, offers space and tech support to hedge funds at an office building in Santa Monica. Knowledge Suites, a company with hedge fund advising expertise, has opened Toronto's first hedge fund hotel.

The tech component the new providers offer is straightforward — even basic. The Eze setup, which is among the most extensive, comes with Internet access via an in-house network, BlackBerry and phone service, a dedicated file server, a disaster file-recovery and backup system, and connections to market-data vendors. The standard deal includes trial software. Eze keeps an office one floor down, giving tenants immediate access to a round-the-clock help desk staffed by 25 technicians.

Outpost CEO Forlenza acknowledges that the arrangement comes at a price: "Do I think we could have gotten it slightly cheaper? Yes. But it is cost-effective for what we need."

Skeptics say that for some managers, however, hedge fund hotels aren't worth it. New York-based Isabel Schauerte, an analyst with financial research and consulting firm Celent, says experienced managers launching new funds should be able to get started on their own.

"Star traders usually don't have difficulty bringing in assets or setting up the required infrastructure," Schauerte says. "For lesser-known players, however, it is of enormous value to get this technological and infrastructural start-up boost."

Others caution that the hedge fund industry is more likely to consolidate than spawn a wave of start-ups, which could spell trouble for the new breed of hedge fund hotels.

"I'm not sure there is a ton of business out there for them," Tabb says.