MEKETA CAPITAL

Decoding the Potential Co-Investment Advantage

Four Questions with Co-CEO Steve McCourt

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The new year often inspires fresh perspectives and strategic planning, particularly for investment professionals focused on portfolio positioning and delivering value to clients. Private markets continue to take center stage as advisors seek innovative ways to balance risk, return, and cost efficiency.

Among the options for accessing private markets—primary funds, secondaries, or co-investments—co-investments may stand out as a compelling strategy. They offer direct access to private companies without the typical "2 and 20" fee structure, potentially saving investors 5%–8% annually. But how do co-investments work? Why do general partners (GPs) offer them? And what does it take to gain access to these opportunities?

In this paper, Steve McCourt, Co-CEO of Meketa Investment Group, explores the strategic role of co-investments, why GPs value them, and how Meketa leverages its experience, relationships, and disciplined due diligence to make the most of these opportunities.

What are co-investments, and what strategic role do they typically play in a private markets portfolio?

Co-investments are direct investments made into a company alongside a general partner (GP). To better understand what makes co-investments different, consider a typical private equity fund: limited partners (LPs) provide capital into a blind pool with little insight into the individual companies being purchased. In contrast, co-investments are direct invitations to invest in a specific company.

Put another way, imagine you pay for a popular meal kit service. The meal kit provides a collection of pre-portioned ingredients for a meal. While you may have chosen the type of meal, you don't get to select the specific ingredients—similar to investing in a traditional fund. By contrast, co-investing is like going to the grocery store to shop for particular ingredients. You can browse the aisles yourself, evaluate the options, and decide if it's something you want to buy. You also sidestep the mark-up of the meal kit service.

One of the strategic roles co-investments generally play in private markets portfolios is providing access to private investments while offering greater control over managing fees. This is especially important in maximizing investment outcomes, which typically happens by controlling what can be controlled. Primary and secondary funds are typically accompanied by management and performance fees, commonly referred to as "2 and 20"—a 2% management fee and a 20% performance fee.

Co-investing, however, is often done without those fees, which can be a significant advantage. Fee savings from co-investments may amount to as much as 5%–8% per year, making them a compelling option for enhancing net returns in a private markets portfolio.

Why do general partners offer co-investments at reduced fees outside of their typical fund structure, where they get the "2 and 20" management fee?

Private equity funds often have diversification limits (e.g., no more than 10% in a single company), requiring additional equity capital to close deals. Without co-investment capital, a GP may be at risk of losing deals.

Further, access to co-investment capital allows GPs to invest their funds more quickly (allowing them to raise new funds more quickly). Also, co-investment capital can be a very efficient way for GPs to finance add-on acquisitions to platform companies in their funds. Without access to this capital, they are less able to grow their platform businesses.

By offering reduced fees, co-investments have historically incentivized large institutional limited partners (LPs) to provide this needed capital. This practice began in the early 2000s and has grown as equity requirements in private equity transactions have increased, driven by reduced bank lending.

Today, access to co-investment capital gives GPs a competitive edge, allowing them to close deals quickly and compete more effectively in the market. Co-investment capital has become increasingly valuable and essential for private equity managers to execute transactions.

How do general partners make the selection of who gets access to these co-investments?

Accessing most co-investments requires meeting a few key criteria. General partners (GPs) prioritize working with investors who can evaluate investment opportunities quickly and effectively within tight timeframes, as speed and efficiency are critical to closing deals.

Additionally, GPs prefer to accept co-investment capital from organizations with whom they have long-standing relationships. For organizations like Meketa, with over 25 years of experience investing in private markets, these relationships are built on trust and consistency.

As a result, GPs welcome co-investment capital from us because of our scale and our established presence in the private markets industry. They trust that we'll continue to provide capital reliably for decades to come. Moreover, they know that when we express interest in co-investing, we believe we have the expertise and resources to evaluate and execute the deal within the compressed timeframes required for such transactions.

How do you effectively diligence co-investment opportunities?

The first step in evaluating a co-investment is understanding the general partner (GP). Since every co-investment is tied to a GP, it's crucial to know who they are, what their track record looks like, and how they approach their investments.

When we look at a co-investment opportunity, we dig into all the due diligence the GP has done to underwrite the deal, as well as any additional analysis from outside consultants working with the private equity manager.

We also take a close look at our portfolios to see if this co-investment would be a good fit. Does it add diversification? On top of that, we evaluate whether the investment lines up with the GP's historical strengths—that's where we believe they're most likely to succeed.

At the end of the day, it's about being thoughtful and deliberate. Our goal is to choose co-investments that align with our goals, leverage the GP's expertise, and have the potential to deliver meaningful long-term value.

For more information about co-investments and opportunities from Meketa Capital, please contact us at info@meketacapital.com.

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