

FALKIRK COUNCIL

Subject: PRIVATE EQUITY AND ALTERNATIVES UPDATE
Meeting: PENSIONS COMMITTEE
Date: 5 JUNE 2014
Author: CHIEF FINANCE OFFICER

1. INTRODUCTION

- 1.1 This report updates the Committee on the progress and key events arising from each Manager's investment programme for the three months to 31 March 2014.
- 1.2 The Fund's private equity and alternatives programme is managed as follows:
- | | | |
|----------------------------|---|-------------------------|
| SL Capital (Standard Life) | - | European Private Equity |
| Wilshire Associates | - | Global Private Equity |
| Grosvenor | - | Global Infrastructure |
| M&G | - | Credit Markets |
- 1.3 The Fund's strategic allocation to private equity and alternatives (excluding the allocation to the Baillie Gifford Diversified Growth Fund) is set at 10% of total fund assets. This is split 5% to private equity and 5% to infrastructure.
- 1.4 The attached schedule gives details of the current valuations and commitment levels.

2. SL CAPITAL PARTNERS

- 2.1 SL Capital is a subsidiary of Standard Life Investments, who in turn own 60% of the business. The remaining 40% is owned by 8 partners.
- 2.2 The Fund's overall commitment to SL Capital is €102m (£84m), spread across four European Investment Funds – ESP 2004, ESP 2006, ESP 2008 and ESF 1 – all being fund of fund structures.
- 2.3 The first quarter of 2014 has seen the manager reasonably active with the Fund benefitting from distributions of €1.8m from the maturing 2004 and 2006 ESP Funds. With regard to drawdowns, €2m was called in for ESP 2008 and ESF I.
- 2.4 In terms of market outlook, the manager observes a gradual acceleration in economic growth in northern Europe. However, Italy and France remain areas of concern due to a lack of financial reform, whilst with Spain - where cost cutting measures have been implemented - the challenge is in finding underlying managers of proven quality.

- 2.5 Recent strategic developments include a final close for ESF 1 at the end of 2013 and the taking over of the private equity investments of Ignis Asset Management to the value of €800m. In respect of this latter development, SL Capital have indicated they will be increasing their staffing complement accordingly.
- 2.6 SL Capital have a pipeline of products available for investment, however as the Fund's actual allocation to private equity is in line with its strategic allocation, there is no pressing need to make a further commitment at this stage.

3. WILSHIRE ASSOCIATES

- 3.1 The Fund has made various commitments to Wilshire Associates covering several geographical areas. €10.9m has been committed to European focused funds, \$53.2m to US and \$3.8m to Asia, On top of this there is the recent \$15m commitment to Fund IX which has a global scope. In total, this equates to £52m.
- 3.2 In their quarterly update, Wilshire reaffirm their view that 2013 was a turning point for global economic recovery and the longer term stabilisation of private capital markets. This is based on global GDP growth in 2013 being 3% and Wilshire's observation that private fund-raising and deployment of capital are all continuing to improve.
- 3.3 During the quarter, there was a slight decrease in deal flows across Wilshire's Euro Funds with €36k called in and €393k distributed. The US Dollar funds continued to show greater activity with \$546k called in and \$1.5m being distributed.

4. GROSVENOR CAPITAL

- 4.1 The Fund's global infrastructure investments are made through an \$80m commitment to the Customised Infrastructure Strategies Fund managed by the GCM Customised Fund Investment Group (CFG).
- 4.2 Although no distributions were made during the quarter, healthy investment activity was demonstrated by CFG calling in €4.6m and advising that they expected to make the final investments to the Customised Fund in Q2 2014 which will make the Fund fully subscribed.
- 4.3 Grosvenor have recently announced that they are seeking to raise capital of \$750m for a second infrastructure fund (CIS II). As with CIS I, the team are targeting a mix of primary funds, secondary fund purchases, direct/co-investments and, opportunistically, infrastructure debt. The Fund will be looking to have 45% of investments in North America, 45% in Western Europe and 10% in the rest of the world.
- 4.4 CIS II has a target return of 10% plus and a cash yield of between 3%-5% p.a. The managers advise that they are seeking broad diversity by investing across different sectors and geographies, by investing in a mix of green and brownfield investments (although tilted heavily towards brownfield) and by investing in a range of structures over a three year period – broadly speaking, a similar strategy to CIS I.

- 4.5 The CFG team of 6 senior professionals have an average of 18 years' experience in infrastructure and with bases in New York and London appear well placed to have oversight of global opportunities. Net returns from CIS I have been just above 10% (for 1st close investors) and the team continues to have the endorsement of the Fund's investment adviser, Hymans Robertson.
- 4.6 Setting aside the potential investment of £30m that may be made to UK/Scottish Infrastructure, the Falkirk Fund's allocation to global infrastructure is 5% of the Fund value. As the current commitment equates to around 3%, a further commitment could be made to the CFG to increase investment levels towards the 5%.

5. CREDIT MARKETS

- 5.1 The M&G UK Companies Financing Funds provide the pension fund with exposure to UK credit markets. The Funds play a valuable economic role in providing debt financing to UK companies that face refinancing challenges. The aim of the M&G Funds is to create attractive levels of income for investors - LIBOR plus 3%-6% - with low levels of risk.
- 5.2 Falkirk's commitment to the M&G Fund I is £11.8m and this has now been fully invested. The more recently agreed commitment of £10m to Fund II is in the process of being drawn down.
- 5.3 The most significant event recently affecting Fund I has been the sale by the Stobart Group of 51% of their transport and logistics business. This resulted in them having to repay their Fund I loan together with an early repayment fee of £750k. Fund I also includes loans of between £30m and £100m made to companies such as Hogg Robinson, Taylor Wimpey and Provident Financial. The return from the Fund is currently 5% and all loans are being repaid in accordance with their covenants.
- 5.4 In relation to Fund II, five loans equalling £135m have now been made to companies including Workspace Group plc, Caffè Nero and Hall & Woodhouse Ltd. The average loan period in this Fund is 6.4 years. Since the launch in November, 2012, the Fund has achieved a net return of 5.25%.

6. CONCLUSION

- 6.1 The investment experience of our private equity managers is that conditions are becoming more receptive to fund-raising and deal making. This gradual thawing of the financial climate is welcome as several of our funds are reaching their divestment or harvesting stage with managers of the underlying funds actively seeking opportunities to realise their assets through public offerings, trade sales or secondary sales.
- 6.2 Grosvenor Capital Management are raising capital for a second Customised Infrastructure Strategies Fund. As the Falkirk Fund is underweight in its allocation to global infrastructure, consideration should be given to making a commitment to the new fund.

7. RECOMMENDATIONS

7.1 The Committee is asked:

- (i) to note the progress of the Private Equity, Infrastructure and Credit Markets Programmes as at 31st March 2014;**
- (ii) to agree whether or not a commitment should be made to the new infrastructure Fund being launched by Grosvenor CM; and**
- (iii) subject to the decision in (ii) above, the amount of any commitment.**

Chief Finance Officer

Date: 23 May 2014

Contact Officer: Alastair McGirr

LIST OF BACKGROUND PAPERS

NIL

Appendix A

Falkirk Council Pension Fund Alternative Markets Update - 31/03/2014

Exchange Rates	
\$	1.6574
€	1.2031

Alternative Assets Summary - Approx Sterling Value

Manager	Fund	Commitment £,000	Unfunded £,000	(a) Cost £,000	(b) Return of Cost £,000	(c) Distribtn Gains £,000	(d) Market Value £,000	(b + c + d) Total Value £,000	Total Value to Paid in Cap.	Inception Rate of Return
<u>Private Equity</u>										
SL Capital Partners	European Strategic Partners 2004	24,936	2,876	22,060	7,354	5,637	13,474	26,465	1.20	5.5%
SL Capital Partners	European Strategic Partners 2006	24,936	3,418	21,518	5,175	1,433	17,846	24,454	1.14	2.4%
SL Capital Partners	European Strategic Partners 2008	22,442	10,101	12,341	1,069	-	12,381	13,450	1.09	-0.7%
SL Capital Partners	European Smaller Funds I	12,468	10,224	2,244	-	-	1,871	1,871	0.83	N/A
SL Capital Partners Total		84,782	26,619	58,163	13,598	7,070	45,572	66,240		
Wilshire Associates	Fund VI - Europe	2,992	230	2,762	1,320	913	1,519	3,752	1.36	5.8%
Wilshire Associates	Fund VII - Europe	2,992	290	2,702	477	270	2,147	2,894	1.07	-0.8%
Wilshire Associates	Fund VIII - Europe	3,075	740	2,335	372	307	2,160	2,839	1.22	30.7%
Wilshire Associates	Fund VI - US	8,447	495	7,952	2,691	2,572	5,442	10,705	1.35	3.5%
Wilshire Associates	Fund VII - US	6,939	531	6,408	1,713	1,408	4,998	8,119	1.27	3.2%
Wilshire Associates	Fund VIII - US	7,663	1,133	6,530	1,723	786	5,697	8,206	1.26	5.2%
Wilshire Associates	Fund VII - Asia	1,086	114	972	402	237	599	1,238	1.27	3.1%
Wilshire Associates	Fund VIII - Asia	1,207	720	487	104	34	480	618	1.27	-15.5%
Wilshire Associates	Opportunities Fund II-B	9,050	2,319	6,731	3,547	1,221	3,840	8,608	1.28	9.5%
Wilshire Associates	Fund IX	9,050	9,050	0	0	0	0	0		
Wilshire Associates Total		52,501	15,622	36,879	12,349	7,748	26,882	46,979		
Private Equity Total		137,283	42,241	95,042	25,947	14,818	72,454	113,219		
<u>Infrastructure</u>										
Credit Suisse/Grosvenor	Customised Infrastructure Strategies	48,268	13,568	34,700	3,519	1,933	34,006	39,458	1.14	7.0%
Infrastructure Total		48,268	13,568	34,700	3,519	1,933	34,006	39,458		
<u>Credit Markets</u>										
Prudential/M&G	UK Companies Financing Fund	11,835	0	11,835	2,593	103	10,752	13,448	1.14	4.7%
Prudential/M&G	UK Companies Financing Fund II	10,000	7,371	2,629	0	21	2,681	2,702	1.03	2.5%
Credit Market Total		21,835	7,371	14,464	2,593	124	13,433	16,150		
Total Alternative Fund Value		207,386	63,180	144,206	32,059	16,875	119,893	168,827		