

FALKIRK COUNCIL

Subject: PRIVATE EQUITY AND ALTERNATIVES UPDATE
Meeting: JOINT MEETING OF THE PENSIONS PANEL AND COMMITTEE
Date: 11 DECEMBER 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 30 September 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 Capital | - 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 (£81m)**, spread across four European Investment Funds – ESP 2004, ESP 2006, ESP 2008 and ESF 1 – all being fund of fund structures. The partnerships have been established for 14 years from the final close of each Fund.
- 2.3 The third quarter of 2014 has seen the manager remain reasonably active. The Fund continues to benefit from its maturing investments in the 2004 and 2006 ESP funds, receiving **distributions of €2.9m (£2.3m)** during the quarter. As in the previous quarter, there was **€1.4m of calls (£1.1m)**, the majority relating to ESP 2008 and ESF 1 funds, which are in the seed/growth stage of their investment lifecycles.
- 2.4 All funds comfortably outperformed the MSCI Europe Index of 2.6% for the quarter. Highlights included increases in the value of the Alchemy and Altor III Funds and rises in the value of various co-investments including HSS Hire, Unifeeder and the Spotless Group. In the 2008 Fund,

a new co-investment was made in Parques Reunidos, a Spanish leisure facilities operator. In the ESF 1 Fund, a new commitment has been made to a France Special Situations Fund II.

- 2.5 There has been little change in manager sentiment from the previous quarter with the northern part of the Eurozone giving grounds for optimism and the southern part being more of a challenge - the exception being Spain where some signs of recovery have been evidenced..

3. WILSHIRE ASSOCIATES

- 3.1 During the period from 2004, the Fund has made various commitments to Wilshire Associates covering several geographical areas as follows:

European Funds	-	<u>€10.9m</u>
US Funds	-	\$53.2m
Asian Funds	-	\$ 3.8m
Global (Fund IX)	-	<u>\$15.0m</u>
Dollar Funds		<u>\$72.0m</u>
Total Commitment		<u>£54.4m</u>

- 3.2 In their quarterly update, Wilshire highlight the dangers of overpaying for assets in the US and the formation and challenges of a new US regulatory group reporting on how Private Equity and Hedge Funds value assets, disclose fees and communicate with investors. Nevertheless, Wilshire remain cautiously optimistic of the global macroeconomic environment, albeit wary of rising geopolitical tensions.
- 3.3 During the quarter, **€817k (£650k) was distributed** from the Euro funds while **€192k (£150k) was called**. As one would expect, given the larger allocation to dollar funds, **\$2.9m (£1.8m) was distributed** and **\$775k (£490k) called**. The majority of distributions this quarter have come from the US Funds VI, VII and VIII.
- 3.4 In terms of personnel, Kevin Nee, president of the Wilshire Private Markets business has departed and his role taken up by the existing Chief Investment Officer, Karl Beinkampen. Wilshire are comfortable that the change in personnel can be absorbed having had a strategy of strengthening their global senior management team over the past couple of years.

4. GROSVENOR CAPITAL

- 4.1 The Fund's global infrastructure investments are made via a commitment of **\$80m (£51m)** to the Customised Infrastructure Strategies (CIS) Fund managed by the Grosvenor Capital Customised Fund Investment Group (CFIG). The Fund has now funded around 80% of its commitments.

- 4.2 The CIS Fund seeks to generate attractive risk-adjusted returns by investing in a diversified range of infrastructure funds, co-investments and secondaries. A pipeline of deals is in the process of being evaluated. These focus on Northern America and Europe in the transportation and energy delivery sectors.
- 4.3 Although no distributions were made in Q3, a major distribution of around **\$7m** is expected in Q4. Capital calls in Q3 amounted to **\$2.5m**. Total value to paid-in capital stands at over 1.20 and CFG are confident that the 10% IRR target for the fund will be comfortably achieved.
- 4.4 The CFG team are raising capital for a second infrastructure fund and are seeking commitments for a first close. Hymans remain positive about the CFG team. They are performing well and although a Fund of Funds structure, they target a high proportion of co-investments and secondaries, in order to mitigate costs and the J-curve impact. Hymans do point out however that any commitment would effectively be a commitment to an illiquid asset and consequently the Committee may prefer to await the outcome of the impending strategy review before making any financial decision.
- 4.5 Details of the CFG Investment proposition are attached as an Appendix to this report. Not for Publication.

5. M&G UK COMPANIES FINANCING FUNDS

- 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 facing refinancing obstacles. The aim of the Funds is to create attractive levels of income for investors - LIBOR plus 3%-6% - with a low level of risk.
- 5.2 Falkirk's commitment to the M&G Funds is **£11.8m to Fund I** and **£10m to Fund II**. Fund I has been fully invested and Fund II is in the process of being drawn down - **£390k** being drawn down in the quarter.
- 5.3 For Fund 1, the portfolio consists of 8 loans with an average repayment period of 5.3 years and average credit rating of BB+. For Fund II, the portfolio now consists of 7 loans with an average repayment period of 6 years. The latest loan is £20m to Holidaybreak Leisure, a provider of educational activity holidays.
- 5.4 All loans continue to be paid in accordance with their covenants.

6. CONCLUSION

- 6.1 The investment outlook of the Fund's private equity managers remains broadly optimistic, with valuations in recent quarters being ahead of listed equity markets and merger and acquisition activity on the increase. The infrastructure and credit market managers continue to source deals at a satisfactory rate.
- 6.2 It is noticeable that rates of return on individual funds are gradually improving as distributions increase from the more mature private equity funds. The cash thrown off by these funds has

helped maintain Fund liquidity generally and will help investments such as the Social Housing mandate and local Infrastructure to be invested without other assets having to be liquidated.

- 6.3 It remains the intention to commission further analysis of the Fund's private equity performance as part of the broader review of strategy.

7. RECOMMENDATIONS

- 7.1 **The Panel and Committee is asked to note the progress of the Private Equity, Infrastructure and Credit Markets Programmes as at 30th September and invited to comment as appropriate.**
- 7.2 **The Committee is asked agree that a decision to invest in the Second Infrastructure Fund of Grosvenor / CFGIF be delayed until the Fund's strategic investment review has been completed.**

Chief Finance Officer

Date: 30 November 2014

Contact Officer: Alastair McGirr

LIST OF BACKGROUND PAPERS

Appendix to this Report Not for publication by virtue of Paragraph 9 of Part 1 of Schedule 7A of the Local Government (Scotland) Act 1973.

Any person wishing to inspect the background papers listed above should telephone Falkirk 01324 506304 and ask for Alastair McGirr

Appendix A

Falkirk Council Pension Fund Alternative Markets Update - 30/09/2014

Exchange Rates	
\$	1.5723
€	1.2598

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
Private Equity										
SL Capital Partners	European Strategic Partners 2004	23,813	2,753	21,060	8,016	6,449	11,844	26,309	1.25	5.9%
SL Capital Partners	European Strategic Partners 2006	23,813	3,052	20,761	5,726	2,126	17,075	24,927	1.20	3.2%
SL Capital Partners	European Strategic Partners 2008	21,432	8,352	13,080	1,212	107	14,265	15,584	1.19	1.3%
SL Capital Partners	European Smaller Funds I	11,907	9,020	2,887	-	-	2,559	2,559	0.89	N/A
SL Capital Partners Total		80,965	23,177	57,788	14,954	8,682	45,743	69,379		
Wilshire Associates	Fund VI - Europe	2,858	177	2,681	1,646	1,023	1,177	3,846	1.43	7.2%
Wilshire Associates	Fund VII - Europe	2,858	208	2,650	778	367	1,957	3,102	1.17	0.5%
Wilshire Associates	Fund VIII - Europe	2,937	650	2,287	596	410	2,087	3,093	1.35	31.9%
Wilshire Associates	Fund VI - US	8,904	522	8,382	3,242	3,050	5,514	11,806	1.41	5.7%
Wilshire Associates	Fund VII - US	7,314	455	6,859	2,013	1,900	5,645	9,558	1.39	5.8%
Wilshire Associates	Fund VIII - US	8,077	852	7,225	2,271	1,292	6,394	9,957	1.38	9.8%
Wilshire Associates	Fund VII - Asia	1,145	113	1,032	521	352	607	1,480	1.43	6.8%
Wilshire Associates	Fund VIII - Asia	1,272	713	559	151	37	586	774	1.38	-14.2%
Wilshire Associates	Opportunities Fund II-B	9,540	2,162	7,378	4,181	1,518	3,971	9,670	1.31	9.7%
Wilshire Associates	Fund IX	9,540	8,668	872	0	0	1,432	1,432		
Wilshire Associates Total		54,445	14,520	39,925	15,399	9,949	29,370	54,718		
Private Equity Total		135,410	37,697	97,713	30,353	18,631	75,113	124,097		
Infrastructure										
Credit Suisse/Grosvenor	Customised Infrastructure Strategies	50,881	10,767	40,114	3,710	2,037	43,069	48,816	1.22	8.0%
Infrastructure Total		50,881	10,767	40,114	3,710	2,037	43,069	48,816		
Credit Markets										
Prudential/M&G	UK Companies Financing Fund	11,835	0	11,835	4,747	0	8,822	13,569	1.15	4.9%
Prudential/M&G	UK Companies Financing Fund II	10,000	6,696	3,304	0	89	3,330	3,419	1.03	6.0%
Credit Market Total		21,835	6,696	15,139	4,747	89	12,152	16,988		
Total Alternative Fund Value		208,126	55,160	152,966	38,810	20,757	130,334	189,901		

Note: This appendix has not been published as part of the public agenda as it is considered that it contains exempt information as defined in Paragraph 9 of Part 1 of Schedule 7 of the Local Government (Scotland) Act 1973.

Successor Fund

Fund Overview

The Successor Fund seeks to provide investors with a comprehensive infrastructure solution through a single commitment.

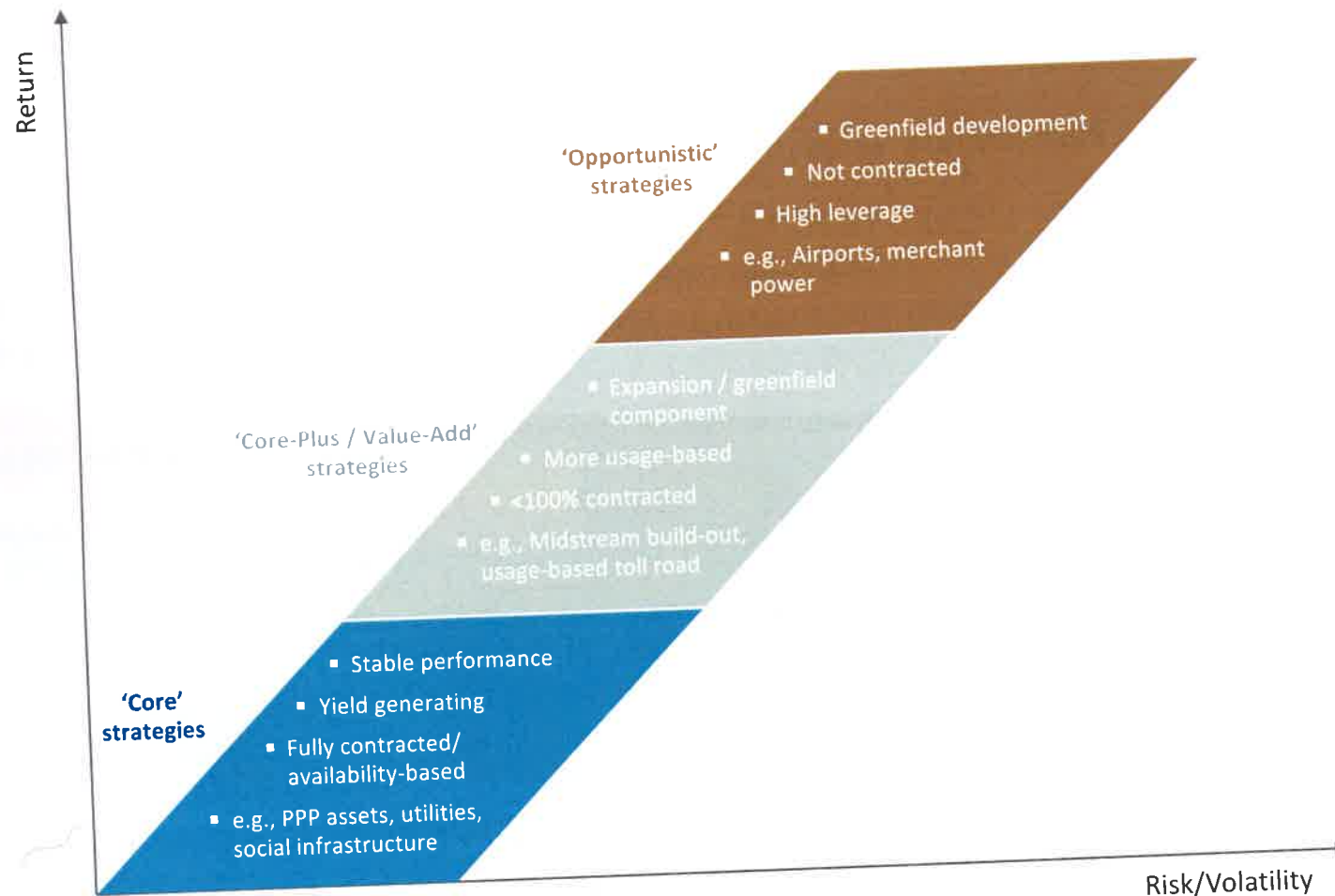
- Successor Fund is targeting total commitments of \$650 million
 - › Target diversification across core, core-plus/value-add and select opportunistic infrastructure assets
 - › Geographic focus on North America, Western Europe and primarily OECD countries in the rest of the world
 - › Predominantly brownfield investments, with small potential allocation to greenfield
- The Fund will target investments in primary infrastructure funds, secondary fund purchases, direct/co-investments, and infrastructure debt investments
- The Fund will take a defensive approach to the asset class, emphasizing current yield
- Target net return of 10%+; cash yield of 3% - 5%¹
- Continue successful CIS I strategy

¹ Target returns and risk parameters are hypothetical in nature and are shown for illustrative, informational purposes only. See the "Target Returns and Risk Parameters – Private Markets" Notes and Disclosures following this presentation for additional information. **THERE CAN BE NO ASSURANCE THAT ANY GCM GROSVENOR PRIVATE MARKETS FUND OR STRATEGY PURSUED BY ANY GCM GROSVENOR PRIVATE MARKETS FUND WILL ACHIEVE ITS OBJECTIVES OR AVOID LOSSES.** Additional detail concerning the methodology used and assumptions is available upon request.

Note: This appendix has not been published as part of the public agenda as it is considered that it contains exempt information as defined in Paragraph 9 of Part 1 of Schedule 7 of the Local Government (Scotland) Act 1973.

Infrastructure Risk-Return Spectrum

The Fund will target core, core-plus and limited opportunistic investments and strategies, as shown below.



This chart is for illustrative purposes only and may not reflect the actual risk-return profile of infrastructure as an asset class or the various infrastructure sub-sectors.

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Fund Advantages

GCM Grosvenor Private Markets believes that the Fund is a unique way for investors to obtain the benefits of a diverse infrastructure portfolio while potentially mitigating some of the challenges of infrastructure investing.

Challenges to Infrastructure Investing

- Emerging asset class
- Large number of first-time funds
- Ability to create a diversified portfolio
- Expensive fee structure; deep J-Curve
- Transparency/knowledge of the asset class
- High investment minimums

the Fund Advantages

- Access to information and opportunities
- Extensive, specialized due diligence
- Prudent diversification
- Appropriate fee structure and lower cost strategies such as direct/co-investments
- Potential to enhance returns and mitigate the J-Curve through direct/co-investments and secondary purchases
- Scale benefits

No assurance can be given that any investment will achieve its objectives or avoid significant losses.

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Summary of Select Terms and Conditions¹

Successor Fund

Name	Successor Fund (the "Fund")
Organization	Delaware limited partnership for U.S. investors; additional structures may be created for non-U.S. and ECI sensitive investors.
Minimum Commitment	\$5 million, subject to waiver by the General Partner
General Partner	GCM Grosvenor Fund Partners I, L.P., or an affiliate of GCM Grosvenor Private Markets
Investment Period	Three years from Final Closing
Term	The fifteenth anniversary of the final closing date plus two successive one-year extensions at the discretion of the General Partner
Management Fee	0.60% per annum of aggregate commitments during Investment Period; thereafter, 0.60% per annum of invested, committed and reserved capital
Carried Interest	Primary Fund Investments – 2.5% Secondary Funds and Direct/Co-Investments – 7.5%
Preferred Return	8.0% per annum, compounded annually

¹ Preliminary, subject to change. This summary of selected terms and conditions is qualified in its entirety by reference to the Fund's limited partnership agreement and other operative documents, copies of which will be provided to prospective investors upon availability and request.