

FALKIRK COUNCIL

Subject: PRIVATE EQUITY AND ALTERNATIVES UPDATE
Meeting: JOINT MEETING OF THE PENSIONS COMMITTEE AND PENSION BOARD
Date: 10 DECEMBER 2015
Author: DIRECTOR OF CORPORATE & HOUSING SERVICES

1. INTRODUCTION

- 1.1 This report updates the Pensions Committee and Board on the progress and key events arising from each Manager's investment programme for the three months to 30 September 2015.
- 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 |
| Hearthstone | - Social and Affordable Housing |
| Lothian Co-Investments | - UK Focused Infrastructure |
- 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 schedules give details of the current valuations and commitment levels in both the original currencies and summarised in Sterling (appendices A and B).

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 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 During the quarter (Q3), €5.3m was returned from ESP 2004, 2006 and 2008 Funds with the largest distribution - €2.6m - coming from ESP 2006. Funds drawn down amounted to €1.3m, split between the 2008 and ESF 1 Funds. This leaves SL with around €22m to be drawn down from the original commitment of €102m. Overall, during the quarter, fund values increased by around 3% which compared favourably with the MSCI Europe which declined by 4%.

- 2.4 Within the portfolio, primary funds tended to outperform co-investments. Investments in Axis Well technology and Expro International declined due to the slump in oil prices, whilst Loch Lomond (whisky producer) and HSS (tool hire) declined due to their respective trading outlooks. These were offset by the sale of Sunrise Medical and increases in the value of funds managed by Clyde Blowers Capital and Living Bridge.

3. WILSHIRE ASSOCIATES

- 3.1 The Fund's commitments to Wilshire Associates are as follows:

European Funds	-	<u>€10.9m</u>
Dollar Funds		<u>\$72.0m</u>

- 3.2 Roughly 9% of the Euro funds and 25% of the dollar funds remain to be drawn down.
- 3.3 During the quarter, Wilshire distributed €0.3m and \$2.5m respectively from the European and Dollar denominated Funds. The main distributions flowed from US Fund VI and the Opportunities Fund II. Capital calls were limited to \$0.7m and, as in Q2, were in respect of US Fund VIII US and Fund IX).

4. GROSVENOR CAPITAL

- 4.1 The Fund's global infrastructure mandate comprises a commitment of \$80m to the Customised Infrastructure Strategies (CIS) Fund managed by the Grosvenor Capital Customised Fund Investment Group (CFIG).
- 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.
- 4.3 Capital called in Q3 amounted to \$1.6m. There were no distributions. The net value of the investments increased from 1.29 to 1.34 of invested capital. The most significant valuation changes related to EIF United States Power Fund IV (owner of power generator across North West America, Macquarie European Infrastructure Fund 1 (owners of company operating Brussels Airport), Coriance S.A (a French provider of heating services) and South Staffordshire Plc (UK water company).
- 4.4 The mandate is almost fully invested with only 11% of the commitment remaining to be drawn down.

5. GROSVENOR CAPITAL – INVESTMENT OPPORTUNITY

- 5.1 As intimated at previous meetings, Grosvenor is seeking to raise \$650m for a second global infrastructure fund ("CIS II"). The second close for this fund is scheduled to take place in early January, 2016. The Fund is targeting a return of 10% with a regular cash yield of 3-5%.

- 5.2 Through their specialist team (average experience in infrastructure of 21 years), Grosvenor have delivered a net IRR of 11% for the CIS I Fund, outperforming the MSCI World Infrastructure Index. Capital has been deployed promptly and the team have demonstrated the ability both to build a diversified portfolio and source new opportunities. Further information about CIS II is attached at Appendix C. It should be noted that there may be scope to negotiate a reduced management fee depending on the level of investment.
- 5.3 As part of its overall remit, the investment sub-group has been considering the extent to which the Fund should be invested in infrastructure. Their conclusion, which takes into account the views of the Fund's investment adviser, Hymans Robertson, is that the allocation should gradually be increased to 9% with a corresponding reduction in equity exposure. The adviser considers that the increased infrastructure allocation could be achieved through further investment with Grosvenor Capital or through the collaborative arrangement with Lothian, or, preferably, through a combination of these options.
- 5.4 The current allocation to infrastructure is approximately 4.6%. A further commitment of \$80m to CIS II (matching the original CIS I investment) and £30m to the collaborative arrangement with Lothian would equate to around 4.5% of the Falkirk Fund and would bring the allocation to infrastructure to a theoretical 9%.
- 5.5 In reality, the adviser considers that capital of between £130m - £150m may actually be required to achieve the 9% target taking account of future distributions. The adviser suggests however that a measured approach be taken towards reaching this goal given the dangers of over-pricing in this asset class and with regard to the timeframe for rebalancing equity.
- 5.6 A representative from Hymans Robertson will be attending the joint meeting and will be happy to discuss this matter further.

6. M&G UK COMPANIES FINANCING FUNDS

- 6.1 The M&G UK Companies Financing Funds provide the Fund with exposure to UK credit markets. The Funds provide debt finance to UK companies facing refinancing obstacles. The Funds aim to create an attractive level of income for investors – LIBOR plus 3%-6% - with a low level of risk.
- 6.2 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.
- 6.3 For Fund 1, the portfolio consists of 8 loans with an average repayment period of 4 years and average credit ratings of BB+. Loans have been made to companies such as Barrett, Drax, Wincanton and Provident Financial. Since inception the return has been 4.8%.
- 6.4 For Fund II, the portfolio consists of 9 loans but with an average repayment period of 5.5 years. This includes loans to Caffè Nero, Holidaybreak Limited and Workplace Group plc. Since inception the return has been 3.9%.
- 6.5 No distributions or drawdowns occurred during Q3 and all loans continue to be paid in accordance with their covenants.

7. SOCIAL AND AFFORDABLE HOUSING

- 7.1 The Committee has made a £30m commitment to Hearthstone Investments to fund Social and Affordable Housing via their Housing Fund for Scotland. The Fund objective is to deliver returns of RPI + 2%. Hearthstone is working in partnership with Castle Rock Edinvar, the Edinburgh based Housing Association.
- 7.2 The Fund's initial investment of £15m has facilitated a building programme of 195 units across the Forth Valley area. This is being supported by local authorities and the Scottish Government. All units are scheduled for completion by 2017.
- 7.3 Hearthstone are in dialogue with various house builders including Cruden Homes, Taylor Wimpey and Barrett with a view to extending the affordable housing element of the portfolio.

8. LOTHIAN PENSION FUND CO-INVESTMENTS

- 8.1 As outlined in 5.3, the Falkirk Fund has made a commitment of £30m to be invested in UK infrastructure in collaboration with Lothian Pension Fund.
- 8.2 The arrangement involves potential infrastructure deals being sourced, analysed and proposed by the in-house investment team based in Edinburgh. The final decision in relation to each proposed investment has been delegated to the Chief Finance Officer.
- 8.3 To date, three commitments have been made as follows:
 - FIM Harburnhead - £3m towards the construction of a wind farm in the Pentland Hills
 - Ancala Renewables - £4m towards a series of small scale hydroelectric plants in the Highlands
 - Dalmore Capital - £7.5m towards construction of the Thames Tideway Tunnel (sewer)
- 8.4 A more detailed update on the nature and status of the three investments is being provided in a separate report at this meeting.
- 8.5 In view of the fact that Committee is being asked to make a decision regarding a possible infrastructure investment with Grosvenor Capital, it may be appropriate in the light of comments in Section 5 of this report to consider whether to make a further commitment to the shared arrangement with Lothian.

9. CONCLUSION

- 9.1 The alternatives portfolio returned 4.12% over Q3 and comfortably outperformed the cash benchmark by around 4%. The private equity managers noted a rise in the number and size of European deals being undertaken with the average purchase price rising to 8.5 times EBITDA (Earnings before Interest, Tax, Depreciation and Amortisation). It remains to be seen whether this momentum will be sustained in the light of the recent market downturns.
- 9.2 Grosvenor Capital is raising capital for their second infrastructure fund. The Falkirk Fund has agreed to adopt a gradual de-risking strategy which will involve a reduction in equities and an increase in the allocation to infrastructure. Making a commitment to Grosvenor is supported by Hymans Robertson and gives Falkirk the opportunity to invest in a global infrastructure fund with an experienced and successful manager.

- 9.3 The in-house investment team have demonstrated an ability to source a range of diverse and attractive infrastructure projects in UK/Scotland. Consideration should be given to making a further commitment to this arrangement.
- 9.4 Hymans Robertson is supportive of a strategy which involves boosting the allocation to infrastructure through investments with Grosvenor and through the collaborative arrangement with Lothian.

10. RECOMMENDATIONS

- 10.1 The Committee and Board are asked to note the progress of the Fund's Alternatives investments as at 30 September 2015 and invited to comment as appropriate.
- 10.2 The Committee is asked to determine whether:
- i) a commitment of \$80m should be made to Grosvenor Capital's CIS II Fund;
 - ii) a commitment of £30m should be made in respect of the Fund's collaboration in infrastructure investment with the Lothian Pension Fund.

pp Director of Corporate & Housing Services

Date: 27 November 2015

Contact Officer: Bryan Smail/Alastair McGirr

LIST OF BACKGROUND PAPERS

NIL

Appendix A

Falkirk Council Pension Fund Alternative Markets Update - 30/09/15

Alternative Assets Summary - Original Currency

Manager	Fund	Commitment 000's	Unfunded 000's	(a) Cost 000's	(b) Return of Cost 000's	(c) Distrbtn Gains 000's	(d) Market Value 000's	(b + c + d) Total Value 000's	Total Value to Paid in Cap.	Inception Rate of Return	Percentage to be drawn down
Private Equity											
SL Capital Partners	European Strategic Partners 2004	30,000.00	3,169.00	26,831.00	13,858.00	9,919.00	11,682.00	35,459.00	1.32	6.4%	
SL Capital Partners	European Strategic Partners 2006	30,000.00	3,078.00	26,922.00	11,522.00	6,531.00	17,356.00	35,409.00	1.32	4.2%	
SL Capital Partners	European Strategic Partners 2008	27,000.00	7,364.00	19,636.00	3,558.00	2,226.00	19,079.00	24,863.00	1.27	1.9%	
SL Capital Partners	European Smaller Funds I	15,000.00	8,529.00	6,471.00	-	-	6,274.00	6,274.00	0.97	-33.0%	
SL Capital Partners Total		€ 102,000	€ 22,140	€ 79,860	€ 28,938	€ 18,676	€ 54,391	€ 102,005			21.7%
Wilshire Associates	Fund VI - Europe	3,600	223	3,377	2,106	1,336	1,413	4,855	1.44	8.1%	
Wilshire Associates	Fund VII - Europe	3,600	170	3,430	1,335	799	2,402	4,536	1.32	1.3%	
Wilshire Associates	Fund VIII - Europe	3,700	610	3,090	800	850	2,870	4,520	1.46	30.9%	
Wilshire Associates Europe Total		€ 10,900	€ 1,003	€ 9,897	€ 4,241	€ 2,985	€ 6,685	€ 13,911			9.2%
Wilshire Associates	Fund VI - US	14,000.00	751.00	13,249.00	6,172.00	6,324.00	6,851.00	19,347.00	1.46	6.8%	
Wilshire Associates	Fund VII - US	11,500.00	538.00	10,962.00	3,846.00	4,324.00	7,942.00	16,112.00	1.47	8.1%	
Wilshire Associates	Fund VIII - US	12,700.00	624.00	12,076.00	4,197.00	3,193.00	10,345.00	17,735.00	1.47	11.8%	
Wilshire Associates	Fund VII - Asia	1,800.00	142.00	1,658.00	977.00	710.00	730.00	2,417.00	1.46	8.6%	
Wilshire Associates	Fund VIII - Asia	2,000.00	1,114.00	886.00	361.00	154.00	756.00	1,271.00	1.43	-9.5%	
Wilshire Associates	Opportunities Fund II-B	15,000.00	1,954.00	13,046.00	7,450.00	2,728.00	8,050.00	18,228.00	1.40	12.3%	
Wilshire Associates	Fund IX	15,000.00	12,450.00	2,550.00	-	-	2,653.00	2,653.00			
Wilshire Associates US and Asia Total		\$ 72,000	\$ 17,573	\$ 54,427	\$ 23,003	\$ 17,433	\$ 37,327	\$ 77,763			24.4%
Infrastructure											
Grosvenor Capital	Customised Infrastructure Strategies	80,000	9,305	70,695	13,887	11,208	64,508	89,603	1.27	9.0%	
Grosvenor Capital Total		\$ 80,000	\$ 9,305	\$ 70,695	\$ 13,887	\$ 11,208	\$ 64,508	\$ 89,603			11.6%
Credit Markets											
Prudential/M&G	UK Companies Financing Fund	11,835	-	11,835	4,943	-	8,817	13,760	1.16	4.7%	
Prudential/M&G	UK Companies Financing Fund II	10,000	6,034	3,966	249	89	3,872	4,210	1.06	4.0%	
Credit Market Total		£ 21,835	£ 6,034	£ 15,801	£ 5,192	£ 89	£ 12,689	£ 17,970			27.6%
Social / Affordable Housing											
Hearthstone plc	Housing Fund for Scotland	30,000	6,850	23,150	-	-	23,150	23,150	1.00		
Social/Affordable Housing Total		£ 30,000	£ 6,850	£ 23,150	£ -	£ -	£ 23,150	£ 23,150			22.8%
UK Infrastructure											
	UK Infrastructure	£ 30,000	£ 23,450	£ 6,550	-	-	£ 6,571	£ 6,571	1.00		
UK Infrastructure Total		£ 30,000	£ 23,450	£ 6,550	£ -	£ -	£ 6,571	£ 6,571			78.2%

Appendix B

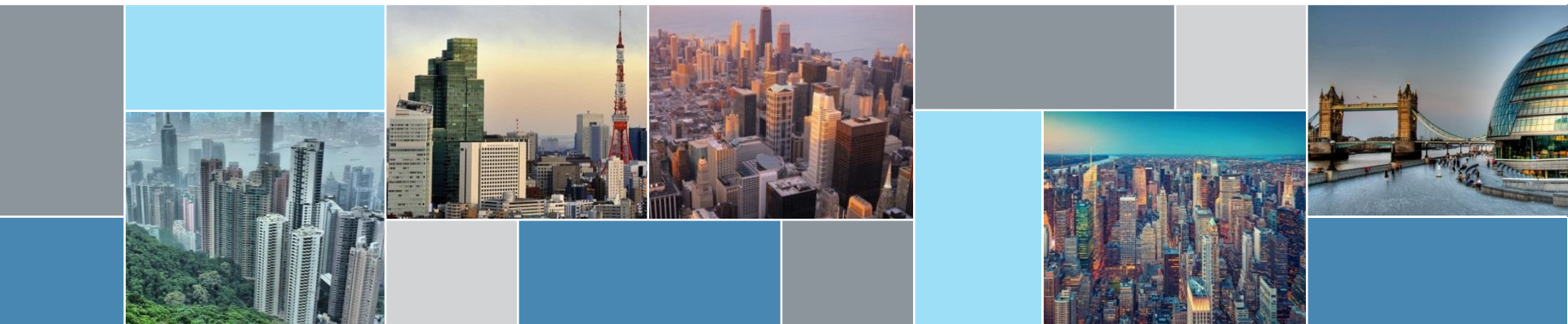
Falkirk Council Pension Fund Alternative Markets Update - 30/09/15

Exchange Rates	
\$	1.5147
€	1.3565

Alternative Assets Summary - Sterling

Manager	Commitment £ 000's	Unfunded £ 000's	(a) Cost £ 000's	(b) Return of Cost £ 000's	(c) Distrbtn Gains £ 000's	(d) Market Value £ 000's	(b + c + d) Total Value £ 000's	Total Value to Paid in Cap.
SL Capital Partners	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!
Wilshire Associates	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!
Grosvenor Capital	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!
M & G	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!
Hearthstone plc	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!
UK Infrastructure	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!
	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!	#REF!	
Allocation to Private Equity (based on unfunded commitment plus market value)		#REF!						
Allocation to Private Equity (based on market value only)		#REF!						
Allocation to Infrastructure (based on unfunded commitment plus market value)		#REF!						
Allocation to Infrastructure (based on market value only)		#REF!						

GCM Grosvenor Customized Infrastructure Strategies II, L.P.



The Notes and Disclosures following this presentation are an integral part of this presentation and must be read in connection with your review of this presentation.

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Executive Summary

GCM Grosvenor Customized Infrastructure Strategies II, L.P.

GCM Grosvenor Private Markets is targeting \$650 million for its second diversified commingled infrastructure fund – GCM Grosvenor Customized Infrastructure Strategies II, L.P. ("CIS II").

- Attractive continuing opportunity in the infrastructure space
 - › Growing private infrastructure opportunity driven by ongoing global privatization, the energy/shale revolution, and the "infrastructure gap"
- Global leader in managing infrastructure investments for institutional clients
 - › \$2.3 billion in infrastructure assets under management
 - › Investing since 2003
- Leading investment team with average of 21 years of experience in infrastructure
 - › Specialized team led by four senior professionals¹
 - › Supported by mid-level and junior members of the GCM Grosvenor Private Markets investment team
- Attractive returns generated by our first diversified commingled infrastructure fund, Customized Infrastructure Strategies I, L.P. ("CIS I")
 - › CIS I has generated a net IRR of 11.3%; net multiple of invested capital of 1.24x^(xi)
 - › CIS I has significantly outperformed the Barclays Aggregate Bond Index, MSCI World Infrastructure Index, and the U.S. CPI^(xii)

Data as of June 30, 2014, unless otherwise indicated. Data updated quarterly.

¹ Includes one consultant who serves as an infrastructure specialist for GCM Grosvenor Private Markets in a part-time capacity.

Data source: Barclays Aggregate Bond Index information is sourced through Thomson Reuters DataStream, U.S. CPI information is sourced through the U.S. Bureau of Labor Statistic, and MSCI World Infrastructure information is sourced through S&P Capital IQ as of June 2014.

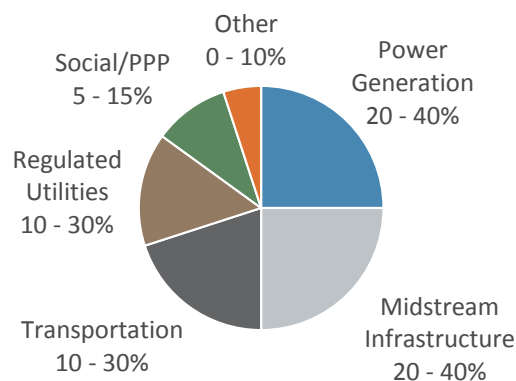
A number of assumptions were made in presenting this track record, some of which are discussed in the "Infrastructure Track Record" Notes and Disclosures following this presentation. Unless otherwise specifically indicated, returns are shown net of all fees, expenses, and carried interest. **Past performance is not necessarily indicative of any future results. No assurance can be given that any investment will achieve its objectives or avoid significant losses.** Additional detail concerning the methodology used and assumptions are available upon request. **CIS I is closed to new investors.**

CIS II Fund Strategy

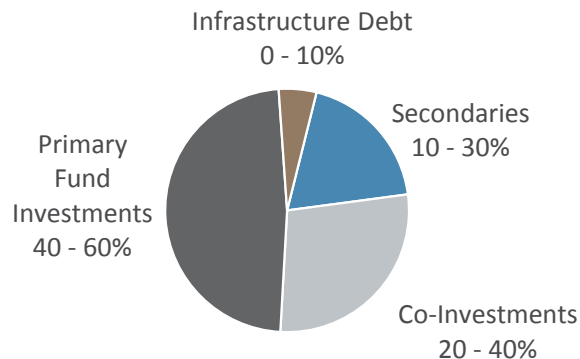
CIS II seeks to continue the successful investment strategy of CIS I.

- Targeting a diversified portfolio of primary funds, secondary investments in funds ("secondaries"), direct/co-investments and, opportunistically, infrastructure debt
- Target net return of 10%+¹

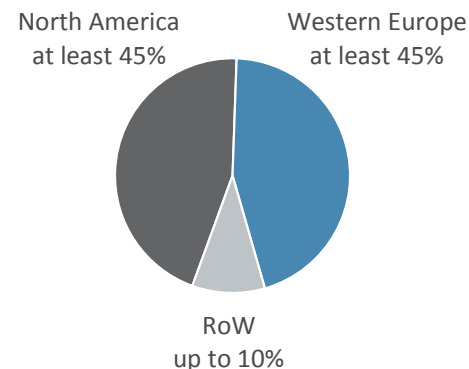
CIS II target sectors



CIS II target strategy



CIS II target geography



¹ Target returns, projections 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 report for additional information regarding target returns and risk parameters. **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.

GCM Grosvenor Customized Infrastructure Strategies II, L.P.

Fund Overview

CIS II seeks to provide investors with a comprehensive infrastructure solution through a single commitment.

- CIS II is targeting total commitments of \$650 million
 - › Target diversification across core, core-plus 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
- CIS II will target primary infrastructure funds, secondaries, and equity and debt co-investments
- CIS II will take a defensive approach to the asset class, emphasizing current yield
- Target net return of 10%+; cash yield of 3% - 5%*

* Target returns, projections 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 report for additional information regarding target returns and risk parameters. **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.

Summary of Select Terms and Conditions

GCM Grosvenor Customized Infrastructure Strategies II, L.P.

Name	GCM Grosvenor Customized Infrastructure Strategies II, L.P.
Organization	Delaware limited partnership structured for U.S. investors; feeder vehicle structured for UBTI and ECI sensitive investors also available
Minimum Commitment	\$5 million, subject to reduction at the General Partner's discretion
General Partner	GCM CFG Fund Partners IV, L.P., an affiliate of GCM Grosvenor Private Markets
Commitment Period	Three years from Final Closing
Term	15 years after the Final Closing; two successive one-year extensions at the discretion of the General Partner
Management Fee	0.60% per annum of aggregate commitments during Commitment Period; thereafter, 0.60% per annum of invested, committed and reserved capital
Carried Interest	Primary Fund Investments – 2.5% Secondaries and Direct/Co-Investments – 7.5%
Preferred Return	8.0% per annum, compounded annually

This summary of selected terms and conditions is qualified in its entirety by reference to CIS II's Private Placement Memorandum, agreement of limited partnership and other operative documents as finalized by GCM Grosvenor Private Markets and the client.