

Falkirk Council

Title: Private Equity and Alternatives Update

Meeting: Joint Meeting of Pensions Committee and Pension Board

Date: 16 March 2017

Submitted By: Director of Corporate and Housing Services

1. Purpose of Report

1.1 This report updates the Committee and Board on the progress and key events arising from the Fund's Private Equity and alternatives programme for the three months to 31 December 2016.

2. Recommendation

2.1 The Committee and Board are asked to note the progress of the Fund's Private Equity and Alternatives programme for the quarter to 31 December 2016.

3. Background

3.1 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

In House/Lothian - UK Infrastructure

- 3.2 The strategic allocation to alternatives is 15% of fund assets, split 5% to private equity and 10% to infrastructure (incl. social and affordable housing). The longer term strategy is to run down the private equity allocation and replace it with other real income generating assets.
- 3.3 Appendices 1 and 2 give details of the current valuations and commitment levels in local currencies and in sterling. Appendix 3 shows the history of calls and distributions over the past 3 years.

4. SL Capital

4.1 SL Capital is a subsidiary of Standard Life Investments, who own 60% of the business. The remaining 40% is owned by 8 partners.

- 4.2 The Fund's 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. The most juvenile of the Funds ESF 1 will be in existence until 2027.
- 4.3 During the quarter (Q4) **3m** was returned and **1.2m** called, reducing the unfunded commitment to **15m** (c.**15%** of the commitment).
- 4.4 Within the unrealised part of the portfolio, there were modest increases in valuations, albeit increases were generally below the MSCI Europe index which increased by 3.8%. Total value to paid-in capital remained at **1.28**.

5. Wilshire Associates

5.1 The Fund's commitments to Wilshire Associates is spread across 10 separate funds as follows:

3 European Funds <u>€10.9m</u> 7 Dollar Funds <u>\$72.0m</u>

- 5.2 **7%** of the Euro funds and **19%** of the dollar funds remain to be drawn
- 5.3 During the quarter, Wilshire distributed €0.7m and \$3.2m. Capital calls during the quarter were \$0.3m. Total value to paid-in capital increased slightly to 1.51 largely on currency weakness.

6. Grosvenor Capital

- 6.1 The Fund's global infrastructure mandate comprises a \$160m commitment split equally between two Customised Infrastructure Strategies (CIS) Funds managed by Grosvenor Capital.
- 6.2 During the quarter, the Funds called **\$11.5m** and distributed **\$5.6m**. Total value to paid-in capital was stable at **1.30**. The returns remain above 10% p.a. Fund 1 is almost fully invested with only **6%** still to be drawn down.
- 6.3 Grosvenor continues to invest in a wide range of infrastructure assets in primary funds, co-investments and in the secondary market. The most recent commitment is to the Macquarie European Infrastructure Fund with capital being deployed in energy generation (including renewables), transport and communications infrastructure.

7. M&G

7.1 The M&G UK Companies Financing Funds provide debt finance to companies facing refinancing obstacles. The target return is LIBOR plus 3%-6% with low risk.

- 7.2 Falkirk's overall commitment to M&G is £15.8m which has been fully drawn down. During Q4, £3.2m was returned, being in the main the repayment of several loans.
- 7.3 The remaining investment consists of 10 loans with an average outstanding repayment period of around 4 years and average credit rating of BB+. The net annualised return from the Funds has been **4.5%**.
- 7.4 All loans continue to be paid in accordance with their covenants.

8. Hearthstone Investments

- 8.1 The Falkirk Fund has made a £30m commitment to Hearthstone to fund Social and Affordable Housing via the Housing Fund for Scotland vehicle. The return objective over the expected investment period of 10 years is RPI + 2%. Around 12.8% of the commitment (i.e. £3.8m) remains to be drawn down. No calls for capital were made during the latest quarter.
- 8.2 An initial £15m invested in support of the social housing programme is being recycled to buy units of affordable housing with these being leased back to the Places for People Group.
- 8.3 Hearthstone has advised that Christopher Down, the business's founder, has stepped down as Chief Executive, but remains a major shareholder. The new Executive Director is Peter Beaumont. The Pensions Manager met with Mr Beaumont and his team recently to gain assurance regarding the strategic direction of the company and to discuss the pipeline of deals being pursued (four separate sites are currently being appraised three in the Lothians and one in the Fund area). At the meeting, Mr Beaumont accepted that Hearthstone should be looking to speed up the deployment of capital and improve the level of reporting.
- 8.4 In relation to the Social Housing Programme which was initiated by the Fund's original commitment, Castle Rock Edinvar have provided an update, as follows:
 - Falkirk area 60 units have been completed at Bellsdyke, Larbert
 - Interest is being pursued in a site at Reddingmuirhead delivering 28 units
 - Stirling area Discussions are progressing with Stirling Council,
 Robertsons and Forth Housing Association with a view to 58
 new units being built as part of the next phase of the Raploch
 Regeneration project.
 - Clackmannanshire Castle Rock are undertaking a viability assessment around a proposed site at Burnside. Progression at this site is likely to depend on the level of grant that can be secured under the Affordable Supply Housing Programme and other available grants.

9. In-House – UK Infrastructure

- 9.1 The Fund has a commitment of **£100m** to UK infrastructure through its collaboration with Lothian Pension Fund.
- 9.2 As at 31 December, 2016, capital has been committed and drawn down for the undernoted six investments:

Investment Partners/Project	Sector	Invested
FIM Harburnhead	Renewables	£3.0m
Wind Farm in the Lothians		
Ancala Partners	Renewables	£5.8m
Scottish Highlands Hydro		
Electric		
Dalmore Capital	Sewerage	£4.7m
Thames Tideway Tunnel		
Ancala Partners	Renewables	£7.8m
Solar Assets in England		
Ancala Partners	Utilities	£7.4m
Gas Supply and Distribution		
Channel Islands / Isle of Man		
Ancala Partners	Utilities	£3.5m
North Sea Gas Pipeline	Otilities	25.5111
UBS	Litilition	
Water & Sewerage Company	Utilities	£6.2m
Totals		£38.4m

9.3 A number of other projects are currently under review or subject to due diligence.

10. Conclusions

- 10.1 The Fund's alternatives programme continues to evolve with private equity funds gradually maturing and infrastructure mandates building up.
- 10.2 Managers remain cautious about the outlook for the global economy being nervous about the ramifications of Brexit and the recent US election.

Director of Corporate & Housing Services

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Date: 8 March 2017

Appendices

Appendix 1 – Alternative Assets Summary – Local Currency

Appendix 2 – Alternative Assets Summary – Sterling
Appendix 3 – Calls and Distributions – Local Currency

List of Background Papers:

None

Appendix 1

Falkirk Council Pension Fund Alternative Markets Update - 31/12/16

Alternative Assets Summary - Original Currency

								(a)		(b)	(c Mari		(b + c) Total	Total	Inception	Percentage
Manager	Fund	Vintage Year	Currency	Cor	nmitment 000's		funded 100's	Cost 000's		istributions 000's		ue	Value 000's	Value to Paid in Cap.	Rate of Return	to be drawn
Private Equity																down
SL Capital Partners	European Strategic Partners 2004	2004	EUR		30,000		3,031	26,9	69	31,609	4	1,677	36,286	1.35	7.7%	
SL Capital Partners	European Strategic Partners 2006	2006	EUR		30,000		2,813	27,1	87	26,797	9	789,	36,586	1.35	6.0%	
SL Capital Partners	European Strategic Partners 2008	2008	EUR		27,000		3,596	23,4	04	11,137	18	3,546	29,683	1.27	4.1%	
SL Capital Partners	European Smaller Funds I	2011	EUR		15,000		5,851	9,1	49	190	8	3,631	8,821	0.96	-24.4%	
		SL Capital F	Partners Total	€	102,000	€	15,291	€ 86,7	09 €	€ 69,733	€ 41	,643	€ 111,376			15.0%
Wilshire Associates	Fund VI - Europe	2005	EUR		3,600		223	3,3	77	4,002		956	4,958	1.47	8.2%	
Wilshire Associates	Fund VII - Europe	2006	EUR		3,600		149	3,4	51	2,960		,603	4,563	1.32	4.2%	
Wilshire Associates	Fund VIII - Europe	2007	EUR		3,700		397	3,3	03	3,215	2	2,466	5,681	1.72	31.5%	
		Wilshire Associates	Europe Total	€	10,900	€	769	€ 10,1	31 €	€ 10,177	€ 5	,025	€ 15,202			7.1%
Wilshire Associates	Fund VI - US	2006	USD		14,000		751	13,2	49	15,685	4	1,525	20,210	1.53	8.9%	
Wilshire Associates	Fund VII - US	2006	USD		11,500		468	11,0	32	10,524	6	5,100	16,624	1.51	9.1%	
Wilshire Associates	Fund VIII - US	2007	USD		12,700		528	12,1	72	10,826	8	3,861	19,687	1.62	13.9%	
Wilshire Associates	Fund VII - Asia	2006	USD		1,800		112	1,6	88	1,974		500	2,474	1.47	10.3%	
Wilshire Associates	Fund VIII - Asia	2007	USD		2,000		1,098	9	02	786		522	1,308	1.45	-6.7%	
Wilshire Associates	Opportunities Fund II-B	2008	USD		15,000		1,102	13,8	98	10,942	10	,389	21,331	1.53	15.8%	
Wilshire Associates	Fund IX	2014	USD		15,000		9,770	5,2	30	847	į	5,338	6,185	1.18	23.2%	
	W	ilshire Associates US a	and Asia Total	\$	72,000	\$	13,829	\$ 58,1	71 \$	51,584	\$ 30	5,235	\$ 87,819			19.2%
<u>Infrastructure</u>																
Grosvenor Capital	Customised Infrastructure Strategies	2011	USD		80,000		5,091	74,9	09	47,181	53	3,568	100,749	1.34	12.8%	
Grosvenor Capital	GCM Grosvenor CIS II	2016	USD		80,000		65,715	14,2	85	351	14	1,510	14,861	1.04	11.0%	
		Grosvenor	Capital Total	\$	160,000	\$	70,806	\$ 89,1	94 \$	47,532	\$ 68	3,078	\$ 115,610			44.3%
Credit Markets																
M&G	UK Companies Financing Fund	2010	GBP		11,835		-	11,8	35	10,024	4	1,303	14,327	1.21	4.7%	
M&G	UK Companies Financing Fund II	2012	GBP		3,966		-	3,9	66	2,617		,738	4,355	1.10	4.2%	
		Credit	Market Total	£	15,801	£	-	£ 15,8	01 £	12,641	£	5,041	£ 18,682			0.0%
Social / Affordable Housing	1															
Hearthstone plc	Housing Fund for Scotland	2014	GBP		30,000		3,850	26,1	50	-	25	5,454	25,454	0.97	-1.3%	
	-	Social/Affordable H	lousing Total	£	30,000	£	3,850	£ 26,1	50 £	- 3	£ 25	,454	£ 25,454			12.8%
UK Infrastructure	UK Infrastructure	from 2015	GBP		100,000		61,506	38,4	94	314	40),231	40,545	1.05	n/a	
			ructure Total	£	100,000	£	61,506		94 £),231				61.5%
		5.1dot			.00,000	_	,	_ 55,1		, VIT		,	0,0.0			01.070

Appendix 2

Falkirk Council Pension Fund Alternative Markets Update - 31/12/16

Exchange Rates	
\$	1.2356
€	1.1715

Alternative Assets Summary - Sterling

			(a)	(b)	(c)	(b + c)	Total
Manager	Commitment £ 000's	Unfunded £ 000's	Cost £ 000's	Distributions £ 000's	Market Value £ 000's	Total Value £ 000's	Total Value to Paid in Cap.
SL Capital Partners	87,068	13,052	74,015	59,525	35,547	95,071	1.28
Wilshire Associates	67,576	11,849	55,727	50,435	33,615	84,050	1.51
Grosvenor Capital	129,492	57,305	72,187	38,469	55,097	93,566	1.30
M & G	15,801	0	15,801	12,641	6,041	18,682	1.18
Hearthstone plc	30,000	3,850	26,150	0	25,454	25,454	0.97
UK Infrastructure	100,000	61,506	38,494	314	40,231	40,545	1.05
	£429,937	£147,562	£282,374	£161,384	£195,985	£357,368	
Allocation to Private Equity (based on unfunded commitmen	nt plus market value)	4.4%					
Allocation to Private Equity (based on market value only)		3.3%					
Allocation to Infrastructure (based on unfunded commitmer	nt plus market value)	10.1%					
Allocation to Infrastructure (based on market value only)		4.5%					

Appendix 3

Falkirk Council Pension Fund Alternative Markets Update - 31/12/16

Alternative Assets Calls and Distributions - Original Currency

			2014					
SL Capital	Currency	in '000	Q1	Q2	Q3	Q4	Total	
	EUR	Capital calls	(2,036)	(1,418)	(1,454)	(3,267)	(8,175)	
	EUR	Distributions	1,868	2,070	2,909	7,167	14,014	

2015								
Q1	Q2	Q3	Q4	Total				
(1,537)	(1,243)	(1,389)	(2,868)	(7,037)				
2,426	3,207	5,313	6,198	17,144				

		2016		
Total	Q4	Q3	Q2	Q1
(4,656)	(1,181)	(1,632)	(486)	(1,357)
16,573	3,028	3,233	3,246	7,066

					2014		
Wilshire Associates	Currency	in '000	Q1	Q2	Q3	Q4	Total
	EUR	Capital calls	(36)		(182)	(221)	(439)
	EUR	Distributions	394	767	818	686	2,665
	USD	Capital calls	(546)	(2,172)	(703)	(1,504)	(4,925)
	USD	Distributions	1,505	2,521	2,993	2,095	9,114

		2015		
Total	Q4	Q3	Q2	Q1
(36)				(36)
1,806	1,032	342	244	188
(2,653)	(835)	(629)	(889)	(300)
8,666	1,707	2,763	2,687	1,509

		2016		
Total	Q4	Q3	Q2	Q1
(186)	0	0	(93)	(93)
1,386	757	290	247	92
(2,526)	(300)	0	(949)	(1,277)
6,987	3,189	1,311	1,482	1,005

			2014				
Grosvenor	Currency	in '000	Q1	Q2	Q3	Q4	Total
	USD	Capital calls	(4,470)	(3,008)	(4,916)	(1,316)	(13,710)
	USD	Distributions				7,153	7,153

		2015		
Q1	Q2	Q3	Q4	Total
(2,266)	(239)	(1,615)	(1,393)	(5,513)
920	7,653		4,403	12,976

	2016							
Total	Q4	Q3	Q2	Q1				
(17,500)	(5,575)	(1,552)	(9,791)	(582)				
17,683	11,497	4,012	2,174	0				

			2014				
M&G	Currency	in '000	Q1	Q2	Q3	Q4	Total
	GBP	Capital calls	(580)	(290)	(387)	(290)	(1,547)
	GBP	Distributions		2,220		312	2,532

2015						
Q1 Q2 Q3 Q4 Total						
	(371)			(371)		
	331		1,364	1,695		

		2016		
Q1	Q2	Q3	Q4	Total
0	0	0	0	0
1,259	442	870	3,226	5,797

			2,014				
UK Infrastructure	Currency	in '000	Q1	Q2	Q3	Q4	Total
	GBP	Capital calls					0
	GBP	Distributions					0

2,015						
Q1	Q2	Q3	Q4	Total		
	(4,898)	(1,845)	(887)	(7,630)		
		173		173		

2016							
Q1	Q2	Q3	Q4	Total			
(7,131)	(8,518)	(4,744)	(4,183)	(24,576)			
49	0	0	85	134			