AGENDA ITEM 3

DRAFT

FALKIRK COUNCIL

MINUTE of JOINT MEETING of the PENSIONS COMMITTEE/BOARD held in the MUNICIPAL BUILDINGS, FALKIRK on THURSDAY 24 SEPTEMBER 2015 at 9.30 A.M.

PRESENT:	Committee:- Councillors Falkirk Council: Jim Blackwood Tom Coleman Steven Carleschi Craig Martin Dr Craig R Martin Depute Provost John Patrick (Convener) Councillor Colin Campbell, Stirling Council Ian McLean, Pensioner Representative Board:- Susan Crook, Unison Sandy Harrower, UCATT Gordon Laidlaw, Scottish Autism Herbie Schroder, UNITE
ATTENDING:	Justyna Korszen-Bennett, Accountant Bryan Smail, Chief Finance Officer Antonia Sobieraj, Committee Services Officer
ALSO IN ATTENDANCE:	Bruce Miller, Investment Manager, Lothian Pension Fund Claire Watson, Graeme Rutter, Neil Turner and Andrew Lyddon, Schroder Investment Management Alan MacDougall, Managing Director, PIRC Ltd Jim Rundell and Louise Dodds, Audit Scotland Linda Selman, Hymans Robertson Kieran Quinn, Chair of Local Authority Pensions Fund Forum (LAPFF)

PE14. APOLOGIES

Apologies were intimated on behalf of Councillor Archie Drummond, Clackmannanshire Council; Jennifer Welsh, SEPA and Ed Morrison, Scottish Children's Reporter Administration's (SCRA).

PE15. DECLARATIONS OF INTEREST

No declarations were made.

PE16. MINUTE

Decision

The minute of the joint meeting of the Pensions Committee and Board on 26 June 2015 was approved.

PE17. GENERAL GOVERNANCE MATTERS

The Committee and Board considered a report by the Director of Corporate and Housing Services presenting an update on various matters associated with the governance of the Falkirk Council Pensions Fund.

The areas covered within the report included the following:-

- The Internal Audit Report;
- The Class Actions;
- The Local Government Pension Scheme Advisory Board;
- The Pensions Regulator; and
- The Local Authority Pension Fund Forum (LAPFF) of 58 local authority Pension Funds.

Decision

The Committee and Board noted the report.

PE18. FALKIRK COUNCIL PENSION FUND - ANNUAL ACCOUNTS 2014/15

The Committee and Board considered a report by the Director of Corporate and Housing Services on the Falkirk Pension Fund's Annual Accounts for 2014/2015 in terms of Regulation 31A of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008, which required administering authorities to publish a Pension Fund Annual Report, recognising that Pension Fund accounts were separate from other accounts of the administering authority, and referring (a) to the incorporation of the ISA 260 report within the annual Report; and (b) attaching as an appendix for inspection, a copy of the Fund's Audited Accounts for 2014/15.

Decision

The Committee agreed to approve the Audited the Pension Fund Annual Report and Accounts for 2014/15 as detailed in the Appendix to the report.

Councillor Coleman left and re-entered the meeting during consideration of the following item of business.

PE19. FALKIRK COUNCIL PENSION FUND - REPORT TO THOSE CHARGED WITH GOVERNANCE ON THE 2014/15 AUDIT

The Committee and Board considered a report by the Director of Corporate and Housing Services on a report by Audit Scotland issued in accordance with the International Standard on Auditing (ISA 260) "Report to those charged with Governance on the 2014/15 Audit".

The report indicated that Regulation 31A of the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 required administering authorities to publish a Pension Fund Annual Report and Accounts which were separate from the other accounts of the administering authority. The report and associated accounts were also subject to a separate audit. The Pension Fund's Unaudited Annual Report and Accounts for 2014/15 were submitted for audit on 19 June 2015 in line with the required statutory deadline.

Under the International Standard on Auditing 260 (ISA 260), auditors, before certifying the accounts, were required to communicate matters relating to the audit to those charged with governance. The report, referred to as the ISA 260, was to be provided in sufficient time to enable remedial action to be taken if necessary.

The ISA 260 reported that, subject to a final review, the audit would be unqualified.

The matters worthy of note included:-

- The revision of the Annual Governance Statement since presenting the Unaudited accounts to reflect feedback from external audit; and
- The incomplete year end reconciliation between annual returns from employing bodies and the ledger due to not all admitted bodies having submitted returns. All the main admitted bodies had now submitted annual returns and any variances highlighted by the reconciliation were not material. All admitted bodies would be reminded to submit their annual returns timeously.

The matters on which the auditor had specifically commented were as follows: -

- That the Pensions Committee should receive a copy of internal audit plans, specifying any pensions related items, to ensure that the scope of work was significant, to allow the Committee to obtain independent assurance on internal controls and risk management;
- The Local Authority Accounts (Scotland) Regulations 2014 introduced a new requirement from 2014-15 for all local authorities (including pension funds) to undertake an annual review of their control system and report this in an annual governance statement. Pension Committee should obtain an annual assurance report from Internal Audit giving their opinion on the control environment including the new pensions system;
- The Internal audit plan for the financial year 2014-2015 did not include any pension specific work. However, this was rectified by including specific pension

work in the 2015/16 internal audit plan, submitted to the council's Audit Committee in April 2015. Subsequently the work was undertaken in early 2015-16 and reported to the management on the 15 July 2015. The Internal Audit report is covered in the General Governance Matters report; and
- The concerns about the staffing level in the Pension Administration Team and the permanent Accountant post.

The Fund's external auditors, Audit Scotland, had completed their report to those charged with governance and anticipated being able to issue an unqualified audit certificate. Matters arising from the 2013-14 report were subsequently addressed during 2014/15.

Decision

The Committee agreed to approve the proposed Annual Audit Report, incorporating the ISA 260 report to those charged with governance from Audit Scotland.

PE20. INVESTMENT STRATEGY REVIEW - PROGRESS UPDATE

The Committee and Board considered a report by the Chief Finance Officer providing an update on the work of the Sub Group reviewing the Pension Fund's Investment Strategy.

The Pensions Committee had agreed on 26 June 2015 to the establishment of an Investment Strategy Sub Group, the purpose being to review the Fund's Investment Strategy and make appropriate recommendations to the Committee. The Group would take forward a de-risking plan within the context of a wider review of the Strategy.

The Sub Group had to date held three meetings and the minutes of meetings were attached as an Appendix to the report. The report also detailed the subject matter to be covered at future meetings.

Decision

The Committee and Board noted the report.

PE21. FUND MANAGER PERFORMANCE REVIEW

The Committee and Board considered a report by the Chief Finance Officer reviewing the overall performance of the Fund and of the undernoted Fund Managers:-

- Aberdeen Asset Management;
- Baillie Gifford (Bond Mandate);
- Baillie Gifford (Diversified Growth);
- Legal and General;
- Newton Investment Management; and
- Schroder Investment Management (UK Equities and Property).

Decision

The Committee and Board noted the Fund Managers' performance and the action taken by them during the quarter to 30 June 2015, in accordance with their investment policies.

PE22. PRIVATE EQUITY AND ALTERNATIVES UPDATE

The Committee and Board considered a report by the Director of Corporate and Housing Services on the progress of the Pension Fund's private equity and alternatives investment programme for SL Capital (Standard Life), Wilshire Associates, Grosvenor Capital, M&G, Hearthstone and Lothian Co- Investments for the quarter ending 30 June 2015.

Decision

The Committee and Board noted the progress of the Pension Fund's private equity and alternatives investment programme for the quarter ending 30 June 2015.

PE23. PRESENTATION - CORPORATE GOVERNANCE

The Committee and Board received a presentation by Councillor Kieran Quinn, Chair of Local Authority Pensions Fund Forum (LAPFF) and Alan MacDougall, Managing Director, PIRC Ltd on shareholder engagement in relation to corporate governance of the local authority Funds.

The presentation covered the undernoted:-

- The value and effectiveness of shareholder engagement;
- The reforms following the global financial crisis;
- The carbon risk strategic resilience resolutions;
- The Board diversity;
- The engagement accountability; and
- The reform of Investment Regulations.

The Convener thanked Councillor Quinn and Mr MacDougall for their comprehensive presentation.

Councillors Carleschi left and re-entered the meeting prior to consideration of the following item of business.

Councillors Dr C R Martin and C Martin left the meeting during consideration of the following item of business.

PE24. PRESENTATION - SCHRODER INVESTMENT MANAGEMENT

The Committee and Board received a presentation by Claire Watson, Graeme Rutter, Neil Turner and Andrew Lyddon, Schroder Investment Management.

The presentation covered the undernoted:-

- Private Market Approach to Infrastructure;
- Customised Infrastructure Strategies, Overview and Portfolio;
- Comprehensive Alternative Investment; and
- Drivers of Infrastructure Opportunities.

The Convener thanked Ms Watson, Mr Rutter, Mr Turner and Mr Lyddon for their comprehensive presentation.

AGENDA ITEM 4

FALKIRK COUNCIL

Subject:	**GENERAL GOVERNANCE MATTERS**
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 Board and Committee on miscellaneous matters associated with the business of Falkirk Council Pension Fund.

2. PENSIONS INCREASE

2.1 Public Sector Pensions, such as the Local Government Pension Scheme, are increased annually each April with the increase being based on the rise in the Consumer Price Index (CPI) in the preceding September. The increase in April, 2016 will therefore be based on the CPI for September 2015. However, as this was a negative of -0.1%, there will be no increase for pensioner and deferred pensioner members in 2016. A zero increase last occurred in 2010. Had the increase been, say 1%, this would have added around £450,000 to the annual pensioner paybill.

2.2 The negative CPI also has an impact on active members. With the LGPS now being a career average scheme, the amount of pension earned each year falls to be revalued in line with CPI. However, the negative CPI means that pensions earned in 2015/16 will not attract a revaluation in 2016. Moreover, it remains to be seen whether HM Treasury will seek to apply a negative revaluation or allow the nil revaluation to stand.

3. PROPOSED SCHEME CHANGES

3.1 The Scottish Public Pensions Agency is amending the Scheme rules as follows:

- to ensure that the surviving spouse of a same sex marriage and the surviving partner of a same sex partnership are entitled to the same benefits as couples of the opposite sex, and

- in the event that a scheme employer ceases to have any active members, to allow administering authorities to delay seeking a cessation payment for a period of up to 3 years, provided they have reasonable grounds to think that the employer will have active members within the permitted delay period.

4. SCHEME ADVISORY BOARD

4.1 The Scheme Advisory Board (SAB) is the body with statutory responsibility for providing advice to the Scottish Ministers on the efficient management of the Local Government Pension Scheme. The SAB works in close conjunction with the Scottish Public Pensions Agency to a work plan agreed by the Scottish Ministers. The latest meeting of the SAB was held in Edinburgh on 26 November.

4.2 The key items on the Board's work plan are as follows:

	Work Scheduled	**Target Date**
1.	Agree a strategic approach to the collection of Fund data in order to facilitate a benchmarking exercise	30 April 2016
2.	Complete a review of the structure of the Scottish LGPS.	30 September 2016
3.	Consider how to improve transparency across the Funds in relation to investment decisions	30 September 2016
4.	Provide guidance as necessary across the Scheme on fiduciary duty, taking account of recent evidence and opinion	31 March 2016
5.	Consider issues surrounding cessation valuations (i.e. where an employer is exiting the Scheme)	30 June 2016
6.	Consider the results of various valuation exercises (i.e. national scheme valuation undertaken by GAD and individual fund valuations)	30 November 2016
7.	Review the Scheme Governance arrangements	31 March 2017

4.3 With regard to item 5, the SAB has considered representations from certain Admission Bodies who are concerned that recent cessation valuations may place their organisations in jeopardy. The SAB is sympathetic to these concerns while recognising that it would be unreasonable to expect other employers to meet the cost of these payments. The change to scheme rules set out in 3.1 can be seen as an initial step in providing Funds with more flexibility to deal with cessation circumstances.

4.4 In relation to item 6, the Government Actuary (GAD) is pursuing work on the Cost Cap mechanism whereby it will be necessary to adjust member contribution rates or the benefit accrual rate if the latest scheme cost has varied by more than 2% from the original 2015 costings. So far, GAD has completed an initial analysis of data from each of the 11 Scottish Funds and is broadly satisfied with its reliability.

5. INFRASTRUCTURE – SCOTTISH PARLIAMENT COMMITTEE REPORT

5.1 The Local Government and Regeneration Committee of the Scottish Parliament has recently published its "Report on pension fund investment in infrastructure and city deal spend". The Chief Finance Officer was one of a number of officers from Scottish Funds who gave evidence to the Committee.

5.2 The report examines the extent to which LGPS Funds are making investments in infrastructure within UK/Scotland; the perceived barriers to further infrastructure investment; and whether public policy initiatives could create an environment for fund investment vehicles to be developed.

5.3 The Committee noted that there was no central overview across LGPS (Scotland) as to how fund assets were being allocated. The Committee considered this an omission, albeit recognising that this information was going to be collated by the Scheme Advisory Board.

5.4 The main barriers to greater infrastructure investment were cited by Funds as project and regulatory risk; governance overheads; high fees; expertise and market presence to source and analyse deals; and the investment limits set by the LGPS Investment regulations.

5.5 Whilst recognising the fiduciary duty owed by Funds to their stakeholders and the need to deliver an appropriate rate of return, the Committee urged Funds not take an unnecessarily cautious approach to risk, but to be proactive in seeking out local infrastructure opportunities.

5.6 The Committee was aware of proposals in England and Wales to pool their 89 funds into 6 large wealth funds. The Committee indicated that it was less attracted to this for the Scottish LGPS Funds on the basis that informal collaborations were working well and because there was a willingness to work together for a shared vision and benefit. In this regard, the Committee recognised the efforts made by Strathclyde, Lothian and Falkirk to invest in domestic infrastructure. However, the Committee observed that at present only an estimated 1% of fund assets nationally were allocated to infrastructure and that this was low in consideration of the positive social and economic impact these investments could bring, not to mention the fact that infrastructure's characteristic of low volatility should make it an attractive proposition for fund investment. The Committee exhorted all funds to challenge themselves to explore local infrastructure opportunities, share expertise and work collaboratively.

6. CORPORATE GOVERNANCE MATTERS

6.1 In discharging its obligations as a responsible investor, the Fund is a member the Local Authority Pension Funds Forum (LAPFF). The LAPFF represents the interests of 65 local authority pension funds with combined assets of around £175 billion. Its mission is to promote the highest standards of corporate governance and social responsibility amongst the companies in which member funds invest.

6.2 The LAPFF is supported by PIRC Ltd, who are the Forum's company research and engagement partner. PIRC are also the Falkirk Fund's proxy voting agents and advisers on ESG matters.

6.3 The recent quarter has seen LAPFF highlight the potential risk to portfolios from climate change. In order to limit the average rise in global temperatures to 2^{o}C, it is estimated that CO2 emissions will require to fall 60% by 2050. Against this scenario, governments may be forced to impose carbon taxes with companies facing the full environmental costs of their actions. Asset owners are therefore being encouraged to understand the extent of carbon exposure within their portfolios. Increasingly, Fund Managers will have to respond to questions such as:

- To what extent is carbon risk embedded in their investment process?
- How is ongoing carbon risk measured and managed?

- Has the Manager made any specific commitment to disclosing the carbon footprint of their investment portfolios?

The issue of carbon risk is on the agenda of the forthcoming LAPFF annual conference.

6.4 Q3 has seen the publication of a legal opinion reinforcing LAPFF's view that accounting standards do not adequately reflect UK company law. This misalignment has led to argue that companies transacting on the basis of unrealised profits contributed to corporate mismanagement in the run up to the financial crisis of 2008.

6.5 The following engagement was undertaken by LAPFF during the quarter:

- BT Group regarding lack of auditor rotation
- Vodafone regarding a possible conflict of interest - a newly appointed director had recently worked for the company's auditors
- Trinity Mirror regarding company strategy and phone hacking claims
- John Menzies regarding its health and safety policy in the light of fatalities at Los Angeles International Airport

6.6 A recent study by PIRC into executive pay amongst the companies comprising the Standard and Poor's 500, disclosed that Chief Executive Officer compensation had increased between 2014 and 2015 by an average of 13%. The study showed that the average pay of a CEO was 328 times the average annual pay of a US employee (around $41k). The analysis showed that there was no significant correlation between the generous salaries and company performance. PIRC regularly votes against inappropriate corporate remuneration packages - recent examples being Microsoft, Medtronic, BHP Billiton, Dixons Carphone.

7. PERSONNEL UPDATE

7.1 Claire Watson who, for many years, has been the Fund's client relationship contact at Schroders is moving to a new role within the organisation. Her replacement is Lyndon Bolton who is a client director for a number of local authority funds.

7.2 Linda Selman, the Fund's longstanding investment adviser with Hymans Robertson is retiring shortly. Discussions are underway with Hymans regarding a replacement adviser. It is anticipated that a verbal update will be provided at the meeting.

8. NAME CHANGE FOR NAPF

8.1 The National Association of Pension Funds, of which the Falkirk Fund is a member, is rebranding itself as the Pensions and Lifetime Savings Association (PLSA). Chief Executive Joanne Segars said the move to rebrand was made "because pensions are changing". Ms Segars added: "Just as the lines are blurring between pensions and other forms of savings, between work and retirement, we have to think differently so we can keep helping our members."

9. FUTURE MEETINGS

Pensions Committee & Pensions Board meetings scheduled for 2016 are as follows:

- 11 March 2016
- 23 June 2016
- 22 September 2016
- 8 December 2016

10. RECOMMENDATION

10.1 The Pensions Committee and Pension Board are invited to note the content of this report and comment as appropriate.

pp **Director of Corporate & Housing Services**

Date: 30 November 2015

Contact Officer: Alastair McGirr

LIST OF BACKGROUND PAPERS

NIL

AGENDA ITEM 5

<u>FALKIRK COUNCIL</u>

Subject: **PENSION FUND - INVESTMENT SUB GROUP 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 provides the Committee and Board with an update on the progress of the Sub Group charged with taking forward the Strategy review. A copy of the Sub Group's latest meeting minute is attached.

2. BACKGROUND

2.1 The meeting of the Pensions Panel and Committee on 11 December 2014 agreed that a review of Fund investment strategy should proceed on the following basis, recognising that the approach would be to work sequentially from a) to d)

a) Determine the level of risk that the Committee was prepared to tolerate
b) Determine the mix of growth and defensive assets that the Fund should target
c) Determine the mix of assets that the Fund should hold in order to meet its objectives
d) Determine the managers who should manage these assets?

2.2 The Pensions Panel and Committee at their meeting on 12 March 2015 agreed that a de-risk plan be progressed and a Sub Group be formed to take forward a wider strategy review.

2.3 Under the new governance regime the Board and Committee at their meeting on 26 June 2015 crystallised the arrangements for the Sub Group.

2.4 A progress report was presented to the Board and Committee on 24 September 2015. It summarised the outcome of the 3 meetings to date and appended minutes of these meetings. The status of progress was summarised thus:-

* a) 5% from Equities but how and to where?
b) Potentially increase allocation to Property, but with regard to the position with Schroders
c) Pursue Smart Beta mandate but to what extent? This would involve Manager search with one possibility being an in-house option via an extension of the shared service arrangement with Lothian
d) Increase Infrastructure allocation, probably via Grosvenor's new Fund and/or further direct fund exposure via collaboration with Lothian
e) Passive wind-down of Private Equity
f) Reluctance to pursue Bond/Debt at this time.

* There are significant work elements to be addressed beyond the above e.g. approach to Environmental, Social and Governance (ESG) issues, at future meetings of the Sub Group.

3. CURRENT POSITION

3.1 The 4th meeting of the Sub-Group was on 2 October 2015 and a minute of the meeting is attached.

3.2 The position may be summarised as follows:-

a) The topicality and importance of Environmental, Social and Governance issues was recognised and it was acknowledged that further work was needed to update the Fund Statement of Investment Principles. [the updated legal opinion being pursued by the National Scheme Advisory Board will inform this work]
b) It was agreed that pursuit of an allocation to "Smart Beta" was attractive. A training session on this would be arranged for the whole Committee and Board.
c) There was agreement that no movement on Bonds was appropriate at this time.
d) There was interest in increasing the allocation to Infrastructure via both Grosvenor and the Lothian Partnership. [note references to Infrastructure in other reports on today's agenda]
e) With respect to Property the main points related to what to do about Schroders and the manner by which the allocation would be increased to 10%.

3.3 The next meeting of the Sub-Group is being arranged for late January/early February and it is expected this meeting will review the position reached to ensure coherence of the draft proposals and also tie-up loose ends. Whereas there may prove in the event to be a need for a further meeting, it is anticipated that a final report with recommendation will be available for consideration by the Committee and Board at their Spring meeting.

4. CONCLUSION

4.1 The Strategy review is progressing well and the Sub-Group has reached substantive positions on a range of key strands. A further report will be submitted to the Spring meeting of the Committee and Board.

pp **Director of Corporate & Housing Services**

Date: 30 November 2015

Contact Officer: Bryan Smail

LIST OF BACKGROUND PAPERS

NIL

DRAFT

FALKIRK COUNCIL

MINUTE of MEETING of the PENSIONS COMMITTEE INVESTMENT REVIEW SUB GROUP in the MUNICIPAL BUILDINGS, FALKIRK on FRIDAY 2 OCTOBER 2015 at 2.00 P.M.

SUB GROUP MEMBERS:	Committee: Councillor Tom Coleman, Falkirk Council Councillor Callum Campbell, Stirling Council Andrew Douglas, Unison Depute Provost John Patrick (Convener) Officers: Bruce Miller, Investment Manager, Lothian Pension Fund Bryan Smail, Chief Finance Officer
ATTENDING:	Pensions Board: Councillor Archie Drummond, Clackmannanshire Council Sandy Harrower, UCATT Jennifer Welsh, SEPA
ALSO ATTENDING:	Simon Jones, Hymans Robertson Antonia Sobieraj, Committee Services Officer

INV27. APOLOGIES

Apologies were intimated on behalf of Linda Selman, Hymans Robertson.

INV28. DECLARATIONS OF INTEREST

No declarations were made.

INV29. MINUTE

Decision

The minute of the meeting of the Pensions Committee Investment Review Sub Group on 9 September 2015 was approved.

INV30. REVIEW OF STATUS OF ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) ISSUES

The Sub Group considered the Fund Statement of Investment Principles last updated in August 2012.

Discussion took place on the need to upgrade the Statement in particular at Section 9 relating to social, environmental and ethical considerations. The significance of these issues could not be understated.

Issues raised included the use of fossil fuels and the question of the morality of investments in companies not paying the living wage.

Clarification was also sought on whether there was a conflict of interest in Hymans Robertson acting as both actuary and adviser to the Fund. In response, the Chief Finance Officer advised that this was a legitimate question and that officers had become comfortable with the position. It was also noted that the actuarial services were shortly going out to tender.

Decision

The Sub Group agreed to consider further the issues associated with the updating of the Fund's Statement of Investment Principles.

INV31. EQUITY STRUCTURE - INTRODUCING AN ALLOCATION TO 'SMART BETA' AND LINK WITH 5% EQUITY REDUCTION

The Sub Group considered a report by Hymans Robertson on options for introducing an allocation to "smart beta" to the Fund.

The report highlighted:-

- The exploration of the merits of introducing an allocation to different "smart beta" strategies within the current equity structure;
- The specific consideration of three different equity structures assuming a 20% allocation of the total equity allocation (11% of Fund assets, following the proposed 5% reduction in the overall equity allocation);
- The modelling of an allocation to a value factor tilted strategy; and
- The introduction of an allocation to both a value tilted and low volatility strategies offers both the potential for extra return relative to a market cap weighted passive allocation and some dampening of absolute volatility.

The funding analysis had concluded that:-

- The funding of an allocation to "smart beta" strategies by way of a proportionate reduction in the overall equity allocation was an appropriate evolution of the equity structure although there didn't appear to be a case for targeting Aberdeen Asset Management; and the suggestion was moving to 20% of equity over circa 3 years;

- The allocation had to be sufficient in order to have a meaningful impact on the Fund, but reducing only the active equity mandates will impact on expected returns; and
- The appropriateness of rebalancing of the Legal and General Investment Management (LGIM) mandate to remove the current UK bias alongside the introduction of a ''smart beta'' strategy was worthy of discussion.

Decision

The Sub Group:-

(1) noted the report; and

(2) agreed:-

(a) to reach a position on each part of the strategy in the first instance;

(b) to thereafter review these decisions in the round to ensure their coherence; and

(c) to consider this matter further at the next meeting.

INV32. CONFIRMATION OF STANCE ON BONDS/DEBT

The Sub Group discussed in brief the stance on bonds/debt.

Decision

The Sub Group agreed that it was not minded to pursue more risky elements of the spectrum and that this was not the correct timing to switch into core bonds.

INV33. CONFIRMATION ON INCREASED INFRASTRUCTURE ALLOCATION

The Sub Group considered a report by Hymans Robertson on options for increasing the Fund's infrastructure exposure to achieve the target investment allocation of 9%.

The report highlighted the current allocations to infrastructure within the portfolio through the shared services agreement with Lothian Pension Fund and the investment with Grosvenor Capital Management ("GCM") and options to increase infrastructure exposure to the target allocation:-

- The extension of the commitment for Lothian Pension Fund to identify infrastructure assets beyond the current £30m allocation; and/or
- The further commitment to GCM (the Fund's existing infrastructure manager).

The overall size of the target allocation to infrastructure (9%) equated to approximately £150 million. The Fund currently had an exposure of around £55 million, £40-45 million being managed by GCM and £13.5 million managed by Lothian Pension Fund.

The merits of increasing the allocation to Lothian Pension Fund and to GCM were considered in detail.

The report highlighted the need for the deployment of up to £150 million of capital over the next 3-5 years to achieve its target allocation of 9%. A further allocation to GCM along with an expanded allocation to Lothian Pension Fund was viewed as a positive way forward to be considered further.

Decision

The Sub Group agreed to a further allocation to GCM along with an expanded allocation to Lothian Pension Fund as a positive way forward and to be considered further.

INV34. PROPERTY OPTIONS

The Sub Group considered a report by Hymans Robertson on the potential evolution of the property allocation.

The Fund currently had a target allocation of 10% of assets to property. The Fund currently had £130m, equivalent to around 7% of assets, invested in a mandate managed by Schroder Investment Management.

The report highlighted:-

- The current portfolio including the structure/risk profile, the conflict of interest and the illiquidity;
- The desirability of migrating the current allocation to property in line with its long-term target allocation and of targeting a long-term allocation of 15% to property;
- The appropriateness of pursuing outperformance within the core balanced portfolio;
- The attraction of introducing an allocation to a real return property mandate and any further training required; and
- The possible implementation approaches for the future management of the property allocation.

Decision

The Sub Group:-

(1) noted the report; and

(2) agreed to consider how the 7% allocation be increased to 10% and the current portfolio managed by Schroder Investment Management following further discussion at the next meeting of the Committee.

INV35. DATES OF FUTURE MEETINGS

The dates for future meetings of the Sub Group would be confirmed in due course.

AGENDA ITEM 6

FALKIRK COUNCIL

Subject:	**FUND MANAGER PERFORMANCE REVIEW**
Meeting:	**PENSIONS COMMITTEE AND PENSION BOARD**
Date:	**10 DECEMBER 2015**
Author:	**DIRECTOR OF CORPORATE AND HOUSING SERVICES**

1. INTRODUCTION

1.1 The Local Government Pension Scheme Regulations require that Falkirk Council, as administering authority for the Pension Fund, review the investments of its managers at least once every three months, which includes an analysis of returns and risk. This paper reports on performance for the overall Fund and reviews individual manager performance and developments.

1.2 The rates of return achieved by our fund managers are measured against pre-determined benchmarks. This service is provided by the Fund's custodian, Northern Trust.

1.3 The undernoted benchmarks are in place to measure the performance of each Manager.

- Aberdeen Asset Management (AAM) – MSCI All Countries World Index
- Baillie Gifford Bonds (BGB) – a customised benchmark comprising UK Fixed Interest and UK Index Linked Bonds
- Baillie Gifford Diversified Growth (BGDG) – UK base rate
- Legal & General (L&G) – a customised benchmark comprising UK and Overseas Equities
- Newton Investment Management (NIM) – the MSCI AC World (NDR) Index
- Schroder Investment Management (SIM)
    - (i) UK Equities – the FTSE All Share Index
    - (ii) Property – HSBC/APUT Pooled Property Fund Indices

1.4 Full details of each Manager's portfolio activity and any engagement with companies on corporate governance issues are recorded in their individual quarterly investment reports, which are enclosed.

2. MARKET REVIEW AND OUTLOOK

2.1 During the third quarter, equity markets were weak due to speculation that the US Federal Reserve might raise interest rates and due to concerns over the health of the Chinese economy. European & US equity markets declined by around 8-10%, Japanese equities fell 15% while the Chinese stock market fell 24%.

2.2 The US central bank appeared to be close to raising rates in August. However, this coincided with the release of very weak Chinese economic data, and a sell-off in global equity markets, which ruled out an immediate rate rise.

2.3 Bond markets performed well (prices rose and yields fell) during the quarter, benefiting from a further decline in the oil price and flight to quality flows from equities. UK, US & German 10 year bond yields fell by 0.2%-0.3%. The best performing bond markets were Italy & Spain, where yields fell 0.4% - 0.6%. Peripheral European bond markets benefited from greater confidence that Greece would not default or leave the EMU.

2.4 Oil price weakness was another feature of the third quarter. The oil price fell 25%, largely due to the Chinese economic slowdown. The oil price has fallen to a 10 year low and has fallen over 60% from its 2013 peak.

2.5 The outlook for global equity and bond markets critically depends on US monetary policy. The markets already expect a 0.25% increase in interest rates in the fourth quarter and two more 0.25% increases during 2016. If this gradual pace of tightening occurs, the recovery in the global economy should not be derailed and equity and bond markets should react benignly. In terms of currencies, higher US interest rates should benefit the US dollar, especially against the Euro as the European central bank's monetary policy shows no signs of tightening.

3. ANALYSIS OF PERFORMANCE RESULTS

3.1 The total fund and individual external manager returns are shown in the table in Appendix 1. The returns for the quarter ending 30 September 2015 are shown, but this is a very short period to measure performance. It simply reflects the regular reporting cycle. Each manager has been set its own individual investment objective, which depends on the type of mandate awarded. Each active manager is tasked with outperforming its benchmark over either three or five year periods. The table in Appendix 1 incorporates the relevant return and benchmark data and the excess return relative to the manager's benchmark and outperformance objective. More detail on individual manager mandates and objectives can be found in Appendix 2.

3.2 Global equity market indices returned -5.4% in sterling terms over the third quarter of 2015. Returns were positively influenced by the weakness of sterling (-4% to -6%) against the Euro, Dollar and Yen. The FTSE All Stock gilt index rose 3.1% and the FTSE Index Linked gilt index returned +1.9%. The Fund's UK commercial property benchmark index rose +3.1%.

3.3 The overall Fund's return of -3.2% <u>over the quarter</u> was behind the benchmark return by -0.2%. <u>Over the 3 year period</u> the Fund benefited from equity and property market strength, NIM's outperformance in global equities, SIM's outperformance in UK equities and Baillie Gifford's outperformance of its Diversified Growth Fund cash benchmark. The Fund rose +8.9% per annum compared with the benchmark return of +7.5% per annum, an excess return of +1.4% per annum. <u>Long term return data</u> shows Fund appreciation of +8.1% per annum over 5 years and +6.9% per annum since September 2001. These long term returns are above the benchmark returns.

3.4 <u>Over the third quarter of 2015</u>, the returns of the Fund's three active equity managers ranged from -2.3% to -8.8%. AAM and SIM underperformed their respective benchmarks, while NIM outperformed. The Fund's passive equity manager, L&G, produced a return of -5.8%, in line with its benchmark return, and so consistent with its mandate.

The return from BG's bond mandate was +2.4%, ahead of its benchmark by +0.5%. BG's other mandate, the Diversified Growth portfolio, fell -2.6%, behind its benchmark by -2.8%.

The property portfolio managed by SIM rose +3.1%, in line with its benchmark.

3.5 Longer term return data shows that SIM's UK equity portfolio is comfortably ahead of its objective of +1.25% per annum above the benchmark over the 3 year period and since inception.

NIM's global equity mandate stipulates an objective of +3% per annum above the benchmark over 5 year rolling periods. Returns over the past 5 years and since inception have beaten the benchmark comfortably, but they have not achieved the objective.

The AAM mandate's objective is +3% per annum outperformance over 3 year rolling periods. Performance is lagging the benchmark and the objective by a wide margin over 3 years and since inception.

The performance of BG's bond mandate is essentially in line with its benchmark since inception in 2007, but the 3 and 5 year performance have been strong, ahead of the benchmark and in line with the objective. The excess return over the benchmark of +0.8% per annum is close to the objective of +0.9% per annum over rolling 3 year periods.

SIM's property performance has been disappointing in recent years, and this has reversed positive results in the early years of the mandate. Since inception in 2005, a period of low returns for commercial property owners, the portfolio has performed broadly in line with its benchmark, but has fallen short of the objective by 0.9% per annum.

4. CONCLUSION

4.1 The third quarter of 2015 was characterised by sharp falls in equity markets occasioned by a faltering Chinese economy, uncertainty surrounding interest rate rises in the US and the continuing slump in oil prices. By contrast, bonds had a positive quarter as investors sought a safe haven away from equities. The deterioration in global economies saw the Bank of England hold UK interest rates at 0.5%.

4.2 Overall, the fund narrowly missed its benchmark. Newton Global Equities and Baillie Gifford Bonds were both strong performers in the face of market turbulence. However, Schroders UK Equities and Baillie Gifford Diversified Growth were both below benchmark, albeit remaining solid performers over longer time periods. The performance of Aberdeen both in Q3 and cumulatively continues to give cause for concern and will clearly be a matter of discussion at this meeting and at the forthcoming investment sub group meeting.

5. RECOMMENDATIONS

5.1 The Committee and Board are asked to note:-

(i) the Managers' performance for the period ending 30 September, 2015, and

(ii) the actions taken by Managers during the quarter to 30 September, 2015 in accordance with their investment policies.

pp **Director of Corporate & Housing Services**
Date : 27 November 2015
Contact Officer: Bruce Miller, Alastair McGirr

LIST OF BACKGROUND PAPERS

1. The Northern Trust Company – Fund Analytics 30 September 2015

Any person wishing to inspect the background papers listed above should telephone 0131 469 3866 and ask for Bruce Miller

APPENDIX 1 – PERFORMANCE MEASUREMENT (RATES OF RETURN)

Rates of Return by Manager with Excess Returns - 30 September 2015							
			Returns				
Manager	**Market Value £**	**Weight**	**3 months**	**3 year**	**5 year**	**Since inception**	**Inception Date**
Aberdeen Portfolio	199,654,642	11.9%	-8.8%	3.6%	5.7%	5.4%	May-10
Benchmark			-5.9%	9.8%	8.2%	7.4%	
Excess Versus Benchmark			**-2.9%**	**-6.3%**	**-2.5%**	**-2.0%**	
Excess Versus Objective			-	**-9.3%**	**-5.5%**	**-5.0%**	
Baillie Gifford Bond Portfolio	152,913,133	9.1%	2.4%	6.3%	7.6%	6.6%	Mar-07
Benchmark			1.9%	5.5%	6.6%	6.7%	
Excess Versus Benchmark			**0.5%**	**0.8%**	**1.0%**	**-0.2%**	
Excess Versus Objective			**-**	**-0.1%**	**0.1%**	**-1.1%**	
Baillie Gifford Diversified Growth	199,334,732	11.8%	-2.6%	5.0%	**-**	5.5%	Feb-12
Benchmark			0.1%	0.5%	**-**	0.5%	
Excess Versus Benchmark			**-2.8%**	**4.5%**	**-**	**5.0%**	
Excess Versus Objective			**-**	**-**	**-**	**1.5%**	
Legal & General	342,018,648	20.3%	-5.8%	9.5%	8.1%	11.9%	Jan-09
Benchmark			-5.8%	9.4%	8.0%	11.8%	
Excess Versus Benchmark			**0.0%**	**0.1%**	**0.1%**	**0.1%**	
Excess Versus Objective			**0.0%**	**0.1%**	**0.1%**	**0.1%**	
Newton	259,714,793	15.4%	-2.3%	12.2%	10.3%	8.6%	Jun-06
Benchmark			-5.9%	10.0%	8.2%	6.9%	
Excess Versus Benchmark			**3.6%**	**2.3%**	**2.0%**	**1.7%**	
Excess Versus Objective			-	-	**-1.0%**	**-1.3%**	
Schroders UK Equity	219,037,490	13.0%	-7.6%	11.4%	9.3%	8.4%	Sep-01
Benchmark			-5.7%	7.2%	6.7%	6.2%	
Excess Versus Benchmark			**-1.9%**	**4.1%**	**2.6%**	**2.2%**	
Excess Versus Objective			-	**2.9%**	**1.3%**	**0.9%**	
Schroders Property	137,194,460	8.2%	3.1%	11.0%	7.8%	3.6%	Nov-05
Benchmark			3.1%	11.7%	8.9%	3.7%	
Excess Versus Benchmark			**0.0%**	**-0.7%**	**-1.1%**	**-0.1%**	
Excess Versus Objective			-	**-1.5%**	**-1.9%**	**-0.9%**	
Total Fund	1,682,709,373	100.0%	-3.2%	8.9%	8.1%	6.9%	Sep-01
Benchmark			-3.0%	7.5%	6.8%	6.6%	
Excess Return			**-0.2%**	**1.4%**	**1.4%**	**0.3%**	

*** Note that objectives vary and are set over 3 or 5 year periods highlighted in bold for each manager.**

There are small rounding effects in the table above.

APPENDIX 2 - INVESTMENT MANAGER COMMENTS

Aberdeen Global Equity

(11.9% of Total Fund)

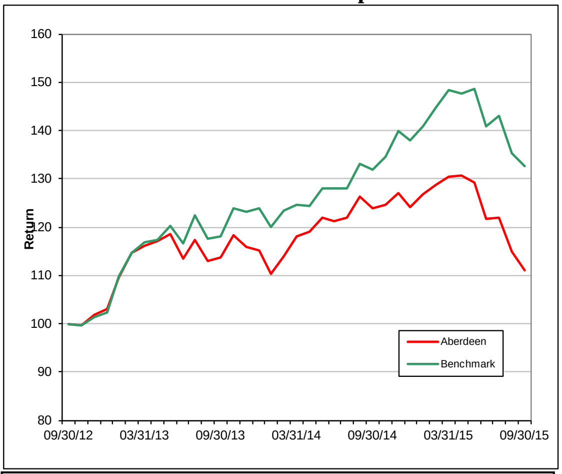
Investment Approach:

High conviction, research-driven house. Only invest in companies they have met. Regional teams produce Global buy list of 330 stocks. Global team carries out comparative analysis and produces model portfolio of 50 stocks from which team must build portfolio. Long-term horizon, trading highly price-sensitive.

Investment Objective:

To outperform the MSCI AC World Index in sterling by 3% per annum, gross of fees, over rolling 3 year periods (inception date 16 May 2010)

3 Year Performance to 30 September 2015



Q3 2015	:	-2.9% excess return
3 Years	:	-6.3% excess return
Since inception	:	-2.0% p.a. excess return

Summary

Terrible 3 year and since inception performance – both below benchmark and objective. Significant asset outflows continue firm-wide. Rumours of firm being up for sale have been publicly denied.

Portfolio

A concentrated portfolio of 50 stocks should be able to achieve its objectives - it is largely unconstrained. No single investment more than 5% of the portfolio is allowed, but sector and country limits are wide (+/-15% for sectors and +/-35% for countries allowed). Cash stands at 3.0%.

The generally defensive sector positioning is largely offset by a significant bias towards the collapsing energy and commodities segments. The portfolio remains u/w N. America by a very significant 20%. As the portfolio is not benchmark constrained this is not in itself a problem, but it is arguably the firm's natural bias towards Asia and emerging markets, which is driving this position rather than the lack of value that the team pronounce every quarter. Regional allocation has cost the portfolio over 3% and stock selection a further 7.5% in relative performance over 12 months. These are big numbers. By sector, the portfolio remains o/w consumer staples and has high relative exposure to materials and energy, although exposure to consumer discretionary remains low. The underrepresentation of financials has grown (-7%). The portfolio continues to perform poorly and, worryingly, its defensive tilt failed to protect it in the recent quarter when equity markets fell sharply. Aberdeen's process and sheer size mean that changes are mainly incremental. Activity increased as market falls meant more opportunities to top and tail existing positions. New buys: Checkpoint Software & M&T Bank. Sales: South32 & United Technologies.

In Q3, the portfolio lagged the index return by 2.9%, due to poor stock selection in the UK, Japan and North America as well as the o/w allocation to Brazil and u/w US stance. By sector, two-thirds of the underperformance was attributable to poor stock selection in financials (Banco Bradesco, Standard Chartered), with selection in industrials (Fanuc, Rolls Royce) and materials (Potash, Vale) also meaningful. The small drag from sector allocation was offset by the 3% cash position. The same themes explain the bulk of the 12 month underperformance, with poor stock selection and an o/w allocation in energy compounding the weakness.

Aberdeen continue to follow their process investing in good quality companies with lower than average levels of debt and relatively stable earnings/cash flows. They admit to mistakes (focussing too much on quality and not enough on valuation) and are looking at ways of "working smarter" [for example, by revisiting investment cases for disruptive technology stocks like Alphabet (Google)], without changing their philosophy or process – to which they remain unshakably committed. However, poor (and deteriorating) performance means there is a heightened risk of flows turning decisively negative, not least because consultants may well revisit Aberdeen's position on their 'buy' lists. We estimate that Aberdeen's Global strategies have already "lost" 30% of their performance-adjusted AuM over the last 2 years and arguably outflows are now driving (or at least exacerbating) the underperformance. Long term investors have remained loyal so far. Aberdeen has reduced the fee at Falkirk's request, but this is a small concession in the context of the performance.

Baillie Gifford Bonds

(9.1% of Total Fund)

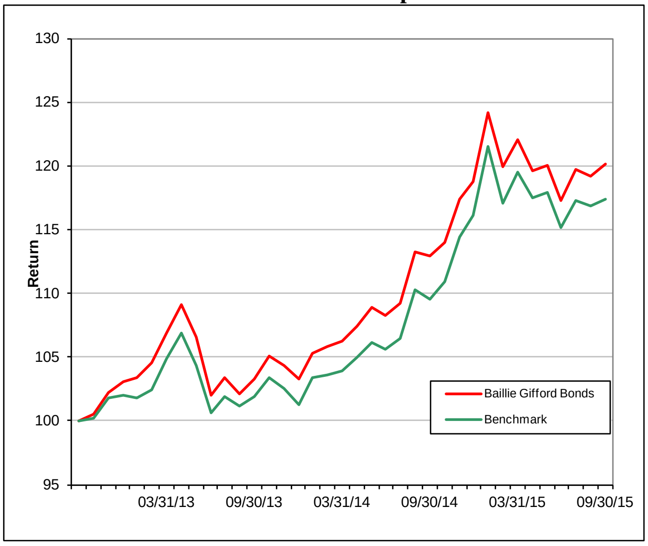
Investment Approach:

Baillie Gifford employs fundamental analysis to identify sustainable trends. It believes that there are inefficiencies that can be exploited in the areas of stock selection and interest rate and currency strategies.

Investment Objective:

To outperform a customised benchmark comprising index-linked gilts, conventional gilts and investment grade bonds by 0.9% per annum net of fees over rolling 3 year periods (inception date 30 March 2007).

3 Year Performance to 30 September 2015



Q3 2015	: + 0.5% excess return
3 Year	: +0.8% p.a. excess return
Since inception	: - 0.2% p.a. excess return

Summary

A strong Q3 takes 3 and 5 year performance close to objective before fees. Portfolio positioned for weaker credit environment. No major issues.

Portfolio

The portfolio has a customised benchmark (20% FT-Actuaries Over 5 Years Index Linked Gilt Index, 30% FT-Actuaries All Gilts, 50% Merrill Lynch Sterling Non-Gilt Index). Baillie Gifford (BG) invests in three BG Funds on a no-fees basis to achieve the appropriate exposure.

Q3 was characterised by Chinese and emerging market economic weakness feeding through into lower commodity prices. This benefited government bonds with conventional gilts returning +3.1% (Q2: -3.4%) and index-linked gilts returning +2.3% (Q2 -3.3%). Investment grade bonds lagged, returning +1.0% (Q2: -3.9%) while high yield bonds returned -1.9% (Q2: -3.9%).

The portfolio outperformed by 0.5% in Q3. The main positive contributors to performance came from asset allocation in the corporate bond portfolio (+0.5%) and currency positioning (+0.4%). Negative contributors to performance came from some single names in the corporate bond portfolio (-0.4%) and stock selection in the index-linked portfolio (+0.2%).

Overall portfolio risk has declined slightly from 0.85% in Q2 to 0.78% in Q3. Emerging market currency exposure was reduced by closing a long Brazilian Real position. The portfolio is still structured to take advantage of a stronger US Dollar, largely against the Euro. The portfolio is also long of selected European peripheral currencies against selected South American currencies. The portfolio's largest positions are 3% long US Dollar and 3% short Euro.

Portfolio duration is in line with the benchmark at 11.7 years. Asset allocation is underweight utilities and overweight securitised bonds. The credit quality of the portfolio (AA) is higher than that of the benchmark (A) as the manager is concerned about potential spread widening in the lower rated investment grade names.

Key considerations/developments

Baillie Gifford is a long established, reputable partnership; the client base is stable and the investment process has not changed.

Baillie Gifford Diversified Growth

(11.8% of Total Fund)

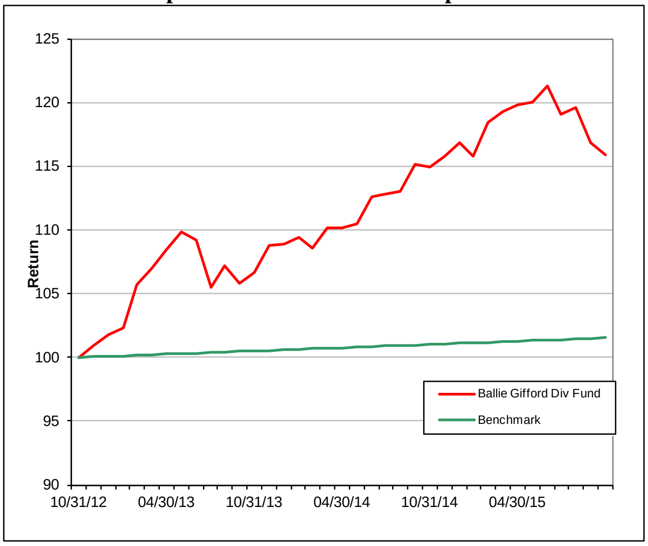
Investment Approach:

Baillie Gifford invests in a broad range of traditional and alternative asset classes, such as equities, bonds, property, private equity, infrastructure, commodities and currencies, adjusting portfolio weightings to reflect the relative attractiveness of the individual assets.

Investment Objective:

Objective: to outperform the UK base rate by at least 3.5% per annum (*after fees*) over rolling five year periods with an annual volatility of less than 10%. (Inception date 2 February 2012)

Since Inception Performance to 30 September 2015



Q3 2015	: -2.8% gross relative to base rate
3 Year	: +4.5% gross relative to 0.5% base rate
Since inception	: +5.0% gross relative to 0.5% base rate

Summary

Co-head of team (and ex Head of Risk at BG) moved to Aberdeen Jan 2015, which is a concern – the target return from here looks too high and estimated risk too low - notably BG claim that “Active Currency” contributes minus “-1.7%” to “predicted volatility”. Capacity management concerns.

Portfolio

Q3 2015 loss essentially shows this fund delivers a return that is not enhanced cash, but watered-down equities, the portfolio’s biggest asset and 60% of total risk. BG’s September 2015 “long-term return expectations” report states that equities have the highest expected return at 3.75% pa over cash. Every other asset return is lower. With fees of 0.7% pa., none of the assets that they invest in will deliver the target return of cash plus 3.5% pa after fees. Unless they have the considerable skill to generate substantial outperformance, the stated target return is too high.

“Active Currency” risk is now stated at just “0.2% of assets” and “-1.7% of predicted volatility” (net). Yet Active Currency has consistently been one of the largest contributors to return over recent quarters. The net long currency positions are now 32% with similar net short making total net currency exposure around 65% of the fund – again by far the largest asset exposure. Q3 trading was £216m equity, £259m bonds and £14,540m currency forwards! It is unrealistic to think these huge currency bets have no risk (or negative risk!). The stated risk is too low.

The stated predicted volatility of the portfolio is now 7.1% net (14.2% before “Diversification effect”) with 59.4% of this from equities. Targeted maximum volatility is 10%. (Global equities are 17.2%).

Key considerations/developments

Mike Brooks, co-head of team and ex- Head of Risk at BG, resigned in January, leaving the firm in March to join Aberdeen to launch a similar, but probably better designed, fund.

Baillie Gifford announced “closure” in the diversified growth strategy in Q4 2012 at £2.8bn, reflecting an estimated “capacity” limit of £5bn and “closure to all new clients” in June 2013. Yet, BG took on over £1bn of net inflows after this “closure” to reach £6bn. They have now launched a similar fund “to enable more capacity” (of “£10bn”), with “the same process run by the same people” (excluding c5% in Insurance-Linked Securities, which were a capacity constraint). Capacity management is a concern for this product and for the firm as a whole, but is not widely recognised.

Newton Global Thematic Equity

(15.4% of Total Fund)

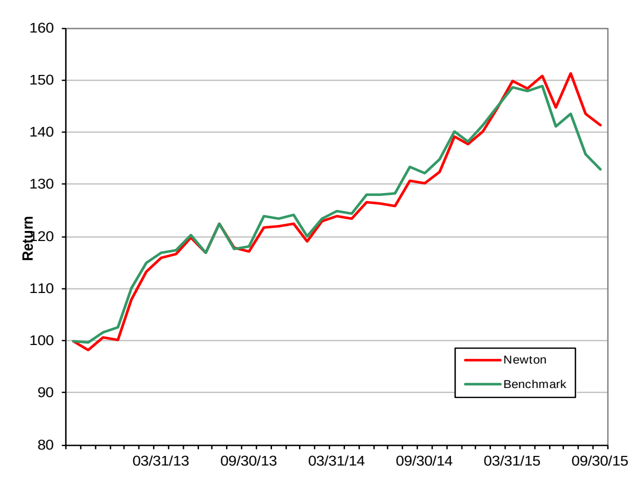
Investment Approach:

Newton identifies structural trends to gain perspective on the important risks and opportunities in investment markets. This thematic framework drives stock selection, which results in a concentrated portfolio.

Investment Objective:

To outperform FTSE All World Index by 3% per annum (net of fees) over rolling 5 year periods (inception date 30 June 2006)

3 Year Performance to 30 September 2015



Q3 2015	: +3.6% excess return (gross)
5 Years	: +2.0% p.a. excess return (gross)
Since inception	: +1.7% p.a. excess return (gross)

Summary

Another fantastic quarter, holding up well in falling market. Portfolio comfortably ahead of benchmark since inception, but still short of objective, especially net of fees. Active process taking advantage of changing valuations.

Portfolio

The portfolio is concentrated in just 44 stocks, indicating that it should be able to achieve its objectives. This is an equity portfolio, but the manager is able to hold up to 10% in cash. The manager continues to take a very defensive stance and cash (mostly short term US Treasuries) was 6.8% at quarter end.

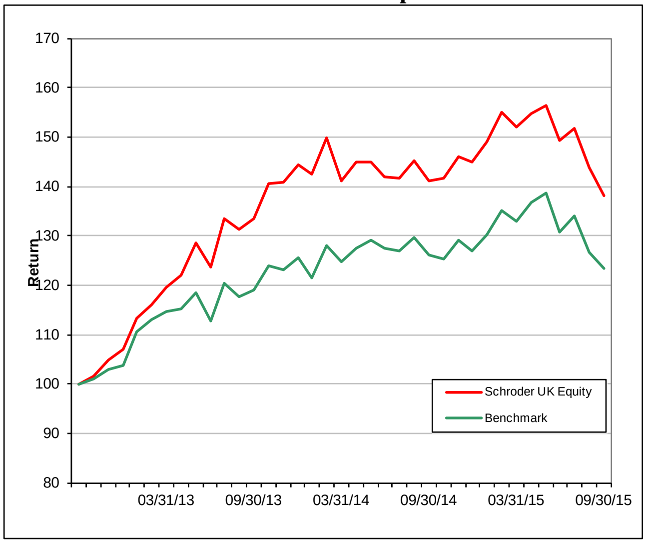
Stock ideas flow from Newton's themes, which include deleveraging, financial concentration and growing Chinese influence. The portfolio is characterised by companies with stable earnings, strong cash flows, competitive advantages, inflation linkage, innovation, exposure to growth economies, good management & governance and attractive valuation.

The portfolio remains overweight Europe/UK (+8%) equities and cash (+7%) and underweight Japan (-6%), Pacific (-5%) and Emerging Markets (-5%). The small underweight N. America has become a small overweight following a 5% investment in the region this quarter. There continues to be high relative exposure to companies in the consumer services sector (+8%), while financials (-13%), telecoms (-4%) and oil & gas (-4%) companies are significantly under-represented. The portfolio's high cash position and defensive tilt protected returns well during the recent equity market weakness even though there is less of a defensive tilt due to the greater representation of cyclical stocks in the portfolio than previously.

The portfolio beat its benchmark handsomely in Q3, due to positive relative returns from Europe and EM. There were positive relative contributions across all sectors apart from utilities and consumer services, in particular from oil & gas, technology and basic materials. The best individual stock contributions came from Google (renamed Alphabet), C.H. Robinson, RELX and TJX. Main detractors from performance included Trimble Navigation, TripAdvisor & Discovery Communications. Turnover and stock count rose as the portfolio took advantage of weakness to introduce several new stocks: Hershey, Merck, Wolseley, Emerson Electric, Mattel, Johnson Matthey and Stratasys. There were outright sales of L'Oreal, Kraft Heinz, Softbank and Vodafone. The cash/bonds position added significantly to relative performance (currency gain from US$).

Key considerations/developments

Newton remains one of Bank of New York Mellon's asset management subsidiaries based in London; the investment process is unchanged since a review in 2011/12 when personnel changes were made; the client base is stable (no flows in or out). Note – some recent stock purchases go against analyst recommendations.

Schroders UK Equity (13.0% of Total Fund)	**3 Year Performance to 30 September 2015**
Investment Approach: Schroder seek to identify stocks which trade at a substantial discount to their intrinsic value and where they believe that profits will surpass expectations. The investment style can be categorised as "value".	
Investment Objective: To outperform FTSE All Share Index by 1.25% per annum (net of fees) over 3 year rolling periods (inception date 30 September 2001)	Q3 2015 : -1.9% excess return 3 Year : +4.1% p.a. excess return Since inception : +2.2% p.a. excess return

Summary

The portfolio underperformed in Q3, but is comfortably ahead of benchmark and objective over 3 years. Clearly articulated strategy with stable ownership, client base and investment team.

Portfolio

The portfolio of 37 stocks deviates from the benchmark meaningfully, which means that the objective should be achievable, but the return profile is likely to be highly variable. Once again, active sector positions are very similar to last quarter. The portfolio retains an overweight position in the food & drug retailers and general retailers sectors. Tobacco & beverages are the largest underweight sectors and are both zero weighted.

The holding in Darty and the underweight Glencore were the biggest positive contributors to Q3 relative returns. Positions in Anglo American, Drax and Home Retail were the biggest detractors, alongside the underweight exposure to British American Tobacco and SABMiller.

The mining sector has been a greater focus of their attention over the last 6 months or so. While holding Anglo has detracted from returns, the team believe that the shares are undervalued reflecting Glencore's issues rather than Anglo's fundamentals. They remain comfortable with the balance sheet and asset backing, though would see sense in a short term dividend cut. Valuation is very attractive (lowest Price to Book ratio in 50 years). They have added to the position and also initiated a position in South32 within the sector, taking advantage of the current fear factor surrounding the materials names.

Amongst other metrics, the team focuses on cyclically adjusted P/E's when it comes to valuations. Banks and miners continue to look cheap on this basis with traditionally stable companies appearing expensive. The market continues its preference for stability up until now.

Andrew commented on some work currently being done on the global performance of value versus growth. The current period of value underperformance is incredibly extended in a historical context.

In terms of activity, they continue to take profits in names that have performed well such as Rentokil Initial and ICAP. The holding in Ladbrokes was sold following the recently agreed merger with Gala Coral.

Key considerations/developments

Schroders is a publicly listed asset management company, which is still controlled by the family; the client base is fairly stable and investment process has not changed. UK Value product, in which Falkirk is invested, runs approximately £5.5bn in assets split roughly 1/3rd institutional and 2/3rd retail. Stable investment team, demonstrates conviction in its investment approach.

Schroders Property Multi-Manager

(8.2% of Total Fund)

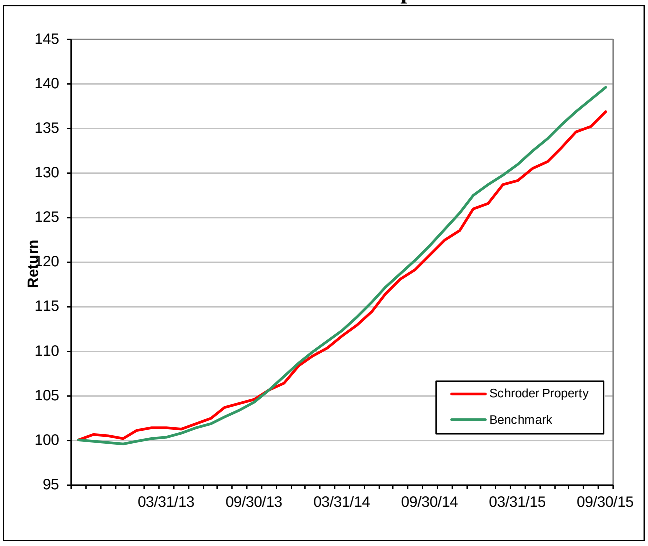
Investment Approach:

Schroders runs a segregated mandate providing a multi-manager portfolio of property funds. The manager seeks to identify attractive property markets and property funds with skilled managers, some of which are sector specialists.

Investment Objective:

To outperform IPD UK Pooled / Quarterly Property All Balanced Funds Weighted Average Index by 0.75% per annum (net of fees) over 3 year rolling periods (inception date 30 November 2005)

3 Year Performance to 30 September 2015



Q3 2015	:+0.0% excess return
3 Year	: -0.7% p.a. excess return
Since inception	: -0.1% p.a. excess return

Summary

Portfolio manager resigned, so resources under pressure; latest 3 year performance remains weak relative (-0.7% pa), but strong absolute (+11% pa). Portfolio has been restructured and is now positioned for the future.

Portfolio

The portfolio is comprised of a diverse group of 15 funds investing in property assets largely in the UK (93%). UK performance has outperformed the benchmark in each long/short period, but the Cont. European exposure remains a drag on performance except in Q3 when it returned 31.1% due to a large capital repayment. The portfolio is valued at £139m.

The manager has re-positioned away from London offices by continuously selling WELPUT[1] and has made commitments for investing in industrial property and a small lot size multi-sector partnership fund (Metro PUT via a new partnership managed by Hermes). The partnership fund is only available to Schroders' clients. No new purchase or sale has been made in this quarter, but Schroders is preparing to purchase a new fund - the Regional Office PUT to gain access to the rest of UK office market.

Continental Europe now amounts to 3% of the portfolio. (Recap in '06-07, 10% of the portfolio was committed to Europe.) The poor three year relative performance has been dominated by this exposure, which is not in the benchmark. Schroders is expecting the recovery in Europe will continue and plans to hold the exposure till maturity (2018).

The portfolio's risk profile has been rebalanced through greater investment in low geared, core balanced property funds and those funds targeting an income focussed approach. As a result, the manager believes the portfolio is well positioned for the current investment environment, in which the income yield on property is very competitive with government bonds.

Current cash level is 4% and uncommitted cash is 1.2%. Schroders' real estate return forecast is still 15% for 2015, but drops to 4% for next year and expects a small fall in capital value in either 2017 or 2018.

Key considerations/developments

Schroders is a publicly listed asset management company, which is still controlled by the family; the **client base** is fairly stable and the **investment process** has not changed. The **investment team** is changing meaningfully: last quarter, the fund manager departed and the portfolio analyst was promoted to be the fund manager. Fund manager access has been difficult during the transition period and the client relations manager has changed too. No quarterly update was arranged.

[1] West End of London Property Unit Trust

APPENDIX 3 – GLOSSARY

Benchmark - The yardstick used to measure the success and structure of a portfolio. All managers are measured against benchmarks. Passive managers are tasked with producing returns that are the same as the benchmark. Active managers are tasked with producing returns that are higher than the benchmark.

Benchmark return - Identifies the total return of the benchmark for the identified period. Return numbers for periods of one year or less show the actual return over the period. Returns for periods of greater than one year are annualised returns - they show the return per annum (%pa).

Dividend Yield - The dividend a company pays divided by its current price.

Duration - A measure of the sensitivity to interest rates of bonds. It identifies the approximate percentage change in a bond's price for a 100 basis point change in yield

Excess Return - Is the out / underperformance of the portfolio relative to the benchmark for the identified period. Return numbers for periods of one year or less show the actual return over the period. Returns for periods of greater than one year are annualised returns - they show the return per annum (%pa).

Investment Objective – All managers (and the Fund) are set investment objectives, which are related to a specific benchmark. The investment objective for a passive manager is to match the returns of the benchmark. The investment objective for an active manager is to exceed the returns of the benchmark by a pre-determined percentage per annum over a pre-determined period.

Market value (£) - Identifies the total market value of the portfolio / Fund

Portfolio return - Identifies the total time weighted rate of return of the assets of the portfolio for the identified period. Returns for periods up to 12 months are the return over that period. Returns for periods longer than 12 months are annualised returns – they show the return per annum (%pa).

Turnover - Is the level of purchases and sales for the period. High turnover is generally regarded as bad because trading costs are incurred.

AGENDA ITEM 7

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	-	€10.9m
Dollar Funds		$72.0m

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 Caffe 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

<u>LIST OF BACKGROUND PAPERS</u>

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

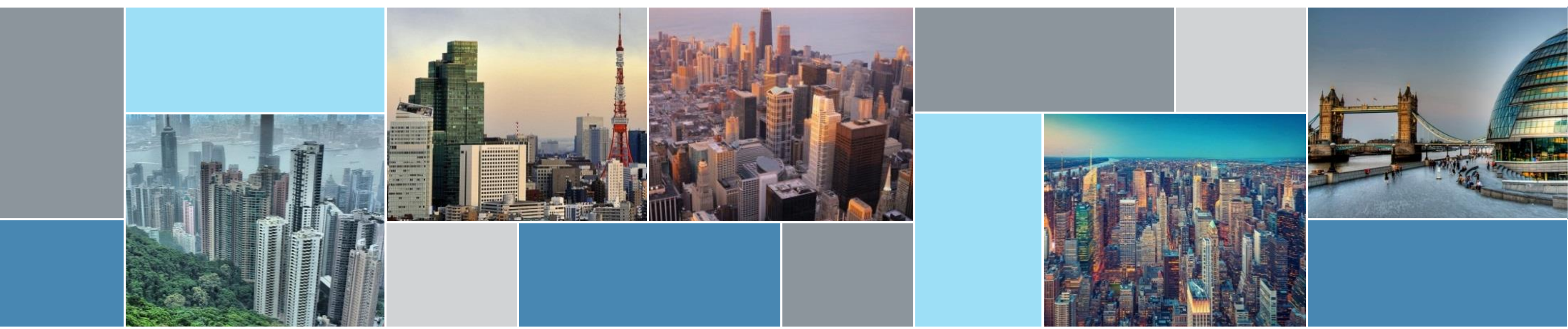
Alternative Assets Summary - Sterling

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

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.

This presentation has been prepared by GCM Customized Fund Investment Group, L.P. (referred to herein as "GCM Grosvenor Private Markets") and Grosvenor Securities LLC.

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 professionals[1]
  - 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.

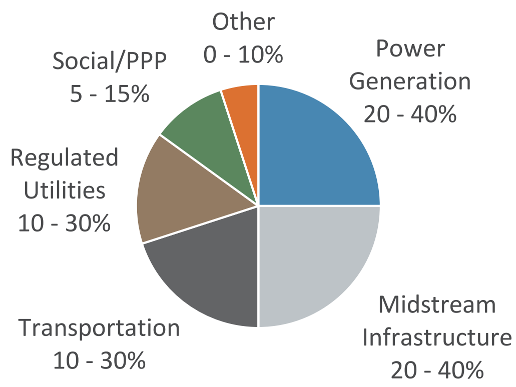
A number of assumptions were made in presenting this track record, some of which are discussed in the "Infrastructure Track Record" Notes and Disclosures following this presentation. Unless otherwise specifically indicated, returns are shown net of all fees, expenses, and carried interest. **Past performance 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

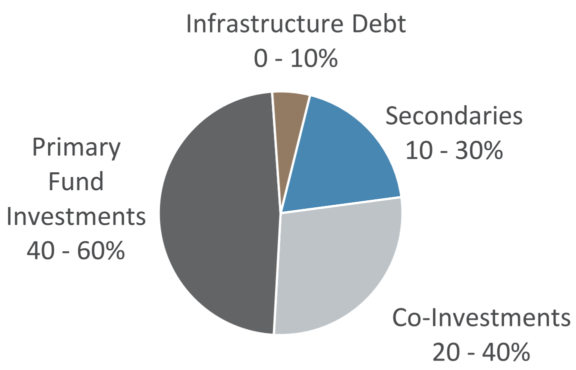
CIS II seeks to continue the successful investment strategy of CIS I.

- 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]

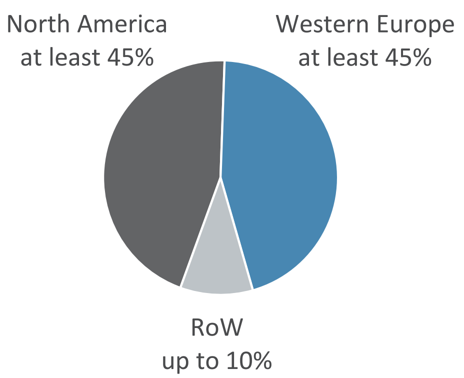
CIS II target sectors



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 CFIG 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.

AGENDA ITEM 8

FALKIRK COUNCIL

Subject:	**UK INFRASTRUCTURE**
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 provides the Board and Committee with information regarding the Fund's commitment to invest in UK infrastructure with Lothian Pension Fund. This includes an outline of the operating parameters as well as a summary of investments made to date.

1.2 The Fund's commitment is £30m, with it being envisaged that monies will be invested in approximately 5 or 6 separate projects to provide appropriate diversification across the portfolio.

1.3 Potential investment opportunities are sourced and analysed by the in-house investment team based in Edinburgh. The due diligence process includes preliminary and final investment review meetings to which officers of Falkirk Council are invited. As previously agreed by the Pensions Committee, the final investment decision is made by the Chief Finance Officer on a project by project basis. Whilst the investments are predominantly UK/Scottish, it is noted that some individual projects may contain a small element of continental European exposure.

1.4 Attention is drawn to other reports on this agenda which also deal with Infrastructure.

2. OPERATING GUIDELINES

2.1 The Fund's UK infrastructure portfolio is being deployed consistently in line with the agreed diversification guidelines as set out below:

Infrastructure risk type	Availability & Regulated	Demand & Market
Examples	*PFI schools, gas distribution*	*Toll roads, ferries*
Inflation, price linkage	*Contracted*	*Limited contracted*
- allocation range	75-100%	0-25%
Target gross returns	+6.5-12.5%	+11.5-17.5%
Target net real returns	+2.2-6.0%	+5.3-8.0%

Geographical	UK	Europe
- allocation range	80-100%	0-20%

Type of fund	Funds	Co-investments
- allocation range	67-100%	0-33%

Notes:

* Net real returns are estimated assuming inflation of 3% and after management fees and carry.

** Funds may include primary LP commitments, secondary LP fund commitments & listed funds.

An opportunistic investment strategy is to be adopted consistent with the above guidelines

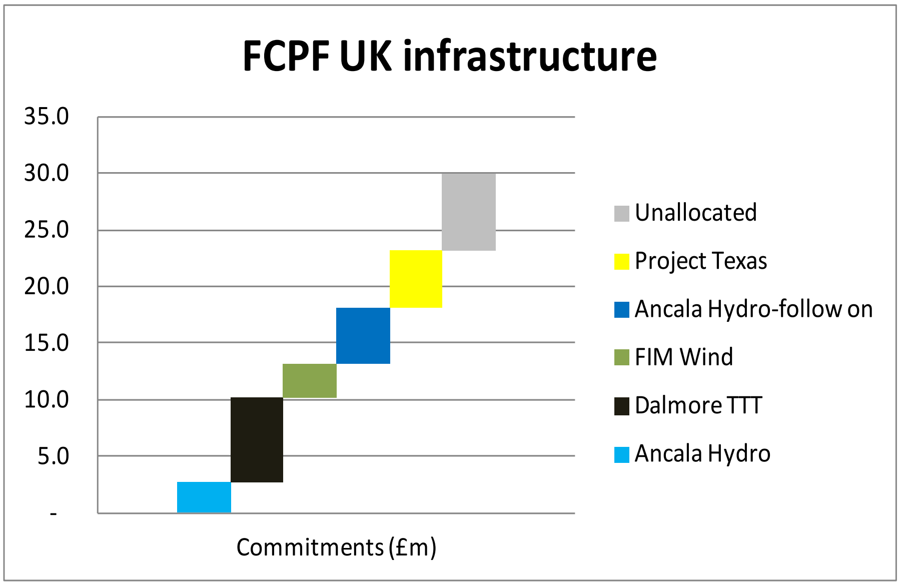
3. SUMMARY OF INVESTMENTS MADE

3.1 During 2015, approximately 150 infrastructure investment opportunities were entered into the deal pipeline, of which 40 were deemed suitable, meeting the Fund's investment strategy criteria. 27 of these opportunities were rejected, while 9 remain in the deal pipeline. 4 investments were completed in 3 new investments and 1 follow-on investment.

3.2 The 3 new investments were:

- all classified under the Availability and Regulated risk type;
- all involved assets in the UK (with 2 investments in Scotland);
- forecast to have target net returns of 7-9% per annum and partially correlated with inflation;
- structured as single asset funds;
- each led by different external specialist managers;
- progressed alongside Lothian Pension Fund

3.3 The build-out of the Fund's portfolio is illustrated below:



3.4 **Ancala Hydro** – relates to a portfolio of Scottish run-of-river projects managed by Perth-based Green Highland Renewables. The investment was sourced and is managed by Ancala Partners founded by Spence Clunie (ex Macquarie) in 2010. The follow-on funding was required to build-out other projects, inc. Eilde Mhor – a loch-sourced scheme near Kinlochleven.

3.5 **Dalmore TTT** – relates to the Thames Tideway Tunnel super-sewerage project currently under construction. The equity investment will be drawn down over a 3 year period. FCPF's commitment was made on the same commercial terms as other larger institutions investing via the Dalmore Fund. Dalmore was founded by Michael Ryan, Ali Ray and John McDonagh in 2009, and have offices based in London and Edinburgh.

3.6 **FIM Wind** – relates to a consented wind farm to be built in West Lothian. FIM appointed technical advisers Natural Power who have offices in Stirling. FIM were founded in 1979 by Richard Crosbie Dawson, who leads the firm and remains committed to investing in forestry and renewable energy plants across the UK, and particularly in Scotland. Recent governmental change in energy policy has delayed financial close by 3 months, but the project remains on track.

4. NEW INVESTMENT OPPORTUNITIES

4.1 The sourcing pipeline continues to focus on Availability & Regulated infrastructure risk-type investment opportunities, although Demand & Market risk-type infrastructure are still being appraised on their respective merits. The current pipeline of deals is illustrated below:

Opportunity name	Segment	Type	FX	Suitability	Status
Project Arizona	Infrastructure	Primary	£	+LBPF+FPF	Due diligence
Project Texas	Infrastructure	SAF	£	+LBPF+FPF	Due diligence
Project Seabird	Infrastructure	SAF	£	+LBPF+FPF	Early DD
Project Magpie	Infrastructure	Co-invest	£	+LBPF+FPF	Early DD
Project Crystal	Infrastructure	SAF	£	+LBPF+FPF	Idea devt
Project E4	Infrastructure	Primary	£	+LBPF+FPF	Idea devt
Project Moir	Infrastructure	Primary	£	+LBPF+FPF	Idea devt
Project IC6	Infrastructure	Secondary	€	+LBPF+FPF	Shelved
Project Pool	Infrastructure	SAF	£	+LBPF+FPF	Shelved
Project D3N	Infrastructure	Secondary	£	+LBPF+FPF	Shelved

4.2 Of note, the Project Arizona follow-on relates to Ancala Hydro, and while the first tranche of funding has completed, a second tranche is due to be funded shortly. Project Texas relates to a portfolio of operational solar projects sourced by Ancala which is targeted to complete by end 2015.

5. CONCLUSION

5.1 The portfolio build-out is progressing slightly ahead of plan. By end December 2015, it is projected that there will have been four commitments made amounting to £23.1m. Of this, £10.7m will have been funded and there will be £12.4m of unfunded commitments. There is currently a broad range of new opportunities available for consideration, sourced through existing managers and new prospective managers of UK and European Funds. In addition, there are likely to be opportunities to collaborate with Grosvenor Capital, the Fund's global infrastructure manager.

6. RECOMMENDATION

6.1 The Pensions Committee and Pension Board are invited to note the content of this report and comment as appropriate.

pp **Director of Corporate & Housing Services**

Date: 30 November 2015

Contact Officer: Andrew Imrie, Alastair McGirr

<u>LIST OF BACKGROUND PAPERS</u>

NIL