

FALKIRK COUNCIL

Subject: PRIVATE EQUITY AND ALTERNATIVES UPDATE
Meeting: JOINT MEETING OF THE PENSIONS COMMITTEE AND PENSION BOARD
Date: 26 JUNE 2015
Author: CHIEF FINANCE OFFICER

1. INTRODUCTION

1.1 This report updates the Committee and Board on the progress and key events arising from each Manager's investment programme for the three months to 31 March 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

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.

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 In Q1, all funds outperformed the MSCI Europe Index of -0.1%, returning between 2% and 4.3%. Total value to paid-in capital across the SL funds is now around 1.2 and returns from the more mature funds around 4%.

2.4 During the quarter €2.4m was returned, mainly from the 2004 and 2006 Funds. Funds drawdown amounted to £1.5m of which £1m related to the ESF 1 Fund. SL have now drawn down 75% of the total commitment of €102m.

- 2.5 Highlights included increases in the value of co-investments Sunrise Medical, Delachaux and the Loch Lomond Whisky Group. In the ESF 1 Fund, five new fund commitments were Auctus IV, Capiton V, Energy Ventures Private Equity V, Herkules Private Equity IV, Sherpa Capital Fund II.
- 2.6 The Manager's perspective at the end of 2014/15 is that ESP 2004 and 2006 have delivered strong growth in the unrealised segment of these portfolios (16% and 21% respectively), however overall returns are still less than expected due to headwinds dating back to the financial crisis. ESP 2008 and ESF1 have made more positive progress and are well placed to generate strong returns.

3. WILSHIRE ASSOCIATES

- 3.1 The Fund has made various commitments to Wilshire Associates as follows:

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

- 3.2 90% of the Euro funds and 75% of the dollar funds have been drawdown.
- 3.3 In their quarterly update, Wilshire note that exits from private equity investments continue to attract high valuations based on the current availability of credit and that such valuations are unsustainable.
- 3.4 Following on from a subdued Q4, Q1 remained quiet for Wilshire with virtually no calls or distributions from the Euro funds. The dollar funds were again more active with calls of \$0.3m and distributions of \$1.2m. Total value to paid-in capital remains around 1.4 for most Wilshire funds.

4. GROSVENOR CAPITAL

- 4.1 The Fund's global infrastructure investments are made via 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 During the quarter, \$2m was returned and \$1m called. The distributions arose following transactional activity with a series of infrastructure funds including KKR, Highstar and Dalmore. Of the original commitment of \$80m, 86% has now been drawn-down. Capital continues to be deployed rapidly and total value is currently close to 1.3.
- 4.4 As previously outlined, Grosvenor Capital is fund raising for a second global infrastructure fund.

5. M&G UK COMPANIES FINANCING FUNDS

- 5.1 The M&G UK Companies Financing Funds provide the Fund with exposure to UK credit markets. The Funds play a valuable role in providing debt financing to UK companies facing refinancing obstacles. The aim of the Funds is to create attractive levels of income for investors – an absolute return of LIBOR plus 3%-6% - with a low level of risk.

- 5.2 Falkirk's commitment to the M&G Funds is £11.8m to Fund I and £10m to Fund II. Fund I has been fully invested and Fund II is in the process of being drawn down.
- 5.3 For Fund 1, the portfolio consists of 8 loans with an average repayment period of 4.5 years and average credit rating of BB+. Loans have been made to companies such as Barrett, Taylor Wimpey, Wincanton and Provident Financial. The net annualised return is 4.5%.
- 5.4 For Fund II, the portfolio also consists of 8 loans but with an average repayment period of 6 years. This includes loans to Caffè Nero, Holidaybreak Limited and Workplace Group plc. The net annualised return is 3.5% with 60% of committed funds remaining to be drawdown.
- 5.5 All loans continue to be paid in accordance with their covenants.

6. HEARTHSTONE SOCIAL AND AFFORDABLE HOUSING

- 6.1 Details of this mandate have been provided in the General Governance Report.

7. CONCLUSION

- 7.1 The investment outlook of the Fund's private equity managers is neutral in terms of Europe and mildly optimistic in terms of US markets. It was noted that Q1 of 2015 had been the slowest in terms of private equity deal volume and activity for a number of years notwithstanding that the first quarter of a new year is traditionally quieter. In the US, the managers remains cautious about high valuations.

8. RECOMMENDATIONS

- 8.1 **The Committee and Board are asked to note the progress of the Fund's Alternatives investments as at 31 March 2015 and invited to comment as appropriate.**

Chief Finance Officer

Date: 10 June 2015

Contact Officer: Alastair McGirr

LIST OF BACKGROUND PAPERS

NIL

Appendix A

Falkirk Council Pension Fund Alternative Markets Update - 31/03/15

Alternative Assets Summary - Original Currency

Manager	Fund	Commitment 000's	Unfunded 000's	(a) Cost 000's	(b) Return of Cost 000's	(c) Distribtn 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	€ 3,362	€ 26,638	€ 12,399	€ 9,090	€ 11,899	€ 33,388	1.25	4.7%	
SL Capital Partners	European Strategic Partners 2006	30,000	3,574	26,426	9,581	4,242	19,177	33,000	1.25	2.6%	
SL Capital Partners	European Strategic Partners 2008	27,000	8,707	18,293	2,947	834	18,478	22,259	1.22	0.4%	
SL Capital Partners	European Smaller Funds I	15,000	9,129	5,871	0	0	5,329	5,329	0.91	N/A	
	SL Capital Partners Total	€ 102,000	€ 24,772	€ 77,228	€ 24,927	€ 14,166	€ 54,883	€ 93,976			24.3%
Wilshire Associates	Fund VI - Europe	€ 3,600	€ 223	€ 3,377	€ 2,106	€ 1,336	€ 1,470	€ 4,912	1.45	6.8%	
Wilshire Associates	Fund VII - Europe	3,600	180	3,420	1,261	645	2,403	4,309	1.26	0.5%	
Wilshire Associates	Fund VIII - Europe	3,700	622	3,078	799	657	2,639	4,095	1.33	30.4%	
	Wilshire Associates Europe Total	€ 10,900	€ 1,025	€ 9,875	€ 4,166	€ 2,638	€ 6,512	€ 13,316			9.4%
Wilshire Associates	Fund VI - US	\$14,000	\$751	\$13,249	\$5,448	\$5,467	\$8,027	\$18,942	1.43	6.5%	
Wilshire Associates	Fund VII - US	11,500	683	10,817	3,464	3,498	8,721	15,683	1.45	7.4%	
Wilshire Associates	Fund VIII - US	12,700	1,299	11,401	3,613	2,491	10,431	16,535	1.45	11.5%	
Wilshire Associates	Fund VII - Asia	1,800	164	1,636	872	633	915	2,420	1.48	9.1%	
Wilshire Associates	Fund VIII - Asia	2,000	1,118	882	261	159	834	1,254	1.42	-10.3%	
Wilshire Associates	Opportunities Fund II-B	15,000	2,004	12,996	7,215	2,510	7,765	17,490	1.35	11.8%	
Wilshire Associates	Fund IX	15,000	13,234	1,766	0	0	2,020	2,020			
	Wilshire Associates US and Asia Total	\$72,000	\$19,253	\$52,747	\$20,873	\$14,758	\$38,713	\$74,344			26.7%
Infrastructure											
Grosvenor Capital	Customised Infrastructure Strategies	\$80,000	\$11,230	\$68,770	\$13,553	\$3,555	\$70,538	\$87,646	1.27	11.2%	
	Grosvenor Capital Total	\$80,000	\$11,230	\$68,770	\$13,553	\$3,555	\$70,538	\$87,646			14.0%
Credit Markets											
Prudential/M&G	UK Companies Financing Fund	£11,835	£0	£11,835	£4,943	£0	£8,821	£13,764	1.16	4.5%	
Prudential/M&G	UK Companies Financing Fund II	10,000	6,405	3,595	117	89	3,565	3,771	1.05	3.6%	
	Credit Market Total	£21,835	£6,405	£15,430	£5,060	£89	£12,386	£17,535			29.3%
Social / Affordable Housing											
Hearthstone plc	Housing Fund for Scotland	£30,000	£12,950	£17,050	£0	£0	£17,050	£17,050			
	Social/Affordable Housing Total	£30,000	£12,950	£17,050	£0	£0	£17,050	£17,050			43.2%

Appendix B

Falkirk Council Pension Fund Alternative Markets Update - 31/03/15

Exchange Rates	
\$	1.5339
€	1.3617

Alternative Assets Summary - Sterling

Manager	Commitment £ 000's	Unfunded £ 000's	(a) Cost £ 000's	(b) Return of Cost £ 000's	(c) Distribtn Gains £ 000's	(d) Market Value £ 000's	(b + c + d) Total Value £ 000's	Total Value to Paid in Cap.
SL Capital Partners	74,906	18,192	56,714	18,306	10,403	40,305	69,014	1.22
Wilshire Associates	54,944	13,304	41,639	16,667	11,559	30,021	58,246	1.40
Grosvenor Capital	52,155	7,321	44,833	8,836	2,318	45,986	57,139	1.27
M & G	21,835	6,405	15,430	5,060	89	12,386	17,535	1.14
Hearthstone plc	30,000	12,950	17,050	0	0	17,050	17,050	1.00
	£233,840	£58,172	£175,666	£48,869	£24,369	£145,748	£218,984	

Allocation to Private Equity
(based on unfunded commitment plus market value) 6.0%

Allocation to Private Equity
(based on market value only) 4.1%

Allocation to Infrastructure
(based on unfunded commitment plus market value) 3.1%

Allocation to Infrastructure
(based on market value only) 2.7%