

**Falkirk Council**

**Title:** Private Equity and Alternatives Update  
**Meeting:** Joint Meeting of Pensions Committee and Pension Board  
**Date:** 22 September 2016  
**Submitted By:** Director of Corporate and Housing Services

**1. Purpose of Report**

- 1.1 This report updates the Committee and Board on the progress and key events arising from the Fund's Private Equity and alternatives programme for the three months to 30 June 2016.

**2. Recommendation**

- 2.1 **The Committee and Board are asked to note the progress of the Fund's Private Equity and Alternatives programme for the quarter to 30 June 2016.**

**3. Background**

- 3.1 The Fund's private equity and alternatives programme is managed as follows:

SL Capital (Standard Life)	-	European Private Equity
Wilshire Associates	-	Global Private Equity
Grosvenor Capital	-	Global Infrastructure
M&G	-	Credit Markets
Hearthstone	-	Social and Affordable Housing
In House/Lothian	-	UK Infrastructure

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

**4. SL Capital**

- 4.1 SL Capital is a subsidiary of Standard Life Investments, who own 60% of the business. The remaining 40% is owned by 8 partners.
- 4.2 The Fund's commitment to SL Capital is **€102m** spread across four European Investment Funds – ESP 2004, ESP 2006, ESP 2008 and ESF 1 – all being fund of fund structures. The partnerships have been established for 14 years

from the final close of each Fund. On this basis, the most juvenile of the Funds – ESF 1 – will be in existence until 2027.

- 4.3 During the quarter (Q2 2016), **€3.2m was returned** from the four funds and **€0.5m called**, leaving the unfunded commitment at **€18m** (c.18% of the commitment).
- 4.4 Within the unrealised part of the portfolio, there were marginal changes in valuations, however this was positive compared with the MSCI Europe index which decreased by 7.7%. During the quarter, SL Capital sold their interest in the Capvis IV Fund due to risks associated with a weakening Swiss Franc. Overall, total value to paid-in capital remained at 1.27.

## 5. Wilshire Associates

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

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

- 5.2 7% of the Euro funds and 20% of the dollar funds remain to be drawn
- 5.3 During the quarter, Wilshire distributed **\$1.5m** and **€0.2m**. Calls amounted to **\$0.9m** and **€0k**. Total value to paid-in capital was stable at 1.45.
- 5.4 With “Brexit” a reality, the Manager's view is that over the next two years, the key parties in the negotiations will be “economically rational”, and the trade regime(s) to emerge will be on the more benign end of the spectrum of potential outcomes. However, growth is likely to slow in both the UK and EU. Ultimately, Wilshire see opportunities where capital is scarce, and will support managers who can thrive in times of dislocation and complexity.

## 6. Grosvenor Capital

- 6.1 The Fund's global infrastructure mandate comprises a \$160m commitment split equally between two Customised Infrastructure Strategies (CIS) Funds managed by Grosvenor Capital.
- 6.2 During the quarter, the Funds called **\$10.0m** and distributed **\$2.2m**. Total value to paid-in capital was slightly down from 1.31 to 1.26 reflecting the substantial capital calls made in the quarter. The return remains above 10% p.a. Fund 1 is almost fully invested with only 8% still to be drawn down.
- 6.3 Notable write ups during the quarter were the A63 French Motorway project, Rovigo – an Italian Solar Farm and South Staffordshire Plc – the UK water company.
- 6.4 The manager continues to track a healthy pipeline of primary, secondary and co-investment opportunities, whilst remaining vigilant about the risks of overpaying for assets. The manager will give an updated briefing at the December committee meeting.

## **7. M & G**

- 7.1 The M&G UK Companies Financing Funds provide debt finance to companies facing refinancing obstacles. The target return is LIBOR plus 3%-6% with low risk.
- 7.2 Falkirk's commitment to Fund I is **£11.8m** which has been fully drawn down. During Q2, the Fund distributed **£0.3m**. The Fund consists of 7 loans with an average repayment period of 3.5 years and average credit rating of BB+. The loans are spread across various sectors with companies such as Hogg Robinson, Barrett and Drax. Net annualised return is 4.7%.
- 7.3 Commitment to Fund II is **£10m** of which **£4m** has been drawn down. As the Fund investment period of 3 years has now elapsed, M&G have confirmed that no further capital calls will be made. During Q2, Fund II distributed **£0.1m**. The Fund consists of 8 loans with an average repayment period of 5.3 years. Loans are spread across various sectors such as Finance, Leisure and Property. The net annualised return is 3.8%.
- 7.4 Loans from both Funds continue to be paid in accordance with their covenants.

## **8. Hearthstone**

- 8.1 The Fund has made a £30m commitment to Hearthstone Investments to fund Social and Affordable Housing via their Housing Fund for Scotland. The return objective is RPI + 2%. Around 23% of the commitment (i.e. £7m) remains to be drawn down.
- 8.2 The Fund's initial investment of £15m has facilitated a building programme of 195 units across the Forth Valley area which is being progressed by the Housing Association, Castle Rock Edinvar. Sites are at Bellsdyke, Shieldhill, Coalsnaughton and Raploch.
- 8.3 The £15m originally invested in a fixed interest security in support of the social housing programme is now being recycled to buy units of affordable housing with these being leased back to the Places for People Group. Q2 was a quiet quarter for the mandate, however a capital call of £3m has been made in the current quarter to secure properties in and around Edinburgh. This is in addition to units purchased in Bo'ness, Rutherglen and Aberdeen.

## **9. In-House – UK Infrastructure**

- 9.1 The Fund has a commitment of **£60m** to UK infrastructure through its collaboration with Lothian Pension Fund.
- 9.2 During the quarter, **£8.5m** was called, leaving **£37m** to be deployed.
- 9.3 As at 30 June 2016, capital has been called for the five investments shown in the table overleaf:

<b>Investment Partners/Project</b>	<b>Sector</b>	<b>Committed</b>	<b>Drawdown</b>
FIM Harburnhead Wind Farm in the Lothians	Renewables	£3.2m	£3.2m
Ancala Partners Scottish Highlands Hydro Electric	Renewables	£7.6m	£5.2m
Dalmore Capital Thames Tideway Tunnel	Sewerage	£7.5m	£2.8m
Ancala Partners Solar Assets in England	Renewables	£4.6m	£4.1m
Ancala Partners Gas Supply and Distribution Channel Islands and Isle of Man	Utilities	£7.5m	£7.4m
<b>Totals</b>		<b>£30.4m</b>	<b>£22.7m</b>

- 9.4 During the current quarter, a £6.25m investment has been made in a sixth project. This is a stake in Southern Water purchased on the secondary market. Southern Water is one of ten water and sewerage companies in England and Wales. It is a regulated entity and should provide stable, inflation linked cash flows. The target return is 9% p.a.
- 9.5 Some photographs of the Lothians Wind Farm under construction are attached at Appendix 4.

## **10. Conclusions**

- 10.1 The Fund's alternatives programme continues to evolve with private equity funds gradually maturing and infrastructure mandates building up.
- 10.2 Managers are agreed that Brexit is likely to result in European market volatility in the medium term, with political and economic ramifications difficult to predict. Other issues affecting their investment outlook include migration pressures within Europe and looming elections in the US, France and Germany.
- 10.2 Despite an uncertain backdrop, private equity fundraising remains strong and in demand as evidenced by the €28bn raised by European managers in the most recent quarter. However, it is noted that the average purchase price for completed transactions has now risen to around 9 times earnings, all of which feeds into the narrative of the dangers of overpaying for assets.

pp **Director of Corporate & Housing Services**

Author: Alastair McGirr, Pensions Manager  
01324 506333 [alastair.mcgirr@falkirk.gov.uk](mailto:alastair.mcgirr@falkirk.gov.uk)

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## **Appendices**

Appendix 1 – Alternative Assets Summary – Local Currency

Appendix 2 – Alternative Assets Summary – Sterling

Appendix 3 – Calls and Distributions – Local Currency

Appendix 4 – Photos of Lothians Wind Farm

## **List of Background Papers:**

None

## Appendix 1

### Falkirk Council Pension Fund Alternative Markets Update - 30/06/16

#### Alternative Assets Summary - Original Currency

Manager	Fund	Currency	Commitment 000's	Unfunded 000's	(a) Cost 000's	(b) Distributions 000's	(c) Market Value 000's	(b + c) Total Value 000's	Total Value to Paid in Cap.	Inception Rate of Return	Percentage to be drawn down
<b>Private Equity</b>											
SL Capital Partners	European Strategic Partners 2004	EUR	30,000	3,092	26,908	29,377	6,650	36,027	1.34	7.5%	
SL Capital Partners	European Strategic Partners 2006	EUR	30,000	2,941	27,059	24,925	11,002	35,927	1.33	5.4%	
SL Capital Partners	European Strategic Partners 2008	EUR	27,000	4,904	22,096	9,114	18,369	27,483	1.24	3.3%	
SL Capital Partners	European Smaller Funds I	EUR	15,000	7,126	7,874	124	7,446	7,570	0.96	-27.2%	
<b>SL Capital Partners Total</b>			<b>€ 102,000</b>	<b>€ 18,063</b>	<b>€ 83,937</b>	<b>€ 63,540</b>	<b>€ 43,467</b>	<b>€ 107,007</b>			17.7%
Wilshire Associates	Fund VI - Europe	EUR	3,600	223	3,377	3,783	1,169	4,952	1.47	8.5%	
Wilshire Associates	Fund VII - Europe	EUR	3,600	157	3,443	2,655	1,740	4,395	1.28	3.6%	
Wilshire Associates	Fund VIII - Europe	EUR	3,700	408	3,292	2,580	2,712	5,292	1.61	33.2%	
<b>Wilshire Associates Europe Total</b>			<b>€ 10,900</b>	<b>€ 788</b>	<b>€ 10,112</b>	<b>€ 9,018</b>	<b>€ 5,621</b>	<b>€ 14,639</b>			7.2%
Wilshire Associates	Fund VI - US	USD	14,000	751	13,249	14,125	5,794	19,919	1.50	8.6%	
Wilshire Associates	Fund VII - US	USD	11,500	495	11,005	9,867	6,495	16,362	1.49	9.0%	
Wilshire Associates	Fund VIII - US	USD	12,700	565	12,135	8,917	9,685	18,602	1.53	13.7%	
Wilshire Associates	Fund VII - Asia	USD	1,800	117	1,683	1,849	629	2,478	1.47	9.6%	
Wilshire Associates	Fund VIII - Asia	USD	2,000	1,100	900	720	543	1,263	1.40	-7.5%	
Wilshire Associates	Opportunities Fund II-B	USD	15,000	1,146	13,854	10,386	9,135	19,521	1.41	14.8%	
Wilshire Associates	Fund IX	USD	15,000	10,103	4,897	458	4,803	5,261	1.07	21.7%	
<b>Wilshire Associates US and Asia Total</b>			<b>\$ 72,000</b>	<b>\$ 14,277</b>	<b>\$ 57,723</b>	<b>\$ 46,322</b>	<b>\$ 37,084</b>	<b>\$ 83,406</b>			19.8%
<b>Infrastructure</b>											
Grosvenor Capital	Customised Infrastructure Strategies	USD	80,000	6,563	73,437	31,672	63,155	94,827	1.29	11.1%	
Grosvenor Capital	GCM Grosvenor CIS II	USD	80,000	70,436	9,564	-	9,926	9,926	1.04	n/a	
<b>Grosvenor Capital Total</b>			<b>\$ 160,000</b>	<b>\$ 76,999</b>	<b>\$ 83,001</b>	<b>\$ 31,672</b>	<b>\$ 73,081</b>	<b>\$ 104,753</b>			48.1%
<b>Credit Markets</b>											
Prudential/M&G	UK Companies Financing Fund	GBP	11,835	-	11,835	7,370	6,830	14,200	1.20	4.7%	
Prudential/M&G	UK Companies Financing Fund II	GBP	3,966	-	3,966	1,175	3,122	4,297	1.08	3.9%	
<b>Credit Market Total</b>			<b>£ 15,801</b>	<b>£ -</b>	<b>£ 15,801</b>	<b>£ 8,545</b>	<b>£ 9,952</b>	<b>£ 18,497</b>			0.0%
<b>Social / Affordable Housing</b>											
Hearthstone plc	Housing Fund for Scotland	GBP	30,000	6,850	23,150	-	23,302	23,302	1.01	n/a	
<b>Social/Affordable Housing Total</b>			<b>£ 30,000</b>	<b>£ 6,850</b>	<b>£ 23,150</b>	<b>£ -</b>	<b>£ 23,302</b>	<b>£ 23,302</b>			22.8%
<b>UK Infrastructure</b>											
	UK Infrastructure	GBP	60,000	36,606	23,394	221	24,278	24,499	1.05	n/a	
<b>UK Infrastructure Total</b>			<b>£ 60,000</b>	<b>£ 36,606</b>	<b>£ 23,394</b>	<b>£ 221</b>	<b>£ 24,278</b>	<b>£ 24,499</b>			61.0%

## Appendix 2

### Falkirk Council Pension Fund Alternative Markets Update - 30/06/16

Exchange Rates	
\$	1.3368
€	1.2033

### Alternative Assets Summary - Sterling

Manager	Commitment £ 000's	Unfunded £ 000's	(a) Cost £ 000's	(b) Distributions £ 000's	(c) Market Value £ 000's	(b + c) Total Value £ 000's	Total Value to Paid in Cap.
SL Capital Partners	84,767	15,011	69,756	52,805	36,123	88,928	1.27
Wilshire Associates	62,918	11,335	51,584	42,146	32,412	74,558	1.45
Grosvenor Capital	119,689	57,599	62,089	23,692	54,669	78,361	1.26
M & G	15,801	0	15,801	8,545	9,952	18,497	1.17
Hearthstone plc	30,000	6,850	23,150	0	23,302	23,302	1.01
UK Infrastructure	60,000	36,606	23,394	221	24,278	24,499	1.05
	<b>£373,175</b>	<b>£127,401</b>	<b>£245,774</b>	<b>£127,409</b>	<b>£180,736</b>	<b>£308,145</b>	

Allocation to Private Equity  
(based on unfunded commitment plus market value) 4.9%

Allocation to Private Equity  
(based on market value only) 3.5%

Allocation to Infrastructure  
(based on unfunded commitment plus market value) 8.9%

Allocation to Infrastructure  
(based on market value only) 4.1%

## Appendix 3

### Falkirk Council Pension Fund Alternative Markets Update - 30/06/16

#### Alternative Assets Calls and Distributions - Original Currency

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

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

2016				
Q1	Q2	Q3	Q4	Total
(1,357)	(486)			(1,843)
7,066	3,246			10,312

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

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

2016				
Q1	Q2	Q3	Q4	Total
(93)	(93)			(186)
92	247			339
(1,277)	(949)			(2,226)
1,005	1,482			2,487

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

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

2016				
Q1	Q2	Q3	Q4	Total
(582)	(9,791)			(10,373)
0	2,174			2,174

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

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

2016				
Q1	Q2	Q3	Q4	Total
0	0			0
1,259	442			1,701

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

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

2016				
Q1	Q2	Q3	Q4	Total
(7,131)	(8,518)			(15,649)
49	0			49



## Appendix III: Photos – July 2016



Levelling of car park outside control building



Blade delivery to WTG16



750 tonne crane at WTG 9



Load ring at WTG13



Rigging Luffer at WTG16



Sand and backfill cables to WTG19



S3 tower lift at WTG16



Met mast base



Hub nacelle and generator at WTG9



WTG17 backfill



Nacelle lift at WTG19



Concrete pour at WTG22