Leicestershire County Council

Meeting:	**Investment Subcommittee**
Date/Time:	**Wednesday, 28 July 2021 at 10.00 am**
Location:	**Sparkenhoe Committee Room, County Hall, Glenfield**
Contact:	**Miss. C. Tuohy (Tel. 0116 305 5483)**
Email:	**cat.tuohy@leics.gov.uk**

Membership

Mr. T. Barkley CC	Cllr. Malise Graham
Cllr. A. Clarke	Mr. D. J. Grimley CC
Mr. D. A. Gamble CC	Mr. Z. Limbada

AGENDA

Item		Report by	
1.	Election of Chairman.		
2.	Minutes of the meeting held on 31 March 2021.		(Pages 3 - 8)
3.	Question Time.		
4.	Questions asked by members under Standing Order 7(3) and 7(5).		
5.	To advise of any other items which the Chairman has decided to take as urgent elsewhere on the agenda.		
6.	Declarations of interest in respect of items on the agenda.		
7.	Strategic Asset Allocation Update and Cash Deployment Plans.	Director of Corporate Resources	(Pages 9 - 14)
8.	Recommended Investment into LGPS Central and Partners Private Debt Product.	Director of Corporate Resources	(Pages 15 - 20)

9.	Recommended Investment: LGPS Central Infrastructure Fund.	Director of Corporate Resources	(Pages 21 - 28)
10.	Date of Next Meeting - 13 October 2021		
11.	Any other items which the Chairman has decided to take as urgent.		

<u>Exclusion of the Press and Public</u>.
The public are likely to be excluded during consideration of the remaining items in accordance with Section 100(A)(4) of the Local Government Act 1972 (Exempt Information).

12.	Supplementary Information informing Recommended Investment into LGPS Central and Partners Private Debt Products.	Director of Corporate Resources	(Pages 29 - 68)
13.	Supplementary Information Informing Recommended Investment: LGPS Central Infrastructure Fund.	Director of Corporate Resources	(Pages 69 - 94)

Leicestershire County Council

Minutes of a meeting of the Investment Subcommittee held at County Hall, Glenfield on Wednesday, 31 March 2021.

PRESENT:

Leicestershire County Council

Mr. P. C. Osborne CC (Chairman)
Mr. T. Barkley CC
Dr. S. Hill CC

Leicester City Council
Cllr. A. Clarke

District Council Representative
Cllr. M. Graham

Staff Representative

Mr. A. Wilson

57. Minutes of the meeting held on 14 October 2020.

The minutes of the meeting held on 14 October 2020 were taken as read, confirmed and signed.

58. Question Time.

The Chief Executive reported that no questions had been received under Standing Order 35.

59. Questions asked by members under Standing Order 7(3) and 7(5).

The Chief Executive reported that no questions had been received under Standing Order 7(3) and 7(5).

60. To advise of any other items which the Chairman has decided to take as urgent elsewhere on the agenda.

There were no urgent items for consideration.

61. Declarations of interest in respect of items on the agenda.

The Chairman invited members who wished to do so to declare any interest in respect of items on the agenda for the meeting.

No declarations were made.

62. Strategic Asset Allocation Update and LGPS Central Climate Fund

Transition.

The Subcommittee considered a report of the Director of Corporate Resources updating Members on the Strategic Asset Allocation and LGPS Central Climate Fund Transition. A copy of the report is filed with these minutes marked '6'.

The Director informed the Subcommittee that the Fund continued to await Property and Infrastructure fund product launches from LGPS Central which the Fund had expressed interest in. In the meantime, the Fund would consider relevant investments to avoid straying further from its Property target allocation.

RESOLVED:

That the report be noted.

63. Recommended Investment into LGPS Central Multi Asset Credit Fund.

The Subcommittee considered a report of the Director of Corporate Resources which provided members with background information relating to a recommended investment in LGPS Central Multi Asset Credit Fund. A copy of the report is filed with these minutes marked '7'.

The Director informed the Subcommittee that the Fund had a target allocation of 4.0% (c.£200million) of total Fund assets to the global credit liquid sub investment grade asset class. Currently the Fund only had a £29million investment with JP Morgan in the asset class, which totalled 0.6% of the total Fund value. Thus an investment into LGPS Central's Multi Asset Credit (MAC) Fund was proposed to reach the Fund's target allocation.

Arising from the detailed discussion the following points were noted:-

i. The Fund had engaged with LGPS Central in the creation of the MAC fund mandate alongside other partner funds to develop a mandate that was suitable for their objectives.

ii. Following a detailed selection process LGPS Central had appointed two managers Western Asset and BMO Global Asset Management. The interview process included questions regarding staff turnover, responsible investment and engagement, portfolio turnover and their decision-making processes. Furthermore, LGPS Central ensured that the managers chosen strategies did not overlap to allow appropriate diversification within the fund.

iii. A concern was raised regarding reference to the use of derivative instruments and collateralized loan obligations within the mandate. The Director assured the Subcommittee that while the fund's ability to invest in a wider pool of securities meant there was a higher risk there was also higher expected return than other investments the Fund had. Members were assured that LGPS Central would monitor its managers and could reign in managers who acted outside of their expected philosophy. Ultimately the mandate only aimed for 4%, a reasonable return, so it was not expected that Managers would need to take excessive risks to obtain this return.

iv. Members were further assured that LGPS Central had a manager monitoring process with all of their managers and funds to assess any changes with how the performed against target, and if necessary Central had the ability to rebalance managers or remove them if ultimately necessary.

RESOLVED:

That the information provided be noted.

64. Recommended Investment Into Adams Street Partners Global Secondary Fund 7.

The Subcommittee considered a report of the Director of Corporate Resources which provided members with background information relating to a recommended investment in Adams Street Partners Global Secondary Fund. A copy of the report is filed with these minutes marked ‘8’.

The Director informed Members that the Fund’s target allocation was 5.75% to private equity of which the Fund had was 0.25% overweight at 6.0%. Despite this it was considered essential to further invest in private equity due to the historic investments returned and the illiquid nature of the asset class. It was expected that as funding returned by 2022 the Fund’s allocation would be 5.23% therefore it was necessary to commit to future vintages.

Members noted that the Fund had invested in Adams Street Partners previously and that the ASP had a long history within the secondaries market. Furthermore it was felt the shorter duration of the Global Secondary Fund 7 was beneficial.

The Subcommittee were aware that officers were in discussions with LGPS Central with other partner funds to launch a 2021 private equity vintage which the Fund had expressed interest in.

RESOLVED:

That the report be noted.

65. Date of Next Meeting - 28 July 2021

That it be noted that the next meeting of the Subcommittee is scheduled to be held on 28 July 2021.

66. Exclusion of the Press and Public.

RESOLVED

That under Section 100(A) of the Local Government Act 1972 the public be excluded from the meeting for the following item of business on the grounds that it involves the likely disclosure of exempt information as defined in Part 1 of

Schedule 12(A) of the Act.

67. Supplementary Information informing the proposed investment in LGPS Cental Multi Asset Credit

The Subcommittee considered supplementary information from the Director of Corporate Resources regarding the recommended investment into LGPS Central Multi Asset Credit Fund and due diligence undertaken by the Fund's investment consultant, Hymans Robertson, which was followed by questions from members. A copy of the briefing note is filed with these minutes marked '10.

The note was not for publication by virtue of Paragraphs 3 and 10 of Part 1 of Schedule 12(A) of the Local Government Act 1972.

The Subcommittee noted that the recommended £200million investment in Central's MAC fund, which was expected to achieve attractive returns, would be funded from:-

- Termination of the JP Morgan Global Credit Mandate totalling circa £29million.
- Rebalancing of the targeted return portfolio managers to the smallest manager Aspect, by selling holdings in Pictet and Ruffer, estimated at £40million and £50million respectively as at December 2020.
- Use of existing cash reserves, estimated at £81million.

Members noted that where valuations had changed since December 2020 the Fund would rebalance each targeted return manager accordingly to Aspect and the cash reserves needed consequently.

Arising from the discussion, the following points were made:-

i. The Fund's exposure to risk within the Multi Asset Credit Fund was limited as the mandate set out that less than ten percent was able to be transferred to emerging market debt which held more risk than developed markets. There was also low allocation within high yield loans and convertibles. Thus the mandate limited the risk by restricting how much managers could invest in higher risk areas.

ii. Hymans Robertson had undertaken due diligence and recommended investment.

RESOLVED:

That the supplementary information provided be noted.

[At this point LGPS Central representatives joined the meeting]

68. Presentation of the Investment Manager - LGPS Central Multi Asset Credit

Fund

The Subcommittee received a presentation by representatives from LGPS Central which was followed by questions from members. A copy of the presentation is filed with these minutes marked ‘12’. The presentation was not for publication by virtue of Paragraphs 3 and 10 of Part 1 of Schedule 12(A) of the Local Government Act 1972.

Arising from the discussion the following points arose:-

i) LGPS Central had a robust manager selection process that ensured managers chosen were right to manage the assets of the partner funds. The criteria included expected performance, a consistent investment process, value for money, transparency and a strong commitment to Environmental, Social and Governance (ESG) factors which both BMO and Western Asset displayed.

ii) LGPS Central had monitored the managers portfolio before any investment to ensure that managers were working as expected. Central also held monthly conference calls with its managers.

iii) The asset managers were limited by the agreed mandate. If a manager was to go outside of that mandate Central would look to understand the reasoning behind the decision through regular meetings. If there was poor performance by a manager Central would undertake a review and work with the manager to consider decisions taken and the justification behind them. Central could ultimately fire the manager if it seemed detrimental to performance long-term.

iv) The Subcommittee were assured that Environmental, Social and Governance factors were still at the forefront of managers minds in the fixed income market. Despite not holding voting rights, they still had a direct line of access and communication with company’s management which could be used to engage and encourage better ESG considerations. LGPS Central also employed its own Responsible Investment Team that undertake due diligence on a continual basis and considered fund portfolio’s and how they ranked.

[At this point LGPS Central representatives withdrew from the meeting]

RESOLVED:

a) That the presentation delivered by LGPS Central be noted.
b) That a £200million commitment to invest in LGPS Central’s Multi Asset Credit Fund as set out in paragraph 18 of the report be approved

69. Change to the Order of Business.

The Chairman agreed to vary the order of business from that set out in the agenda, taking Agenda Item 14 – Presentation of the Investment Manager – Adams Street Partners Global Secondary Fund 7 ahead of Item 13 Supplementary Information Informing the Recommended Investment into

Adams Street Partners Global Secondary Fund 7.

[Representatives from Adams Street Partners joined the meeting]

70. Presentation of the Investment Manager - Adams Street Partners - Global Secondary Fund 7.

The Subcommittee received a presentation by representatives from Adams Street Partners regarding the Global Secondaries Fund 7, which was followed by questions from members. A copy of the presentation are filed with these minutes marked ‘Agenda Item 14’. The presentations were not for publication by virtue of Paragraphs 3 and 10 of Part 1 of Schedule 12(A) of the Local Government Act 1972.

RESOLVED:

That the presentation delivered by Adams Street Partners be noted.

[Representatives from Adams Street Partners left the meeting]

71. Supplementary Information Informing the Recommended Investment into Adams Street Partners Global Secondary Fund 7.

The Subcommittee considered supplementary information from the Director of Corporate Resources informing the recommended investment into Adams Street Partners Global Secondary Fund 7. A copy of the report marked ‘Agenda Item 13’.

The report was not for publication by virtue of Paragraphs 3 and 10 of Part 1 of Schedule 12(A) of the Local Government Act 1972.

RESOLVED:

a) That the supplementary information provided be noted.

b) That a $38million USD commitment to invest into Adams Street Partners Global Secondary Fund 7 be approved.

Wednesday, 31 March 2021
Time Not Specified - Time Not Specified CHAIRMAN

Agenda Item 7

Leicestershire County Council

INVESTMENT SUB-COMMITTEE – 28 JULY 2021

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

STRATEGIC ASSET ALLOCATION UPDATE AND CASH DEPLOYMENT PLANS

Purpose of the Report

1. The purpose of this report is to update the Investment Sub Committee (ISC) on the cash holding of the Leicestershire County Council Pension Fund (Fund) and the plans for its deployment for the rest of 2021.

Background

2. Hymans Robertson, the Fund's Actuary, completed the 2021 Strategic Asset Allocation (SAA) as part of the Funds annual investment review. The Strategy was reviewed by officers and was approved by the Local Pension Committee at the January 2021 meeting.

3. The Fund, as a part owner of LGPS Central (Central), has an aim to transition investments to cost effective and relevant products at Central as and when they are made available.

4. Over the next 12 months, the Fund is working with Central to progress the following products where the Fund may, pending due diligence make an investment:

    a. Central Infrastructure Fund
    b. Central Private Debt vintage 2021
    c. Central Private Equity vintage 2021
    d. Central Direct Property Fund
    e. Central Targeted Return Fund

5. In some cases, owing to the complex nature of building products suitable for a variety of partner funds, delays have been experienced. As a result the Fund has been conscious of making investments outside of Central in order to not stray further from the strategic allocation whilst maintaining an interest in any potential Central product when it becomes available.

SAA 2021 Recap

6. The Fund's 2021 SAA was approved at the January 2021 Pension Committee. A reminder of the 2021 SAA is shown in the table below.

	Proposed target weight (%)	Comments
Growth (55.25%)	55.25	
Listed equity	42.0 (40.0-44.0)	Broad factor based passive allocation implemented December 2020, using LGPS Climate multi-factor sub-fund
Private equity (inc secondaries)	5.75	Increase in strategic target reflecting existing allocations Consider opportunistic investment in Adam Street Secondaries
Targeted return	7.5	Currently higher allocation. Use to fund sub-inv grade credit allocation; Review LGPS sub-fund when details available
Income (36.75%)	36.75	
Infrastructure (inc timberland)	9.75	Review and use LGPS sub-fund
Property	10.0	Consider introducing residential property; Consider LGPS Central proposals
Emerging market debt	2.5	-
Global credit – liquid sub inv grade markets	4.0	Existing JP Morgan fund holding and reduction in Target Return used to fund allocation, subject to due diligence
Global credit - private debt	10.5	Review M&F DOF team mid-year to decide whether to make further allocation to distressed debt
Protection (8%)	8.0	
Inflation-linked bonds	4.5	0.5% reduction in strategic allocation, reflecting recognition of cash held to manage currency hedge
Investment grade credit	3.0	Including up to c.0.5% retained by Aegon to support currency hedge programme
Currency hedge cash	0.5	Recognition of cash held by Aegon for this mandate. Adjust benchmark hedge ratios used by Aegon from 50% to 30%
Total	100.0	

Current cash holding & plans

7. The Fund at 31st March 2021 £170m in cash, or 3.3% of total Fund assets. As at June 2021 end the balance was c£220m. Owing to the positive cashflow nature of the Fund, due to payments to pensioners or dependants being lower than pension contributions and closed end funds returning money, the cash balance grows without regular re investment to realign to the SAA.

8. The table below best describes the change in cash between March 31st and June 30th:

	£m	
March 31st cash balance	**170**	
Net cash expended for LGPS Central MAC	-17	£200m commitment less sales of targeted return managers (102m) & JP Morgan credit (£31m) and recalling £50m of currency hedge collateral
Partners distributions	27	Net distributions from Partner Group
Change in USD account	17	Combination of multiple managers calls and distributions
Net pension contributions less pensions paid	15	Fund pays out less in pensions than it collects in contributions
Other	8.5	£6m is Property distribution
30th June cash balance	**220**	

9. Whilst waiting for new products to be made available the cash balance has grown over the last 12 months.

10. As described earlier there are a number of new products that the Fund is interested in that would reduce the cash balance which are described later in this paper. The table below illustrates the position of the Fund at 31st March 2021 versus the strategic asset allocation.

Growth	31/03/2021 £m	2021 SAA	31/3/20 Actual weight %	Difference, actual to 2021 SAA	£m to target weight	Net commitments approved	Difference to target post commitments agreed £m
Listed Equity - Active and Passive	2,329	42.00%	45.2%	3.2%	-166		-166
Targeted Return Funds	536	7.50%	10.4%	2.9%	-150	-90	-60
Private Equity	339	5.75%	6.6%	0.8%	-43	27	-70

Income	31/03/2021 £m	2021 SAA	31/3/20 Actual weight %	Difference, actual to 2021 SAA	£m to target weight	Net commitments approved	Difference to target post commitments agreed £m
Infrastructure	381	9.75%	7.4%	-2.4%	121	25	96
Global credit - private debt	379	10.50%	7.4%	-3.1%	162		162
Property	392	10.00%	7.6%	-2.4%	123		123
Global Credit - liquid sub inv grade	31	4.00%	0.6%	-3.4%	175	170	5
Emerging market debt	108	2.50%	2.1%	-0.4%	21		21

Protection	31/03/2021 £m	2021 SAA	31/3/20 Actual weight %	Difference, actual to 2021 SAA	£m to target weight	Net commitments approved	Difference to target post commitments agreed £m
Inflation linked bonds	235	4.50%	4.6%	0.1%	-3		-3
Investment grade (IG) credit	106	2.50%	2.1%	-0.4%	23		23
Short dated IG credit	25	0.50%	0.5%	0.0%	1		1
Active currency hedge collateral	119	0.50%	2.3%	1.8%	-93		-93

Rebalancing to target asset allocation

11. Overall, the Fund is overweight growth assets and underweight income assets. The income assets are dominated by illiquid products such private debt, infrastructure and property all of which the Fund has potential to invest in.

12. It is generally easier to invest into and out of the growth assets (except private equity) given their liquidity provided by stock markets. As such rebalancing lower would take far less time if the Fund needed additional cash to fund investment in the underweight income assets class.

Central Infrastructure

13. A proposal is being taken to the ISC as part of today's agenda that would reduce the cash holding if approved by £70m over a period of time that would depend on Central's ability to appoint underlying managers. Officers in consultation with Central expect the majority to be called within 36 months with open ended underlying investments being called within 18 months and closed ended investments taking longer. Given the time to call money and the return of capital from the Fund's existing managers there will be a continual assessment each year of the amount to reinvest in infrastructure.

Central Private Debt and Partners Group

14. A further proposal is being taken to the ISC as part of today's agenda for an investment into two private debt products. The combined proposal totals £160m, about a third to a half (£50m-£80m) could be called before the end of 2021 if approved.

15. The Fund's existing private debt holdings comprising of investments with Partners Group, M&G and CRC. Partners group and CRC will be returning cash over the next 12 months and as such officers plan to take a further paper later in the year or after the SAA for 2022 is agreed in January 2022 to assess the need for a further allocation to this asset class. This additional allocation later this year is likely to be cashflow neutral.

Private Equity

16. There is need to re-invest into the private equity class each year, the Fund has a mature list of investments which are continually returning money. Officers plan to take a paper to the October ISC. Early indications suggest a c£30-40m commitment would be appropriate to maintain the target portfolio weight and vintage diversification.

17. Central are launching a 2021 private equity vintage and this will be considered as part of due diligence. Depending on the actual product selected investing money could take up to five years and as such officers do not expect a commitment to decrease cash holdings significantly.

Property

18. Central have commenced a search for a direct property manager. The Fund at March 31st is underweight by 2.4% or c£120m. The Fund has been waiting for a Central product to be launched and in the meantime has committed a further £35m to its indirect property manager LaSalle who invest in funds rather than direct property. This allocation to LaSalle is in line with the approved target asset allocation.

19. LaSalle aim to invest the money by the end of the calendar year which would decrease the cash holdings.

20. In addition, the Fund's direct property manager has an instruction to bring to the attention of the Fund any direct property that would fit the profile of its existing direct property portfolio.

Targeted Return

21. Central are developing a product which is due to be available for investment in early 2022. This investment if approved will be funded by the Funds existing holdings (Pictet, Aspect and Ruffer) and not by cash.

22. It is worth noting that the investment into the Central product will return c£60m cash given the Fund is currently overweight to this asset class all other things being equal.

<u>Summary of changes 2021:</u>

23. The following tables summarises the decisions taken and planned in 2021 where there is a net change in asset class weight forecasted. In some cases where a commitment is made there may not be a net reduction given the distributions from the manager.

Growth	Difference to target post commitments agreed £m	July ISC recommendation	Distributions / future commitments	Diff to target weight post changes £m	% diff to SAA
Listed Equity - Active and Passive	-166			-166	3.2%
Targeted Return Funds	-60			-60	1.2%
Private Equity	-70		-30	-40	0.8%

Income	Difference to target post commitments agreed £m	July ISC recommendation	2021: Other / future changes	Diff to target weight post changes £m	% diff to SAA
Infrastructure	96	70		26	-0.5%
Global credit - private debt	162	160	-30	32	-0.6%
Property	123		35	88	-1.7%
Global Credit - liquid sub inv grade	5			5	-0.1%
Emerging market debt	21		20	1	0.0%

Protection	Difference to target post commitments agreed £m	July ISC recommendation	2021: Other / future changes	Diff to target weight post changes £m	% diff to SAA
Inflation linked bonds	-3			-3	0.1%
Investment grade (IG) credit	23		20	3	-0.1%
Short dated IG credit	1			1	0.0%
Active currency hedge collateral	-93		-50	-43	0.8%

24. Officers expect that if the above amounts are committed, cash will be reduced from the £220m held at the end of June 2021 to less than £150m by year end. Calls in 2022 are expected for certain asset class commitments which will not be fully called in 2021 such as private debt and infrastructure.

25. Whilst it may appear the Fund is over committed; the timing of calls will allow the Fund to build up cash each month as distributions are received and a forecasted net c£30m from net contributions in expected by the year end. (pension contributions less pension payments)

26. If cash accumulates further then additional rebalancing can take place similar to that described for EMD and IG credit.

27. There are assumptions made for illiquid investments will contain a margin of error given it is unknown when managers will call funds or distribute accurately.

Recommendation

28. It is recommended that the Investment Subcommittee notes the report.

Equality and Human Rights Implications

29. None.

Appendix

None

Background Papers

None

Officers to Contact

Mr C Tambini, Director of Corporate Resources
Tel: 0116 305 6199 Email: Chris.Tambini@leics.gov.uk

Mr D Keegan, Assistant Director Strategic Finance and Property
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Agenda Item 8

INVESTMENT SUBCOMMITTEE – 28 JULY 2021

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

RECOMMENDED INVESTMENT INTO
LGPS CENTRAL & PARTNERS PRIVATE DEBT PRODUCTS

Purpose of the Report

1. The purpose of this report is to provide information in respect of a recommended investment into the LGPS Central (Central) Private Debt 2021 vintage and Partners Group Multi Asset Credit (MAC) VI Fund.

Background

2. Private Debt is the name given to an asset class where money is loaned to companies that has not originated from a bank. Companies choose to raise capital from this source for a number of reasons including the cost of the loan, availability of traditional banking credit and the ability to negotiate terms specific to a deal etc.

3. The loan (or debt /credit) that the investment manager extends to the company is usually senior and secured. Senior debt is the debt that a company must repay first if it goes out of business, before other forms of debt and equity are settled. Secured debt is backed by an asset, such as buildings or equipment, that may be sold to cover the debt if the loan goes into default.

4. Private debt investment products may include subordinated debt (debt less secure than senior debt), preferred equity (equity which ranks higher than ordinary equity but lower than debt) and equity, albeit there will be a limit on the riskiest types of lending as defined in the investment mandate. The companies who take on the debt agree in advance the terms of the loan including the interest rate, (fixed or floating) the term of the loan, and if any security is provided in the event of a defined default by the company.

5. Private Debt is an illiquid product, it takes time for money to be invested and selling an investment is often not possible due to limited markets to trade in. As such proposals are carefully considered with the Fund's advisors.

6. The Fund has a target allocation of 10.5% of total Fund assets to the Private Debt asset class. This allocation was approved at the January 2021 Local Pension Committee meeting. As at 31st March 2021 the actual allocation was 7.4%, implying an underweight position of 3.1% or c£160m.

7. At present the Fund has exposure to this asset class with £379m invested over four Partners Group private debt vintages (£266m), three M&G distressed debt vintages (£73m) and a smaller position with CRC (£40m) who manage a niche bank risk

transfer strategy. This equates to 7.4% of total assets. There are no outstanding committed amounts that have not been called.

8. Officers have engaged with Hymans Robertson to provide assurance for both opportunities which covers the following criteria for both the Central and Partners Group products.

    - Structure, governance & senior leadership of the pool manager
    - Investment team
    - Philosophy & Process
    - Product design & investment strategy
    - Responsible Investment integration
    - Fund structure
    - Fees & additional costs
    - Performance & risk

<u>Proposed investment - LGPS Central Private Debt vintage 2021</u>

9. LGPS Central have created a Private Debt 2021 product with three-sleeves. These sleeves reflect the different risk/return profiles that the partner funds would like exposure to.

10. The Fund is interested in the low return and high return sleeves which matches allocation that the Fund has within the portfolio from existing managers. Target returns for the low return sleeve are 6-8% with 12-14% for the high return sleeve. Target returns are net of all fees which includes the underlying manger’s and Central’s.

11. The third, stable return sleeve targets a net return of circa 3.25% and was created for one particular partner fund although it is open to all partner funds to invest in if needed.

12. At present the Hymans recommendation is for the Fund to consider the low return sleeve for investment and further consider an investment into the high return sleeve. The rationale for this decision is based largely on the more developed proposal for the low return sleeve. The higher return sleeve comes with higher risk and therefore understanding the selected managers, their strategies, philosophies and track record becomes more important.

<u>Low return mandate summary:</u>

13. A summary of the low return sleeves mandate:

The sleeve will target:	**The sleeve will not, without the prior approval of investors by majority consent invest:**
• 3-5 different fund holdings (with c120 underlying loans estimated. All loans will be performing • 85%+ senior secured loans with a maximum of 15% second lien. There is no target allocation to mezzanine or equity	• More than 40% of total commitments in the Fund with a single manager • In direct co-investments • In a fund where one sector may account for more than 20% of that fund, other than business services and healthcare (30% each)

• 90%+ loans to have maintenance covenants with the expectation of two financial covenants per loan • 30-50% of total Commitments in the Partnership in portfolio companies based in North America with a 5% tolerance • 50-70% of total Commitments in the Partnership in portfolio companies based in the European Economic Area, (includes the UK) with a 5% tolerance • No specific industry or sector weights but a bias towards managers favouring defensive sectors but with broad diversification • A cash yield of approximately 6-7%	• In a fund where the average size loan may exceed 5% of the fund • With managers using leverage at fund level • With a manager that has not been established for at least 10 years (or the majority of the investment committee members have not been working in private credit for at least that time) • In a fund where net realised or projected returns over the last two funds are materially more or less than their relevant marketed target return range • With a manager with an aggregate AUM raised less than $2.5bn, or a manager whose previous fund size is less than $500m • In a Fund which does not have at least two previous funds (including predecessor funds at predecessor managers) deploying a broadly similar strategy in the same geography • In a fund which invests in non-OECD countries • With managers who are permitted to invest more than 15% with their private equity business if part of a wider asset management group • With managers who are permitted to invest more than 15% of capital in non-senior debt • In stressed, distressed, and special situation debt • In a co-investment fund which is permitted to invest more than a maximum of 5% in a single investment

<u>The Team and Central's structure:</u>

14. With respect to the team in place Hymans note the team to be of sufficient size and experience and are comfortable the team can manage the strategy. Whilst turnover in the wider private market investment team is of material concern, none of the leavers have been from the private debt team. They also note that the wider team is also responsible for private equity and it is expected that further sleeves will launch in 2021 which could be a resource concern but temper that concern with that fact co investments will not be made which are resource heavy at the time due diligence is performed.

15. Hymans have stated they are overall comfortable with Central's structure, with the firm appropriately regulated to carry out investment activity on behalf of its Partner Funds. They are also comfortable with the level of experience within the leadership team but recommend the stability of the leadership and wider investment teams be closely monitored.

<u>Philosophy, process and potential managers</u>

16. Hymans are comfortable with Central's investment philosophy. They believe the Central team have a robust and repeatable manager selection process in place and responsible investment is given meaningful consideration throughout the process.

Hymans do note however no managers have reached final approval (at the time of writing) and so there is no evidence to support the investment process was followed in accordance with the provided process and procedures. Details of shortlisted managers are included within the private session of today's agenda.

17. They also note that there is material blind pool risk in committing to either sleeve but do note that managers within the low return sleeve are further along being finalised and Central expect monies from partner funds to be committed to in 2021.

Investment strategy summary

18. Hymans are comfortable with the design and investment strategy and target returns are in line with their expectations. They note Central seek to provide diversification across geographies and sectors and are supportive of selecting more than 3 managers to achieve the underlying loan diversity.

19. Hymans are also supportive of the restrictions placed upon the strategy which will not materially narrow the investable universe.

Responsible Investment (RI) summary

20. Hymans note that RI is given meaningful importance during the manager selection process and that managers will not be appointed unless are satisfied with the approach to RI and climate risk taken by the manager.

Proposed investment - Partners Group Multi Asset Credit (MAC) 6 Fund

21. A detailed report by Hymans Robertson, on this investment opportunity, which includes exempt information, is included later in today's agenda. A brief overview is included below.

22. Partners Group are a large investment manager whose sole focus is on private markets; they do not offer investment management in areas such as market-listed equities and bonds. One of their areas of expertise is in private debt.

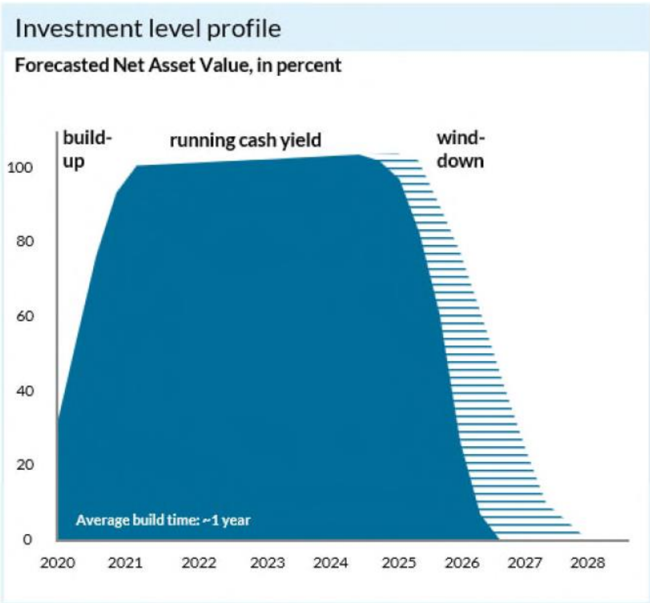
23. The Fund has invested in the previous four iterations of the Multi Asset Credit Fund, in 2014 (£100m), 2016 (£70m), 2017 (£120m) and 2019 (£100m). The investment process remains largely unchanged from that which has previously proven successful.

24. Partners Group are one of few managers who has the required resource, credentials and infrastructure to manage this type of private lending strategy on a global basis. Their regular fund raising provides an efficient and effective governance process in appointing Partners for subsequent mandates. The ISC is familiar with the manager and have had a positive experience to date investing in previous MAC funds.

25. The MAC 6 Fund is the latest in their Multi-asset credit range. Hymans have reviewed the documentation provided by Partners from an investment perspective and rate the Partners Group as "positive" for private debt strategies.

26. MAC 6 has the same investment strategy, target return (cash plus 4%-6%) and risk profile as MAC5 that the Fund invested in 2019.

27. The final close for the Fund is scheduled for October 2021. The GBP denominated fund has a 7 year investment holding period and a further 1 to 3 year wind down phase. The investment profile is best illustrated below, the shaded area represents the wind down of the fund with money being distributed to the fund from around 2025 onwards.



28. As at 31st May 2021 the MAC 6 fund had 9 private market loans, when fully invested the investment should have between 40 to 50 private market instruments. At present the geographical split is 70% North America and 30% Europe but this may change as more loans are made.

29. The Partners global strategy allows for up to 30% invested in Asia / rest of the world (RoW) and between 25% and 75% in Europe or North America. The Partners strategy also allows for up to 20% of assets to be invested in junior debt. The Central strategy allows for a maximum 15% allocation to non-senior (junior) debt which is marginally lower.

Supplementary Information Informing the potential investment

30. Exempt papers by supporting the recommendation including a paper from Hymans Robertson, are included within the private session of today's agenda.

Recommendations

31. The Investment Subcommittee is recommended to consider an investment in the Partners Group MAC 6 product and an investment into the LGPS Central Private Debt low return vintage 2021.

Equality and Human Rights Implications

None specific

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Agenda Item 9

Leicestershire County Council

INVESTMENT SUB COMMITTEE – 28TH JULY 2021

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

RECOMMENDED INVESTMENT: LGPS CENTRAL INFRASTRUCTURE FUND

Purpose of the Report

1. The purpose of this report is to provide information in respect of a recommended investment into the LGPS Central (Central) Infrastructure fund.

Background

2. Institutional infrastructure investing is usually conducted via private markets where units or shares in a fund are not traded on a liquid market. Investing covers a broad spectrum of risk and return.

3. Open ended and closed ended fund structures are available with each having differing characteristics. The Leicestershire County Council Pension Fund ("the Fund") has both open and closed ended investments within the portfolio of holdings. The JP Morgan and IFM holdings being open ended investments where there is some visibility of portfolio holdings when investing and some liquidity exists via queued investment and redemption. The Fund also has some closed ended funds such as KKR and Timberland where investments are usually allowed during the fundraising stage and liquidity is limited to secondary sales or awaiting the natural maturity of the fund which can be from five to twenty-five years.

4. The Fund has a target allocation of 9.75% of total Fund assets to the infrastructure asset class. This allocation was approved at the January 2021 Local Pension Committee meeting. As at 31st March 2021 the actual allocation was 7.4%, implying an underweight position of 2.35% or c£120m.

5. The Fund has made a recent commitment (£20m GBP) in October 2020 to the JPM IIF fund whilst the Central offer was being progressed and the Fund was underweight. This commitment joined the queue of commitments to be called and should be called later this year.

6. At present the Fund has infrastructure exposure via five external investment managers totalling £382m at 31st March 2021.

   a. Stafford Timberland - £135m – closed ended
   b. IFM - £107m – open ended
   c. JP Morgan - £84m – open ended
   d. KKR - £38m – closed ended
   e. Infracapital - £18m – closed ended

7. As at 31st March 2021 the fund had a cash holding of c£170m with a combination of GBP and USD. In addition, the Fund also held collateral with Aegon of £119m for the currency hedging programme.

8. Officers have engaged with Hymans Robertson to provide assurance which covers the following criteria for both the Central infrastructure product.

- Structure, governance & senior leadership of the pool manager
- Investment team
- Philosophy & Process
- Product design & investment strategy
- Responsible Investment integration
- Fund structure
- Fees & additional costs
- Performance & risk

Proposed investment LGPS Central Infrastructure

9. Central have created an open-ended product with two sleeves, one targeting the lower end of returns and one a higher return, these are called core / core + and value add / opportunistic.

10. The decision to defer a commitment to the value add / opportunistic sleeve is based on the following:

    a. Commitments to the sleeve need to be in excess of £150m in order to achieve fee savings
    b. A more realistic target return agreed (at present is CPI + 5%)
    c. Further details of the investment pipeline and likely composition of the initial portfolio are available, including reassurance that the expected fee savings are indeed larger than the Fund could have achieved independently.

11. The Hymans proposal is to consider the lower returning core / core + sleeve for investment at the present time.

12. A summary of the mandate for the core / core+ sleeve is shown below.

The Core/Core+ sleeve will aim to:	**After the fourth anniversary of the sleeve's closing date, the Core/Core+ sleeve will not:**
• Invest in core infrastructure within the range of 35%-65%. • Invest in core-plus infrastructure within the range of 35%-65%. • Hedge foreign currency exposures relating to cash calls or distributions at their discretion. • Limit exposure to infrastructure funds whose investment strategy is exclusively to invest in residential assets to 5% of commitments. • Limit exposure to infrastructure funds whose investment strategy is exclusively to invest in debt	• Invest more than 25% of commitments to funds managed by a single investment manager. • Invest more than the following to a single infrastructure fund: 20% if total commitments to the sleeve are less than £500 million, 15% if total commitments are greater than £500 million but less than £1 billion, and 10% if total commitments are greater than £1 billion. • Invest more than 50% of commitments in non-sterling denominated underlying infrastructure funds. • Invest more than 10% of commitments in underlying investments not domiciled in the OECD.

investments to 3% of commitments. • Diversify across at least three of the following sectors after the fourth anniversary of the first close: energy; utilities; transport; social; telecommunications; and other. • Minimise cash holdings for the primary purpose of distributions to Partner Funds and other capital requirements of the Master Partnership.	• Invest more than 5% of commitments in listed infrastructure funds. • Arrange or permit fund-level leverage. • Invest in co-investments without the prior approval of the LPAC. (advisory committee)

Fund structure

13. Hymans are comfortable with the structure of the infrastructure sub fund which is a sub fund of the Central alternatives pooling partnership (the Master Partnership). The sub fund is GBP denominated and is comprised of the two sleeves described earlier.

14. Commitments can be made on a quarterly basis and are subject to a lock in from the initial commitment date for four years for core / core + and five years for the value add / opportunistic sleeve. Commitments would not be called by Central until required. Redemptions after the lock in period are via two redemption windows per year.

15. Commitments are called in tranches that partner funds invested in. For example, if a Fund commits in Q1 then when a call is made to an underlying investment those Funds who had committed first get called based on their percentage of that tranche. At present two partner funds have made commitments to the core / core + sleeve and as such if the Fund were to commit to the core / core + sleeve the Fund’s commitment would be added to the remaining commitments from the previous two and be drawn pro rata.

16. Any commitments made will be shared amongst all investors in the relevant sleeves on a pro rata basis irrespective of when they commit to the sleeve owing to the open-ended nature of both sleeves.

17. Given that underlying funds may be closed ended and the sub fund is an open ended structure, redemption rights are limited and complex to protect the sub fund and the interests of the partner funds. Distribution from income and return of capital will be made to partner funds on a quarterly basis.

18. Once the lock in periods has expired and partners funds wish to redeem, Central would:

    a) Cancel any outstanding uncalled commitment from the redeeming investor
    b) Draw down other partner funds uncalled commitments to acquire units in the Fund, with proceeds of this providing redemption monies for the exiting investors
    c) See if other Partner Funds wish to make additional commitments to the Fund
    d) Redeem units in underlying open-ended Funds
    e) Use revenue and capital distributions from underlying investments
    f) Sell underlying closed ended funds in the secondary market. Where any loss in value versus holding cost is borne by the exiting investor.

19. In addition, the officers of the various partner funds meet once a month where a standing agenda item will be commitments and redemption into Central products.

20. Hymans are comfortable with the structure but note the liquidity risk in their assurance paper and advise Central be engaged at the earliest opportunity to advance any redemption requests. They further note that Central's valuation policy be monitored given the inherent subjectivity of pricing assets in an illiquid market so as to protect investors. For example, if a new investor invests into a sleeve when asset values may be understated. Hymans have reviewed Central valuation policy and believe it is appropriate.

<u>The Team and Central's structure</u>

21. Hymans note that Central have a comprehensive set of operational policies in place and an independent compliance and risk team. Overall, they are comfortable with LGPS Central's structure, with the firm appropriately regulated to carry out investment activity on behalf of its Partner Funds.

22. They are also comfortable with the level of experience within the leadership team but recommend the stability of the leadership and wider investment teams be closely monitored. Furthermore they have no concerns over ongoing governance at the firm.

23. They also have reviewed the team responsible for managing the infrastructure mandate and note they believe the team to be of adequate size and experience to successfully manage the strategy. They note that the team is small and lacks the depth of infrastructure investing experience typically seen at fund of fund managers but they compare favourably to some infrastructure teams within other LGPS pools.

24. Central's team is lead by an investment director with 23 years investment experience with 10 years infrastructure experience, he is supported by a senior portfolio manager with 13 years' experience across infrastructure, property, M&A and corporate finance. They are also supported by a portfolio manager and two investment analysts. Central aim to add more junior resource which is to be shared amongst the private markets team that infrastructure sits within.

25. Hymans note that the team will be responsible for a number of mandates eventually (direct & indirect property for example) and as such they would be more comfortable with more resource to be added to the team, particularly at more senior level.

<u>Philosophy, process and potential managers</u>

26. Hymans reviewed the nine stage investment process, starting with the design of the mandate and ending with oversight and monitoring of the fund. They are comfortable with the manager's investment philosophy (including the two funds outlined below) and we believe that they have a robust manager selection and monitoring process in place with Responsible Investment given meaningful consideration throughout the process.

27. Hymans have reviewed the one commitment made to the value add / opportunistic sleeve (Copenhagen IV Fund) and the approved commitment to the KKR diversified core infrastructure (DCI) fund for the core / core + sleeve.

KKR DCI fund

28. This is an open ended core infrastructure fund that will look to make long-term investments in developed countries (North America, Western Europe and Asia). The fund has a target IRR of 8-10% gross (7-9% net), with a target cash yield of 4-6% p.a. This is KKR's first core-focused infrastructure fund having focused historically on value-add infrastructure and represents another large infrastructure investor launching a lower risk product to complement their existing value add fund range. The Leicestershire Fund has had previous exposure to the value add KKR funds having invested in a number of their prior closed ended offers.

29. KKR's approach to core is to focus on long-duration, mature assets that are critical to the functioning of economies. There is a strong focus on assets that deliver highly predictable cash flows, with the majority of returns driven by income. Hymans note that in their meetings with KKR they are comfortable that they have sufficient core infrastructure expertise within the firm and note that they have managed core infrastructure mandates for investors for a number of years.

30. Hymans note that the net return of the KKR fund (7-9%) is higher than the target return of the LGPS Central core/core-plus sleeve (CPI+3.5%). However, they note that the KKR fund's target is well within the range they would expect for core/core + funds generally. Further, based on discussions with LGPS Central, they would expect them to use the outperformance of the KKR fund to provide "headroom" above their own target, rather than focusing the remaining investments on very low yielding strategies. Hymans note they are comfortable with this.

31. Officers have been in discussion with Central regarding measurement of performance of the sleeve to reflect the targets of the underlying funds as well as the target for the sleeve set at the outset

Product design and investment strategy

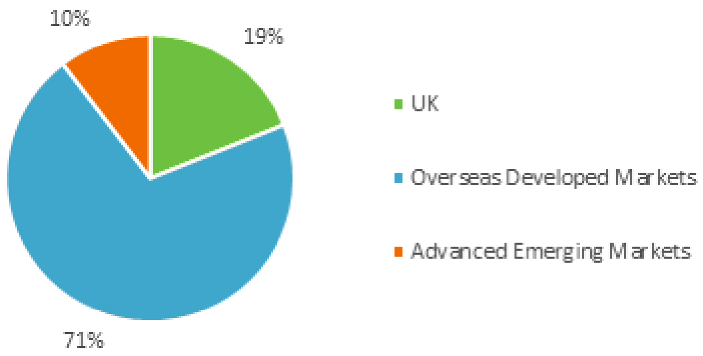
32. As at 31st March 2021 the Fund held £382m in infrastructure funds between 5 managers as described within the background section of this paper. These investments form part the Funds 'income' allocation.

33. Hymans have looked at the Fund's existing holdings and potential new holdings based on the Central mandates (core / core + and value add / opportunistic) to conclude the following:

   a. The Fund's combined infrastructure portfolio of investments, the existing five managers plus Central's offering via the two sleeves will be sufficiently well diversified

   b. Hymans believe that diversification of the Central sleeves will be limited by the requirement to invest 50% of commitments into sterling denominated funds. The inference is that by investing in sterling denominated funds the weighting of UK infrastructure projects would be higher than in a non-constrained setup. Hymans conclude that they consider a 10% - 33% allocation to UK infrastructure to be reasonable and provide the following chart to illustrate what a £90m investment (when fully invested) would mean for the Fund in terms of geographical allocation. UK is allocation is shown at

19%. This assumes the commitment to Central's sub funds is 50% invested in UK assets.



c. Hymans further note that whilst both funds will invest at least 50% in underlying funds denominated in sterling they do not expect this to constraint to materially limit the opportunity set of investments available to invest in. They further note that the UK benefits from a favourable political and regulatory framework and a deep secondary market for infrastructure assets.

d. Hymans note that the Fund may wish to consider future investments outside of the pool on non UK portfolios. This would be to satisfy the Hymans view that the UK allocation should be 10%-33%. At present the Fund has a number of options given the gap to the UK maximum allocation and could use existing managers to drive down the UK allocation. Both JPM IIF (open ended fund, core / core+) and IFM global (open ended, value add / opportunistic) provide sub 15% exposure currently to UK infrastructure so could be used in the future to rebalance the UK weighting and both are currently rated as 'preferred' for infrastructure investments.

e. Other options to rebalance an increasing weighting as considered by Hymans include, redeeming partial investments in the Central funds or collectively challenge Central on the allocation to UK assets with a view to amending the mandate.

<u>Conclusion</u>

34. Hymans are overall supportive of an allocation to the LGPS Central Infrastructure core / core + sub-fund. This view reflects their confidence in the process followed by LGPS Central to select appropriate asset managers, to provide ongoing monitoring and the ability to appropriately structure fund products. It also reflects the significant potential benefits of investing via the pool which include lower investment expenses, wider diversification of manager risk and stronger oversight of underlying fund managers than the Fund could achieve acting independently.

35. Hymans have listed a number of conditions before a commitment can be made which are explained within the private session of today's agenda.

<u>Supplementary Information</u>

36. Exempt papers which are of a sensitive nature is included elsewhere on the agenda which contains supplementary information on the potential investment in the LGPS Central infrastructure Fund.

Recommendation

37. The Investment Subcommittee is recommended to consider an investment into the LGPS Central infrastructure fund.

Equality and Human Rights Implications

38. None

Appendices

None

Background Papers

39. None

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