Leicestershire County Council

**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<br>• 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<br>• In direct co-investments<br>• 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<br>• 30-50% of total Commitments in the Partnership in portfolio companies based in North America with a 5% tolerance<br>• 50-70% of total Commitments in the Partnership in portfolio companies based in the European Economic Area, (includes the UK) with a 5% tolerance<br>• No specific industry or sector weights but a bias towards managers favouring defensive sectors but with broad diversification<br>• A cash yield of approximately 6-7% | • In a fund where the average size loan may exceed 5% of the fund<br>• With managers using leverage at fund level<br>• 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)<br>• 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<br>• With a manager with an aggregate AUM raised less than $2.5bn, or a manager whose previous fund size is less than $500m<br>• 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<br>• In a fund which invests in non-OECD countries<br>• With managers who are permitted to invest more than 15% with their private equity business if part of a wider asset management group<br>• With managers who are permitted to invest more than 15% of capital in non-senior debt<br>• In stressed, distressed, and special situation debt<br>• 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.

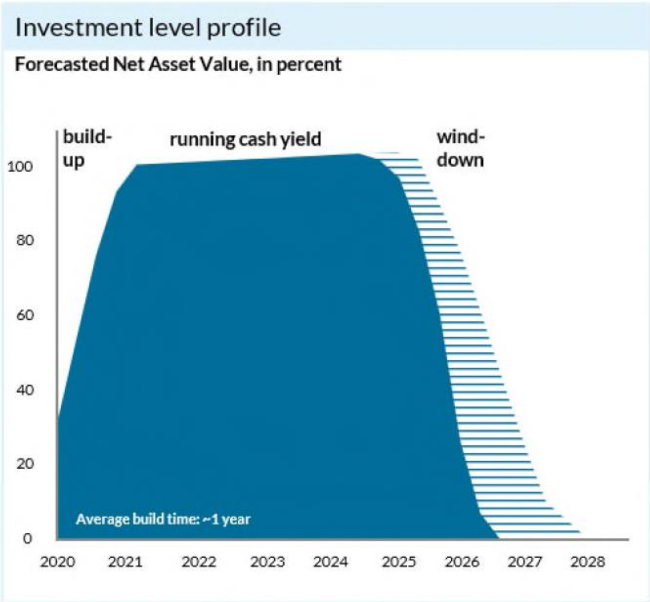
23. The Fund has invested in the previous four iterations of the Multi Asset Credit Fund, in 2014 (£100m), 2016 (£70m), 2017 (£120m) and 2019 (£100m). The investment process remains largely unchanged from that which has previously proven successful.

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

**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
Tel: 0116 305 7668
Email: Declan.Keegan@leics.gov.uk

Mr B Kachra, Senior Finance Analyst - Investments
Tel: 0116 305 1449
Email: Bhulesh.Kachra@leics.gov.uk