

PRIVATE MARKETS INVESTMENTS

Report of the County Treasurer

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

Recommendation: (1) That the Committee is asked to note the progress made to date by the Brunel Pension Partnership in investing the Devon Fund's private markets commitments.

(2) That the Committee support the ongoing work with the Brunel Pension Partnership to bring the Fund's allocation to Property back up to the 10% target.

(3) That the Committee approves an additional £60 million top up commitment to the Infrastructure Portfolio (Cycle 2).

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### 1. Introduction

- 1.1 Private markets comprise investments not traded on a public exchange or market. They are an important part of the Devon Pension Fund's portfolio as:
- They are expected to generate higher returns as a result of the illiquidity premium available to producers of long term capital.
  - They provide diversification of returns.
  - They provide access to investment opportunities not usually accessible through public markets.
  - They provide greater potential for outperformance through active, hands-on management.
- 1.2 The Fund's Investment Strategy Statement shows a medium term target allocation to private markets of 26%. However, the nature of private markets means that it can take time to build up investments to the desired level, as commitments need to be made to suitable funds, which are then drawn down as the funds identify suitable assets to purchase. The current progress towards achieving the target allocations is summarised in the following table:

## **Private Markets Allocations**

| Asset Class          | Medium Term Target Allocation | Current Allocation as at 31 Dec 2020 |
|----------------------|-------------------------------|--------------------------------------|
| Property/Real Estate | 10%                           | 8.1%                                 |
| Infrastructure       | 10%                           | 4.1%                                 |
| Private Debt         | 3%                            | 2.2%                                 |
| Private Equity       | 3%                            | 0.0%                                 |

- 1.3 This report provides the Committee with further details on the individual private market portfolios, and the current position on the commitments made.

## **2. Property**

- 2.1 The Fund has had a longstanding target allocation of 10% to Property. This was gradually built up from around 6% when Aviva were appointed to manage the property allocation in 2012.
- 2.2 Given that a significant proportion of the return from property comes from the income yield, and this has been retained by the Fund to support cashflow, the capital value has not grown in line with other asset classes where income has been reinvested. This had reduced the allocation to around 8.2% of the Fund as at December 2019, and the Committee subsequently resolved to use up-front deficit contributions to add to the property investment to bring it up to 10%. While this did not happen immediately due to the pandemic, additional investments have subsequently been made by Brunel to UK Property funds and £25 million was invested during October.
- 2.3 However, given the significant increase in the total fund value since 31 March 2020 as markets recovered, the property allocation still stands at only just over 8%. It is anticipated that a further £20 million of committed funding will be invested in UK Property over the next couple of months, but this will still leave the allocation short of target.
- 2.4 When Brunel took on the property mandate, they decided to manage UK Property and International Property as two separate portfolios, and the Fund agreed a target 80/20 split between UK and International. Around half of the underweight to the total 10% target is related to the international property allocation. Brunel have been looking to identify opportunities, but their advice has been to hold off on making new international property investments at the present time due to the ongoing pandemic.
- 2.5 Officers will continue to work with Brunel to identify suitable opportunities to invest additional funds in both UK and International Property in order to bring the allocation back up to the 10% target. This is likely to mean both adding to the current investment in some underlying property fund holdings and the identification of new funds that Brunel will be looking to invest in on behalf of all their clients. As part of the pooling agenda Brunel will be looking to rationalise the property holdings of all their clients, so that all clients are invested in Brunel's model portfolio, but this will need to be done over the longer term to avoid significant trading costs.

### 3. Infrastructure

- 3.1 Infrastructure funds are long term funds, typically with a life of 15-20 years. Before the set-up of Brunel, the Devon Fund had invested in five infrastructure funds, and will remain invested in those funds until they reach the end of their fund lives and have sold off all their assets. In addition, the Fund committed £175 million to Brunel's first infrastructure cycle and a further £250 million to Brunel's second infrastructure cycle.
- 3.2 Brunel's infrastructure, private debt and private equity portfolios operate on the basis of a two year cycle, and client funds are required to make commitments at the beginning of the two year cycle, with the opportunity to "top-up" their commitment one year later. No additional commitments are permitted between these dates. Cycle 1 was launched in 2018, and cycle 2 in 2020. Cycle 3 will be launched in April 2022.
- 3.3 The Devon Fund's total current commitments are set out in the following table. It should be noted that for the pre-Brunel funds, the commitment and investment figures are shown to be the same, as those funds are fully drawn down, although the original commitment would have been different.

#### **Infrastructure Commitments as at 31 December 2020**

|                                        | Total<br>Commitment<br>£'000 | Underlying<br>Commitments<br>£'000 | Current<br>Investment<br>£'000 |
|----------------------------------------|------------------------------|------------------------------------|--------------------------------|
| <u>Pre-Brunel Investments</u>          |                              |                                    |                                |
| Archmore (UBS) IIF                     | 16,285                       | 16,285                             | 16,285                         |
| First Sentier European DIF             | 50,605                       | 50,605                             | 50,605                         |
| Hermes IF                              | 48,684                       | 48,684                             | 48,684                         |
| Aviva IIF                              | 17,242                       | 17,242                             | 17,242                         |
| Aviva Ground Rents Fund                | 18,302                       | 18,302                             | 18,302                         |
|                                        | <hr/>                        | <hr/>                              | <hr/>                          |
|                                        | 151,118                      | 151,118                            | 151,118                        |
| <u>Brunel Infrastructure Portfolio</u> |                              |                                    |                                |
| Capital Dynamics CEI VIII              | 20,000                       | 20,000                             | 9,533                          |
| Capital Dynamics CEI VII-A             | 12,712                       | 12,712                             | 5,790                          |
| Vauban CIF II (fka Mirova)             | 10,280                       | 10,280                             | 10,504                         |
| NTR                                    | 8,970                        | 8,970                              | 3,157                          |
| Stepstone Brunel Fund I                | 122,942                      | 62,780                             | 10,927                         |
| Stepstone Brunel Fund II General       | 125,000                      | -                                  | 136                            |
| Stepstone Brunel Fund II Renewables    | 125,000                      | 41,502                             | 12,573                         |
|                                        | <hr/>                        | <hr/>                              | <hr/>                          |
|                                        | 424,904                      | 156,244                            | 52,620                         |
|                                        | <hr/>                        | <hr/>                              | <hr/>                          |
| TOTAL                                  | 576,022                      | 307,362                            | 203,738                        |

- 3.4 Of the five pre-Brunel funds, the Archmore Fund managed by UBS was due to end in 2022. However, an extension to 2024 has now been agreed, to ensure that they can gain good value for the sale of the current investments held by the fund. At the same time, they are marking available an optional liquidity offering which aims to provide investors the opportunity to sell part or all of their holdings in the Fund on the secondary market. Securing full value for the investment assets when they are sold as the fund winds down is a key

risk for closed-end infrastructure funds. Therefore, officers will closely monitor the activity in relation to the liquidity option to ensure we secure maximum value for our investment as the fund winds down.

- 3.5 The First Sentier Fund (previously First State) is also due to end in 2024. As the Archmore and First Sentier investments are fully redeemed it will reduce the Devon Fund's infrastructure allocation and this will need to be offset by the growing Brunel investment. The Hermes fund has an end date of 2029, while the Aviva funds have no specific end date.
- 3.6 £175 million was allocated to Brunel's first cycle infrastructure portfolio, which was launched in 2018. The Brunel Private Markets team identified four individual funds and made commitments to those funds (Capital Dynamics Funds VII and VIII, NTR Capital and the Vauban fund (previously known as Mirova)). It was then decided to deploy the remaining committed capital by setting up a fund in partnership with Stepstone Group, which would then invest in underlying funds. Therefore, just under £123 million was committed to the Stepstone Brunel Fund I, but the investment of that commitment is dependent on the identification of suitable underlying funds. To date around £63 million of underlying commitments have been made split between five different funds.
- 3.7 A further £250 million was then committed to Brunel's second cycle infrastructure portfolio, as agreed by the Committee in November 2019. This has again been committed to funds set up in partnership with Stepstone, and split 50/50 between a generalist infrastructure fund and a renewables fund which will be committed to funds that only invest in renewable energy assets. To date, £42 million of the renewables allocation has been committed to three underlying funds.
- 3.8 The medium term target for infrastructure is an allocation of 10% of the Fund. With a current fund value of £4.9 billion, this would equate to an investment of around £490 million to £500 million. As can be seen from the above table, while commitments have been made, there is still some way to go to achieve that level of investment. Given that the drawdown of commitments is a slow process and we are expecting a return of capital from two of the existing investments over the next 2-3 years, it would be recommended that we should over-commit by around 25-30% in order to be able to get to the desired 10% allocation.
- 3.9 It is therefore proposed that an additional £60 million should be committed in the top-up window provided by Brunel in April 2021. The default option would be for this to be split 50/50 between the General Fund and the Renewables Fund, but it would also be possible to allocate a higher proportion to the Renewables Fund.

#### **4. Private Debt**

- 4.1 Private debt funds work in a similar way to infrastructure, with commitments being made and then drawn down thereafter. However, they generally operate over a shorter timeframe, with a 2-3 year investment period, and total fund life of 6-8 years. The funds provide loans to individual companies,

deriving investment income which is paid out to investors, and returning capital as loans are repaid.

- 4.2 The Fund has a target allocation of 3% to Private Debt. In June 2017, before Brunel was operational, the Fund committed £150 million to two private debt funds. This equated to a commitment of 3.75% of the total fund value at the time with a view to over-committing to achieve the 3% target. The current investment stands at 2.4%, with both the current investments nearing the end of their investment periods, after which capital values are likely to reduce as loans are repaid and capital is returned.
- 4.3 The Investment and Pension Fund Committee therefore agreed in November 2019 to allocate a further £100 million to the Brunel Private Debt Portfolio cycle 2 which launched in April 2020. The current position is set out in the table below.

**Private Debt Commitments as at 31 December 2020**

|                                      | Total<br>Commitment<br>£'000 | Current<br>Investment<br>£'000 |
|--------------------------------------|------------------------------|--------------------------------|
| <u>Pre-Brunel Investments</u>        |                              |                                |
| Arcmont Senior Debt Fund I           | 90,000                       | 90,000                         |
| Golub Capital International Fund 11  | 60,000                       | 60,000                         |
|                                      | 150,000                      | 150,000                        |
| <u>Brunel Private Debt Portfolio</u> |                              |                                |
| Cycle 2 Uncommitted                  | 100,000                      | -                              |
|                                      | 100,000                      | -                              |
| <br>TOTAL                            | <br>250,000                  | <br>150,000                    |

- 4.4 Brunel's private debt portfolio has been delayed as a result of the pandemic and the resignation of the private debt lead person within the Brunel Private Markets team. As a result, no commitments have yet been made. A new appointment has now been made and a similar arrangement to that with Stepstone on infrastructure has been agreed with Aksia LLC to source private debt opportunities. It is hoped that fund commitments will be made in the near future.
- 4.5 While the current investment is below the 3% target, the Devon Fund is already over-committed to private debt, and it is not therefore proposed to make any top-up commitments in April 2021.

**5. Private Equity**

- 5.1 In November 2019, the Committee agreed the Fund's first commitment to private equity, totalling £125 million. The current position is set out in the following table:

## **Private Equity Commitments as at 31 December 2020**

|                                                  | Total<br>Commitment<br>£'000 | Current<br>Investment<br>£'000 |
|--------------------------------------------------|------------------------------|--------------------------------|
| <u>Brunel Private Equity Portfolio (Cycle 2)</u> |                              |                                |
| LGT Crown Global Secondaries                     | 15,725                       | 827                            |
| AlpInvest CoInvestment Fund VIII                 | 18,950                       | -                              |
| Montana ("MCP") Opportunity Seconda              | 9,072                        | -                              |
| New Mountain Capital Partners VI                 | 7,862                        | -                              |
| Uncommitted                                      | 73,391                       | -                              |
|                                                  | <hr/>                        | <hr/>                          |
|                                                  | 125,000                      | 827                            |
|                                                  | <hr/>                        | <hr/>                          |
| TOTAL                                            | 125,000                      | 827                            |

- 5.2 As with infrastructure and private debt, it will take a while for commitments to be drawn down, and only a very small amount has been invested to date. It could therefore take some time to reach the 3% medium term target. However, a key risk with private equity investments is vintage risk. This is the risk that if the investment is made at the wrong point in the economic cycle then it may not achieve the desired outcome. Therefore, private equity investments should be spread over different vintage years in order to diversify the risk.
- 5.3 For this reason, it is not proposed to make any further commitment in the April 2021 top-up window, but to accept that the private equity investment will take time to build up to the target. A further commitment should be made to cycle 3 when it is launched in April 2022, with the aim of making a regular commitment to each subsequent Brunel cycle, which will then balance investments between different vintages.

## **6. Conclusion**

- 6.1 The Committee is asked to note the progress made to date by the Brunel Pension Partnership in investing the Devon Fund's private markets commitments.
- 6.2 The Committee is asked to support the ongoing work with Brunel to bring the allocation to Property back up to the 10% target.
- 6.3 The Committee is also asked to approve an additional £60 million top up commitment in the Infrastructure Portfolio (Cycle 2).

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County Treasurer

Electoral Divisions: All

Local Government Act 1972:

List of Background Papers: Nil

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