DF/22/25
Investment and Pension Fund Committee
25 February 2022

PRIVATE MARKETS ALLOCATIONS

Report of the Director of Finance

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

Recommendation: (1) that the Committee approve the following commitment to Brunel's private markets cycle 3:
(a) £100 million to the Brunel Infrastructure Portfolio.
(b) £180 million to the Brunel Private Debt Portfolio.
(c) £150 million to the Brunel Private Equity Portfolio.
(2) that the Property allocation be maintained at the target weight, with additional sums allocated as required.

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1. Introduction

1.1 Private markets comprise investments not traded on a public exchange or market. They can be an important part of a 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 Private markets investments typically comprise the following headings:

- Property/Real Estate.
- Infrastructure.
- Private Debt
- Private Equity.
- Secured Income.

This report focuses primarily on the Fund's allocations to infrastructure, private debt and private equity, but also addresses the property allocation.

1.3 The strategic investment review undertaken by Mercer investment consultants, that is the subject of a separate report on the agenda for this meeting, recommends the following target allocations:

- Infrastructure – 10%.
- Private Debt – 5%.
- Private Equity – 5%.
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1.4 As a result of the LGPS pooling initiative, future private markets investments will be made via the Brunel Pension Partnership. Brunel manages its private markets investments in two year cycles. Cycle 1 was launched in April 2018, cycle 2 in April 2020, and Cycle 3 is due to be launched in April 2022. Allocations to cycle 3 need to be made by 31 March 2022, and Brunel will then look to commit to underlying funds over the two years, with funds being called for investment by the underlying funds as and when they identify assets to invest in.

1.5 This report therefore sets out the proposed allocations to cycle 3.

2. Infrastructure

2.1 The current position in relation to the Fund's infrastructure investments is set out in the following table.

<u>Infrastructure</u>
<u>Investments and Outstanding Commitment as at 31 December 2021</u>

	Current Valuation £'000	Remaining Commitment £'000
<u>Pre-Brunel Investments</u>		
Archmore (UBS) IIF	12,308	-
First Sentier European DIF	30,308	-
Hermes IF	47,050	2,725
Aviva IIF	16,822	20,000
Aviva Ground Rents Fund	18,425	-
	124,913	22,725
<u>Brunel Infrastructure Portfolio</u>		
Capital Dynamics CEI VIII	9,577	10,899
Capital Dynamics CEI VII-A	11,554	2,134
Vauban CIF II (fka Mirova)	10,369	736
NTR	4,254	3,078
Stepstone Brunel Fund I	46,841	76,307
Stepstone Brunel Fund II General	5,116	149,276
Stepstone Brunel Fund II Renewables	23,011	131,643
	110,722	374,073
TOTAL	235,635	396,798

2.2 Based on the current fund value of £5.6 billion, a 10% allocation would mean an infrastructure investment of £560 million. The current valuation of £235 million is only around 4.2% of the fund, but significant commitments remain undrawn.

2.3 As commitments take some time to be drawn down, and in many cases the underlying fund will not reach the point of drawing 100% of the commitment made it is good practice to over-commit by around an additional 20%. This suggests that the Fund should aim to commit £672 million in order to reach its target.

2.4 In addition, both the Archmore and First Sentier funds are nearing the end of their fund lives and have begun to return capital. We should therefore aim to re-commit that capital in the current cycle. The following table summarises the required allocation to Cycle 3 to bring the investment up to the 10% target.

	£'000
Target Allocation	560,000
Proposed over-commitment	112,000
Commitment Required	**672,000**
Current Investment	(235,600)
Undrawn Commitment	(396,800)
Likely Divestments	42,600
Additional Commitment Required	**82,200**

2.5 The Devon Fund has committed to increasing its allocation to renewable energy infrastructure to 5% by 2025, in effect this would be half of the total allocation to infrastructure. In cycle 2, Brunel offered a dedicated renewables fund, and Devon committed £125 million to that fund. In addition, there are renewable energy assets within the Fund's other infrastructure assets resulting a current investment of around £70 million, with a further £150 million of undrawn commitment.

2.6 Brunel have decided not to offer a dedicated renewables fund for cycle 3. This is mainly because there is now a large demand from investors to invest in renewable energy which outstrips the investment opportunities currently available. This pushes the price up for buying into the market, which then has the effect of reducing the investment returns available, such that Brunel's view is that it would be difficult to meet the targeted level of return.

2.7 Therefore only a generalist infrastructure fund is being offered for cycle 3, but the expectation is that the funds that are invested in will comprise a variety of infrastructure assets that will include renewable energy assets. Brunel have committed to report at an individual asset level on each of the cycle 3 funds that they invest in, to ensure that we can demonstrate the overall level of investment in renewable energy infrastructure.

2.8 The overall size of the Fund is likely to grow further, so it is therefore proposed to round up the proposed commitment and to commit a further **£100 million** to infrastructure via Brunel cycle 3.

3. Private Debt

3.1 Private debt is a broad term that refers to any investment in privately negotiated debt. Borrowers often choose private financing because it can be customised to their needs or when public debt is not available. Private debt funds focus on direct lending to private companies, providing an attractive opportunity with a shorter investment term than infrastructure investments and a regular yield. The Devon Fund's current investments and undrawn commitments are shown in the following table.

Private Debt
Investments and Outstanding Commitment as at 31 December 2021

	Current Valuation £'000	Remaining Commitment £'000
Pre-Brunel Investments		
Arcmont Senior Debt Fund I	42,571	26,986
Golub Capital International Fund 11	48,451	6,795
	91,022	33,781
Brunel Private Debt Portfolio (Cycle 2)		
Aksia Brunel Private Debt Fund	17,314	83,587
	17,314	83,587
TOTAL	108,336	117,368

3.2 It is proposed to increase the target allocation to private debt from 3% to 5% of the total Fund value. Based on the current fund value of £5.6 billion, a 5% allocation would mean an infrastructure investment of £280 million. The current valuation of £108 million is only around 1.9% of the fund.

3.3 While the commitment to the Arcmont and Golub fund has not been fully drawn, it is considered that it is unlikely that further calls will be made on the commitment made. It is more likely, in Arcmont's case, that capital will begin to be repaid as the fund nears the end of its life. The commitment made via Brunel still has some way to go before it is fully drawn. As with infrastructure, we will need to over-commit if we are to achieve the target allocation. The following table therefore summarises the required allocation to Cycle 3 to bring the investment up to the 5% target.

	£'000
Target Allocation	280,000
Proposed over-commitment	56,000
Commitment Required	**336,000**
Current Investment	(108,300)
Undrawn Commitment (Brunel only)	(83,600)
Likely Divestments	25,000
Additional Commitment Required	**169,100**

3.4 To allow for further growth in the fund value it is therefore proposed to commit a further **£180 million** to private debt via Brunel cycle 3.

4. Private Equity

4.1 Private equity is a broad term that refers to any investment in privately owned equity i.e. not listed on a public exchange. Typical investments include venture capital to new or growing businesses and buyouts with the intention of turning the company around. These can be very attractive investments, often producing higher returns than listed equity, and also producing an income yield that is attractive to funds such as the Devon Fund who need cashflow to meet pension payments.

4.2 The Devon Fund made its first commitment and investment in private equity through Brunel's cycle 2 portfolio. Brunel have been working hard to allocate the commitment and the current position and the underlying funds they have committed to are shown in the following table:

Private Equity
Investments and Outstanding Commitment as at 31 December 2021

	Current Valuation £'000	Remaining Commitment £'000
Brunel Private Equity Portfolio (Cycle 2)		
LGT Crown Global Secondaries	4,910	11,442
AlpInvest CoInvestment Fund VIII	3,251	14,917
Montana ("MCP") Opportunity Secondaries	1,035	7,954
New Mountain Capital Partners VI	1,716	5,677
Insight Partners XII	2,488	4,694
Insight Partners X Follow-on Fund	5,136	2,526
Genstar X (Europe)	535	4,636
Genstar X Opportunities	279	1,213
Inflexion Buyout Fund VI	-	7,820
Summa Equity Fund III	-	8,222
Uncommitted (by Brunel)		38,470
	19,350	107,571
TOTAL	19,350	107,571

4.3 It is proposed that the medium-term target allocation for private equity should be increased to 5%. 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. If a commitment is made to the Brunel Private Equity Portfolio, then that investment will be spread over a two year period, but it would still be prudent for the commitment to be built up over a period of time.

4.4 It is therefore proposed to commit a further **£150 million** to private debt via Brunel cycle 3. This will not bring private equity up to the 5% target, but will ensure a gradual increase that manages the vintage risk described in paragraph 4.3 above.

5. Property

5.1 Property is not managed in cycles in the same way as the other private markets investments detailed above. However, the investment in Property is currently below its target allocation, by around £80 million. Brunel are already working to build up the allocation towards its target level, and the Committee has previously agreed that where additional investment is required it should be funded from the allocation to Diversified Returns Funds.

5.2 Therefore, additional sums will be provided to Brunel, when required, to bring the Property allocation up to it's target level, in line with the previous policy decision.

Angie Sinclair
Director of Finance

Electoral Divisions: All

Local Government Act 1972:
List of Background Papers: Nil
Contact for Enquiries: **Mark Gayler**
Tel No: **01392 383621** Room: **G97**