



Glasgow City Council

Strathclyde Pension Fund Committee

Report by Richard McIndoe, Director of Strathclyde Pension Fund

Item 6

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**Direct Impact Portfolio (DIP)
Investment Proposal – Beechbrook UK SME Credit Fund IV**

Purpose of Report:

To set out a proposal for an investment of £50m within DIP.

Recommendations:

The Committee is asked to **APPROVE** an investment of £50m in Beechbrook UK SME Credit Fund IV by DIP.

Ward No(s):

Citywide: ✓

Local member(s) advised: Yes ☐ No ☐ consulted: Yes ☐ No ☐

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1 Background

1.1 Portfolio Establishment

In December 2009, the Strathclyde Pension Fund Committee agreed to establish a New Opportunities Portfolio (NOP) with a broad remit to invest in assets for which there was an attractive investment case but to which the then current structure did not provide access.

1.2 Reviews

The NOP strategy has been subject to 3-yearly reviews with the name changing to the Direct Investment Portfolio in 2015 and again in 2021 to the Direct Impact Portfolio. The most recent review was concluded in November 2024. This made no change to the objectives, structure, risk parameters or governance structure, but did result in increases to the DIP's overall allocation and minimum required investment return and a minor amendment to the definition of the maximum investment size. The Co-Investment Programme was also extended, in conjunction with an increase in the maximum co-investment size.

1.3 Implementation Framework

DIP investment proposals are assessed on their own merits within an agreed implementation framework based on SPF's overall risk-return objectives and specific DIP parameters.

The framework agreed at the 2024 review is summarised below.

Direct Impact Portfolio	
Objectives	Primary objective identical to overall SPF investment objective. Secondary objective of adding value through investments with a positive local, economic or ESG (environmental, social, governance) impact.
Strategy & Structure	In line with SPF risk-return framework but focused on the UK and the Equity, Long Term Enhanced Yield and Short-Term Enhanced Yield asset categories.
Risk and Return	Portfolio benchmark return of CPI +3% p.a. Individual risk and return objectives for each investment. Minimum Investment Return (Net IRR) of 6.5% .
Capacity	Target allocation of 7.5% of total Fund (based on Net Asset Values). Range of 5% to 10% of total Fund.
Investment Size	Target: £30m to £100m Minimum: £20m Maximum: £250m
Decision Making	3 stage process with review and satisfactory due diligence by officers, followed by a presentation to the Sounding Board before a proposal is taken to Committee for approval subject to completion of legal documentation.
Monitoring	Includes individual investment reports, participation in advisory boards and a quarterly DIP monitoring report which is reviewed by the Fund's Investment Advisory Panel.
Co-Investment Programme	Co-Investment Programme (CIP) of £300m with maximum investment per asset of £25m, subject to the agreed CIP investment parameters.

The following proposal has been assessed using this framework and has been reviewed by the SPF Committee Sounding Board.

2 New Investment Proposal

2.1 Key Terms

Name	Beechbrook UK SME Credit Fund IV LP
Investment vehicle	English Limited Partnership
Manager	Beechbrook Capital LLP
Sector	Credit
Investment objective	To provide loans to UK regional businesses in the lower mid-market segment
Term	8 years (3-year Investment Period plus 5-year harvest period)
Target size	£250m (£400m Hardcap)
Proposed DIP investment	£50m
Target return	Internal rate of return (IRR) of 11% (Net) / Multiple of Invested Capital (MOIC) of 1.4x

2.2 Investment Summary

Beechbrook Capital is an investment management firm founded in 2008 by two experienced credit market professionals, Paul Shea and Nick Fenn. Beechbrook focuses on direct lending to Small and Medium sized Enterprises (SMEs) with a geographical focus in northern Europe, including the UK.

The current investment opportunity is to invest in Beechbrook UK SME Credit Fund IV LP, which will provide debt facilities to creditworthy UK-based SME companies.

The firm has a proven track record in this sector with four European funds as well as three previous sterling denominated UK funds and has accordingly demonstrated that it is capable of originating high quality transactions and achieving the targeted investment returns.

DIP previously committed £30m to Beechbrook's second fund (UK SME Credit Fund II) followed by a further £40m to Beechbrook UK SME Credit Fund III; both have performed very strongly to date.

An investment of £50m by DIP in Beechbrook's Fund IV is now proposed.

2.3 Investment Rationale

Fund IV's strategy is a continuation of that of Funds II and III, i.e. to construct a diversified portfolio of loans to (and small upside equity investments in) a range of UK based SMEs with the aim of generating low volatility, attractive risk-adjusted returns and a strong running yield for investors.

The target market of fund IV is UK companies with sales typically in the range of £10m-£100m and EBITDA (i.e. operating profit) of £2m+. Based on their

experience and market feedback, Beechbrook believe that this area of the market is still experiencing a significant lack of external bank financing.

Beechbrook's expectation is that the fund will be well diversified across 20+ investments, assuming a successful fundraise, and expect to make 7-8 investments per annum, which would enable the fund to be fully invested within the three-year investment period.

2.4 Investment Management

Beechbrook Capital LLP is an independent private debt manager established in 2008 which is focused on direct lending to SMEs in Northern Europe including the UK.

It is a limited liability partnership registered in England & Wales that began active investment in 2010 and currently manages funds with total original commitments of over £715m. It has made 76 investments to date.

Beechbrook operates from six offices across the UK and Europe. The business is headquartered in London, with five further offices in Manchester, Birmingham, Leeds, Frankfurt and Cork to support origination and portfolio management.

More information on the investment manager is included in **Schedule 1**.

2.5 Investments

Across 70+ UK focused SME transactions to date, the fund has invested in a wide range of different sectors, supporting the UK's diverse economy and adding diversification to the portfolios. A broad range of sectors allows the fund to make investments which support the development of skills, innovation, transport, science and industry. Examples of previous investments in key sectors, including:

Business Services: companies providing necessary or valuable services to other businesses, such as specialist advisory services, consulting, recruitment and property services;

Consumer and Leisure: providers of services to consumers such as food, travel, entertainment, or other valued services;

Education: such as children's nurseries;

Financial Services: companies that provide key financial services to businesses and/or consumers such as insurance or pensions;

Industrials: producers of high-quality industrial products and services in key industries like aviation;

Technology: Media and Telecommunications.

2.6 Risks

The main risks of the proposed investment in Beechbrook's Fund IV are considered to be as follows: -

- Default Risk
- Ability to source opportunities
- Economic recession

A summary of risks and key mitigants is contained in **Schedule 2**.

2.7 Projected Return

The fund's target investment return is a net IRR of 11% and an MOIC of 1.4% which is considered achievable based on Beechbrook's track record to date, and appropriate given the intended structure and ranking of the debt in the companies which the fund is targeting.

The fund's objective is to generate low volatility, but attractive risk-adjusted returns, combined with an ongoing cash yield of 8%+ p.a.

2.8 Exit

The fund has an expected life of eight years, although this may be extended, subject to investors' agreement, by up to two additional years.

2.9 Fees

The **Management Fee** is typical of the managers in DIP's credit portfolio. The fee will be calculated on fund commitments and invested capital during the investment period (3 years in this case). Overall, the level of the anticipated blended fee is modestly lower than average in DIP's experience of other debt funds during both the IP and post-IP period.

Carried interest (or performance related) provisions also apply to the fund. These will be structured such that Beechbrook, as manager will require to perform strongly before it benefits under these provisions.

The Management Fee is in line with DIP's typical experience in the Credit market, while the Carried Interest structure/rates are relatively typical. Overall, the fee levels are considered acceptable.

2.10 ESG and Impact

DIP's credit investments make a positive impact in 3 broad areas:

- providing capital to SMEs, a sector of the market which has struggled to source funding since the retrenchment of the banks in the wake of the Global Financial Crisis;
- sustaining or creating employment - SMEs account for around 60% of UK private sector employment; and
- maintaining or improving Environmental, Social and Governance (ESG) standards in portfolio companies.

ESG factors cover a broad agenda, including issues relating to the workplace, community, marketplace, environment and governance. Beechbrook recognises that ESG factors can have a significant impact on their investments, creating sustainable value within companies.

A summary of the fund's ESG and Impact factors is contained in **Schedule 3**.

2.11 Investment Size and Cash Requirements

SPF Fund value at 31 st March 2025	£31,010m
DIP allocation (target 7.5% of main fund) NAV	£2,325m
Current DIP NAV	£1,598m
NAV Range (Lower) 5%	£1,550m
NAV Range (Upper) 10%	£3,101m

2.12 Investment Strategy

The proposed investment falls within the credit sector and therefore the Fund's short-term enhanced yield allocation (STEY). Credit is a key area of investment focus for DIP.

Allocations following this investment, based on Fund values at 31st March 2025 and total DIP commitments to credit, would be as follows:

Credit, £ in DIP	£280m
Credit, % in DIP	12%
Credit in DIP as % of Total Fund	0.9%
STEY, % Total Fund (target 17%)	16.7%

3 Policy and Resource Implications

Resource Implications:

Financial: Investment of £50m to be drawn as required. Fee structure is considered to be in line with the market.

Legal: The investment will be subject to satisfactory completion of due diligence, including review and execution of appropriate legal documentation.

Personnel: None

Procurement: None

Council Strategic Plan: SPF supports the mission: ***to enable staff to deliver essential services in a sustainable, innovative and efficient way for our communities.*** The LGPS is one of the key benefits which enables the Council to recruit and retain staff.

Equality and Socio-Economic Impacts:

Does the proposal support the Council's Equalities issues are addressed in the Fund's responsible investment policy.

*Equality Outcomes
2021-25? Please
specify.*

*What are the
potential equality
impacts as a result of
this report?* None

*Please highlight if the
policy/proposal will
help address socio-
economic
disadvantage.* None

Climate Impacts:

*Does the proposal
support any Climate
Plan actions? Please
specify:* Beechbrook has been a signatory to the PRI (UN-supported Principles for Responsible Investment) since 2019. This is consistent with Strathclyde Pension Fund's Climate Change strategy, which is being developed in line with Item 34 of the Council's Climate Action Plan.

*What are the potential
climate impacts as a
result of this
proposal?* No specific contribution from this proposal.

*Will the proposal
contribute to
Glasgow's net zero
carbon target?* No specific contribution from this proposal.

**Privacy and Data
Protection Impacts:** To be fully provided for in the legal documentation for the proposed investment.

Are there any potential
data protection impacts
as a result of this report
Y/N N

If Yes, please confirm that
a Data Protection Impact
Assessment (DPIA) has
been carried out n/a

4 Recommendations

The Committee is asked to **APPROVE** an investment of £50m in Beechbrook UK SME Credit Fund IV by DIP.

Schedule 1	Investment Manager: Beechbrook Capital
Schedule 2	Investment Specific Risks
Schedule 3	Impact and ESG

Investment Manager: Beechbrook Capital

Beechbrook Capital is an independent private debt manager established in 2008 which is focused on direct lending to SMEs in Northern Europe including the UK.

Beechbrook Capital LLP is a limited liability partnership registered in England & Wales. It began active investment in 2010 and currently manages funds with total original commitments of over £715m. It has made 76 UK Investments to date.

Beechbrook operates from six offices across the UK and Europe. The business is headquartered in London, with five further offices in Manchester, Birmingham, Leeds, Frankfurt and Dublin to support origination and portfolio management.

The Manager manages or advises funds that follow three distinct strategies:

Private Debt - funds under this strategy provide senior and junior loans, and equity co-investments to private equity firms to support European buyouts, add-on acquisitions or refinancings. Beechbrook is currently raising its fourth fund under this strategy.

UK SME Credit - funds under this strategy provide mainly senior secured loans alongside equity co-investments to UK businesses that are predominantly not private equity backed. Instead, they are owned by their founders, by families or other entrepreneurs and investors.

Beechbrook Ireland – distinct strategy to support SMEs based in Ireland.

UK SME Credit I ("SME I") held a first close in December 2015 and a final close at c. £152m in January 2017. It completed its investment programme in December 2018.

UK SME Credit II ("SME II") was launched in December 2018 and held a final close at £130m in March 2020. SME II has completed 10 investments to date and expects to complete its investment programme during Q2 2021.

UK SME Credit III ("SME III") was launched in November 2024 and held its final close in June 2023. SME III raised £151m and completed its investment programme in October 2024 having made 15 investments across the UK.

Their fourth UK fund (and the subject of this proposal) **UK SME Credit IV** ("SME IV") held its first close in October 2024 with commitments of £96m. Beechbrook has raised a further £55m in co-investment capital alongside SME IV, increasing deployment capacity to £151m at first close.

Investment Specific Risks

Default Risk

The main risk of lending to smaller businesses is the risk of default of the underlying investee companies. Beechbrook mitigates this by detailed pre-investment appraisal and due diligence processes, which are designed to be “methodical, repeatable and consistent”. Investments will only be made where the target company and the proposed terms are sufficiently attractive against pre-determined investment criteria.

A comprehensive due diligence process aims to evaluate the credit-worthiness of a borrower prior to making an investment and also to structure both debt and security so that they provide protection in the event of underperformance or credit deterioration. Beechbrook’s internal procedures require them to fully consider all aspects of the proposed investment, including reviews of the applicable due diligence reports, visits to the company’s sites, meetings with the management team, evaluation of the company’s historical, current and projected financial performance and the negotiation of suitable legal documentation including financial covenants.

During the appraisal of potential transactions, the Beechbrook team maintains a regular dialogue with the fund’s Investment Committee members on all aspects of the proposal. The successful track record of Beechbrook’s prior UK SME funds to date provides comfort in respect of their debt assessment capabilities.

Ability to source opportunities

Beechbrook continues to experience strong demand for private debt funding given the large-scale withdrawal of retail banks providing debt to this segment of the market.

The lower mid-market segment of the UK market is populated by an estimated 29,000 businesses with a turnover between £10-£100m, which contrasts with c.7,000 businesses in the £50m+ turnover band, a smaller segment of the market which is targeted by more numerous and larger debt capital funds.

Beechbrook currently receives c. 200 good quality introductions per annum as a result of the success of Funds I, II & III, and the fourth fund seeks to continue the momentum developed as a result. Beechbrook remains confident in the strength of their pipeline and in their ability to invest the funds raised in Fund IV.

Economic recession

Caused by a slowing business cycle, or other economic factors. This would lead to rising default rates in the market and possibly the fund.

Beechbrook has many years of credit experience and their investment professionals have worked through several credit cycles. Since Beechbrook was founded they have faced the Global Financial Crisis, Brexit and the Coronavirus pandemic. Beechbrook are highly selective and disciplined in their investment process and have an experienced and independent Portfolio Management team that actively monitors investments, identifying potential problems early. The team also provides knowledge and resource to manage underperforming assets. Together, these help to protect the downside and to minimise potential loss given default.

Impact and ESG

Beechbrook is a signatory to the Principles for Responsible Investment (PRI). These principles are incorporated in their investment analysis and investment decision-making process. Beechbrook also regularly report to PRI and investors on their ESG-related activities and portfolio company improvements. Beechbrook scored above peer average in their PRI Assessments in 2019 and 2020, receiving a rating of A+ and A both years.

Beechbrook is also a supporter of the Task Force on Climate-Related Financial Disclosures.

Beechbrook actively looks for investment opportunities in companies that promote best practice and lead their respective industry in ESG related matters.

Environmental

The issues in this field are diverse but the principal areas are:

- Reduction of toxic emissions, fluids and other materials;
- Sustainability of resources;
- Efficient energy consumption;
- Permanent destruction of forests and other natural habitats;
- Responsible disposal of hazardous materials;
- The impact of climate change on businesses.

Social

During Beechbrook's due diligence process, their managers particularly look at the impact a company has on its staff, local communities and society as a whole.

The principal areas of consideration are:

- Avoidance of any complicity in human rights abuses;
- Health and safety;
- Avoidance of child labour and related business practices;
- Inclusion, equality and diversity;
- Non-discriminatory practices;
- Avoidance of exploitative business practises.

Corporate Governance

Generally, corporate governance refers to the key rights and responsibilities of the management and the oversight of a company including values, structures, and accountability processes and procedures.

In the context of Beechbrook, this relates to the following areas:

- Management structures - checks and balances between members of the management team and the Board;
- Separation of duties;
- Incentive structures and executive remuneration;
- Stakeholder management;
- Corporate Codes of Conduct.