



Glasgow City Council

Strathclyde Pension Fund Committee

Report by Director of Strathclyde Pension Fund

Contact: Richard Keery, Investment Manager ext 77398

Item 5

6th March 2019

### Private Real Estate Debt Manager Appointment

#### Purpose of Report:

To conclude an investment manager selection exercise for private real estate debt as part of the Fund's short term enhanced yield strategy.

#### Recommendation:

The Committee is asked to **APPROVE** the appointment of ICG Longbow to manage a private real estate debt mandate with an initial allocation of 1.0% of total Fund.

Ward No(s):

Citywide: ✓

Local member(s) advised: Yes   
No

consulted: Yes  No

#### PLEASE NOTE THE FOLLOWING:

Any Ordnance Survey mapping included within this Report is provided by Glasgow City Council under licence from the Ordnance Survey in order to fulfil its public function to make available Council-held public domain information. Persons viewing this mapping should contact Ordnance Survey Copyright for advice where they wish to licence Ordnance Survey mapping/map data for their own use. The OS web site can be found at <http://www.ordnancesurvey.co.uk> "

If accessing this Report via the Internet, please note that any mapping is for illustrative purposes only and is not true to any marked scale

# 1 Background

## 1.1 Alt 2 Strategy

At its meeting on 28<sup>th</sup> February 2018, the Committee agreed that the Alt 2 strategy summarised below should be adopted as the strategic target model for the Fund and that the Fund should identify and implement a detailed investment structure over the next 3 years which is consistent with the Alt 2 strategy.

Asset	Alt 1	Alt 2
	%	%
Equity	62.5	52.5
Hedging/Insurance	1.5	1.5
Credit	6.0	6.0
<b>S/T Enhanced Yield</b>	<b>15.0</b>	<b>20.0</b>
L/T Enhanced Yield	15.0	20.0
	<b>100</b>	<b>100</b>

Further background details of the Fund's investment strategy and structure are included at Appendix A.

## 1.2 Short Term Enhanced Yield (STEY)

The objective of the STEY asset category is to deliver an absolute return higher than cash or short-term bonds and with a high degree of predictability. Under Alt 2, the STEY allocation increases from 15% to 20% of total Fund. The Committee agreed the following structure for this allocation.

Asset Class	Alt 2 Target	
	STEY (%)	Total Fund (%)
Absolute Return	30.0	6.0
Multi Asset Credit	22.5	4.5
<b>Private Debt</b>	<b>22.5</b>	<b>4.5</b>
EM Debt	12.5	2.5
DIP	7.5	1.5
Unallocated	5.0	1.0
<b>Total STEY</b>	<b>100.0</b>	<b>20.0</b>

## 1.3 Private Debt

The current and target private debt allocations can be summarised as follows.

Manager	Current (%)	Target (%)
<b>Private Corporate Debt</b>	<b>1.5</b>	<b>3.5</b>
Alcentra	0.75	tbc
Barings	0.75	tbc
tbc		tbc
<b>Private Real Estate Debt</b>	<b>-</b>	<b>1.0</b>
tbc		1.0
	<b>1.5</b>	<b>4.5</b>

The purpose of this paper is to conclude the process for the appointment of a private real estate debt manager.

## 2 Tender Process

Tenders were initiated for:

- private corporate debt and
- private real estate debt mandates.

A list of minimum criteria and scope of service was agreed with the Fund's Investment Advisory Panel. Glasgow City Council Corporate Procurement Unit provided detailed terms and conditions in line with standard Council requirements.

The tender documents outlined a detailed scope of the services required by the Fund and requested responses to qualitative questions designed to assess the expertise of each of the bidders, together with fee proposals. Details of voluntary community benefits were also requested.

A summary of the mandate specifications for real estate debt is included at Appendix B.

Details of the tender process are set out in Appendix C.

Private corporate debt is dealt with in a separate paper.

## 3 Conclusion

8 valid tenders were received. 3 managers reached the final stage of the tender process. The scoring outcome can be summarised as follows.

- DRC Capital: 83%
- ICG: 89%
- M&G: 85%

Based on these scores, it is proposed that ICG Longbow be awarded a private real estate debt mandate.

A brief description of ICG Longbow is included at Appendix C.

## 4 Implementation

Initial target allocation will be **1.0%** of total Fund.

In line with existing practice for the Fund, the Investment Advisory Panel will monitor this allocation and it may be varied over time.

This award, together with private corporate debt allocations which are dealt with in a separate paper, should allow SPF to achieve its target private debt allocation of **4.5%**, but full funding of the mandates is likely to take 12 months or more following satisfactory conclusion of contracts and the formal contract award process.

## 5 Policy and Resource Implications

*Financial:* As per the Alt 2 Strategy, funding of the mandate will be from the Fund's equity portfolios. The majority of the necessary cash balance has already been raised.

*Legal:* The investments will be subject to the review and execution of appropriate legal documentation.

<i>Personnel:</i>	None.
<i>Procurement:</i>	The procurement process is described in Appendices B and C.
<b>Council Strategic Plan:</b>	Strathclyde Pension Fund aligns with the theme of a well governed city.
<b>Equality Impacts:</b>	
<i>Does the proposal support the Council's Equality Outcomes 2017-22</i>	Equalities issues were addressed in the tender process within the Fair Work Practices assessment. ICG is committed to fair work practices across its business and maintains comprehensive policies on diversity and inclusion, wellbeing, and equality.
<i>What are the potential equality impacts as a result of this report?</i>	No specific impact from this proposal.
<b>Sustainability Impacts:</b>	
<i>Environmental:</i>	ICG maintains a policy on minimising its energy use and carbon impact. As a listed UK company, it is required to annually disclose overall carbon usage and take appropriate measures to limit energy use. ICG Longbow completes the Global Real Estate Sustainability Benchmark ("GRESB") annual assessment. ICG is a signatory to the UNPRI and embeds Environmental and Social considerations into the investment process.
<i>Social:</i>	
<i>Economic:</i>	
<b>Privacy and Data Protection impacts:</b>	To be fully provided for in the legal documentation for the proposed investment.

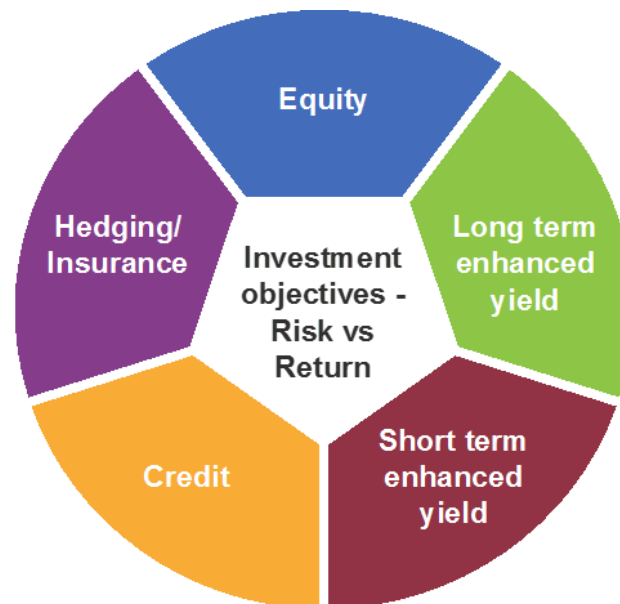
## 6 Recommendations

The Committee is asked to APPROVE the appointment of ICG Longbow to manage a Private Real Estate Debt mandate with an initial allocation of 1.0% of total Fund.

## Background Details

### Investment Strategy and Structure

At its meeting in March 2015 the Fund adopted a risk-return framework as the basis for modelling and agreeing investment strategy.



Within the framework, assets are grouped into 5 broad categories, each with an average expected return, volatility and set of correlations.

Asset Category	Main Objectives	Example Assets
<b>Equity</b>	To generate return.	<ul style="list-style-type: none"> <li>▪ Listed equity in a range of strategies</li> <li>▪ Private equity</li> <li>▪ Equity derivative or options strategies</li> </ul>
<b>Hedging/Insurance</b>	To reduce the exposure of the funding level to variations in interest rates and inflation.	<ul style="list-style-type: none"> <li>▪ UK Gilts and index-linked bonds</li> <li>▪ Overseas sovereign bonds</li> <li>▪ Interest rate and inflation swaps</li> <li>▪ Cash held as collateral</li> </ul>
<b>Credit</b>	To ensure additional yield, provide income and reduce funding volatility.	<ul style="list-style-type: none"> <li>▪ Investment grade sterling non-gilts and corporate bonds</li> <li>▪ Synthetic credit</li> </ul>
<b>Short Term Enhanced Yield</b>	To provide an income stream above the expected return on investment grade corporate bonds.	<ul style="list-style-type: none"> <li>▪ Absolute return strategies</li> <li>▪ Asset backed securities</li> <li>▪ High yield debt</li> <li>▪ Non-sterling bonds</li> <li>▪ Emerging market debt</li> <li>▪ Senior loans</li> <li>▪ Mezzanine loans</li> <li>▪ Real estate debt</li> <li>▪ Hedge funds</li> </ul>
<b>Long Term Enhanced Yield</b>	To provide a long-term income stream and a degree of inflation protection.	<ul style="list-style-type: none"> <li>▪ UK and overseas property</li> <li>▪ UK long lease property, ground rents and social housing</li> <li>▪ Infrastructure debt and equity</li> <li>▪ Timber and farmland</li> <li>▪ Investment grade corporate bonds</li> </ul>

### Mandate Specifications

#### Private Real Estate Debt

The Strathclyde Pension Fund is seeking to appoint an investment manager to manage a real estate debt mandate. The mandate size may range between £200m and £500m depending on how it combines with other debt mandates. The manager must have an appropriate pooled fund or funds for consideration.

The mandate will be focussed on a combination senior secured direct and whole loans, lending against commercial real estate in the UK and/or Europe. The overall portfolio would be viewed as equivalent to sub-investment grade credit risk. The strategy will primarily include senior debt on value-add properties and also can include whole loans on good quality assets, with potential for limited opportunistic allocations to mezzanine/junior debt.

Managers must show evidence of a robust process for sourcing, underwriting and structuring transactions and in risk management, in particular the avoidance of issuer default, the management of prepayment risk (to mitigate against any potential deterioration in yield expectations), implementation risk and liquidity risk.

The manager must also show strong workout capabilities, including restructuring, in the event of issuer default.

The expected returns on the mandate would be in the region of LIBOR plus 4-5% p.a. net of fees and costs.

In order to restrict the potential universe of managers applying for the mandate the following minimum criteria are required:

- Managers must have a minimum 5 year track record in managing a Real Estate Debt strategy.
- Must be appropriately regulated to manage a Real Estate Debt strategy for a UK Local Government Pension Schemes (LGPS).
- Already managed a Real Estate Debt mandate for a UK Pension Fund.
- Already successfully raised capital and invested, within the stated investment period, a Real Estate Debt Fund.
- Must have either a UK or European Real Estate Debt focus.
- Must have a dedicated workout expertise.

### Tender Process

#### 1 **European Single Procurement Document and Invitation to Tender**

The Fund's investment consultant, Hymans Robertson, issued a European Single Procurement Document (ESPD) and supporting Invitation to Tender (ITT) on 20th December 2018. The deadline for submission of completed ESPDs and ITTs was 17th January 2019.

#### 2 **Responses to Invitation to Tender**

In all, 8 valid responses were received from the organisations listed below.

- Aberdeen Standard
- Cheyne
- DRC
- Europa
- GAM
- ICG Longbow
- M&G
- Nuveen

#### 3 **Evaluation of Responses**

Hymans Robertson evaluated the ESPD and ITT responses. All ESPDs were assessed in line with standard Council requirements on a pass or fail basis and each submission was assessed with regard to the mandate specifications listed in Appendix B. 5 candidates met the mandate requirements and progressed to the next stage where each tender was evaluated on the basis of technical / professional capability and pricing.

Those managers who scored within 30 points of the highest scoring bid, were included in a shortlist of bidders.

The scores of 3 of the 5 candidates met the minimum threshold score. DRC Capital, ICG Longbow and M&G were selected to proceed to interview with the Strathclyde Pension Fund Committee Sounding Board.

#### 4 **Strathclyde Pension Fund Committee Sounding Board**

DRC Capital, ICG Longbow and M&G presented to the Strathclyde Pension Fund Committee Sounding Board on 26th February 2019.

A summary of the pre-set tender scoring criteria and scoring outcome is set out below.

## Tender Process

## Tender Scoring Criteria

Stage	Award Criteria	Score
ITT	People	10
	Philosophy	10
	Process	10
	Corporate Capability	10
	Fair Work Practices	5
	Sustainability	5
	Price	20
	<b>Sub Total</b>	<b>70</b>
Sounding Board Interview	Suitability of investment proposal	10
	Likelihood of success	10
	Ability to add value	10
	<b>Sub Total</b>	<b>30</b>
	<b>Total</b>	<b>100</b>

## Scoring Outcome

Top 3 Scoring Candidates	ITT	Sounding Board	Total
DRC Capital	(67/70)	(16/30)	83%
ICG Longbow	(63/70)	(26/30)	89%
M&G	(60/70)	(25/30)	85%

## Manager Profile

### **ICG**

ICG is a global, specialist asset manager in private debt, credit, and equity with over 29 years' history. ICG-Longbow is the trading name of ICG's specialist real estate debt investment management business, which was originally established in 2006 by Kevin Cooper and Martin Wheeler, the founders, with the primary objective of becoming the leading independent provider and manager of debt finance to the commercial real estate sector in the UK. ICG-Longbow is the longest established and largest independent CRE debt manager in Europe, with over £3.6bn of assets under management. ICG is able to source the majority of its investments directly, utilising its extensive contacts amongst property investors, investment agents, asset managers, and other property professionals. The team has invested through multiple property, economic, and credit cycles. The track record of ICG's founders goes back to 2002 and demonstrates their ability to successfully deliver positive returns to investors during various market environments. They have a strong track record and capabilities in investing in value-add properties and good quality assets.

The ICG-Longbow investment team comprises 24 professionals, who together are dedicated to the origination, investment and monitoring of all UK Real Estate Debt investments across the real estate debt strategies. This enables ICG to benefit from a team-based origination approach, through the integration of all investment professionals.