



Glasgow City Council

Strathclyde Pension Fund Committee

Report by Director of Strathclyde Pension Fund

Contact: Richard Keery, Investment Manager ext 77398

Item 4

6th March 2019

Private Corporate Debt Manager Appointments

Purpose of Report:

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

Recommendation:

The Committee is asked to **APPROVE** the appointment of Alcentra, Barings and Partners Group to manage private corporate debt mandates with initial allocations respectively of 1.25%, 1.25% and 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 28th 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
S/T Enhanced Yield	15.0	20.0
L/T Enhanced Yield	15.0	20.0
	100	100

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
Private Debt	22.5	4.5
EM Debt	12.5	2.5
DIP	7.5	1.5
Unallocated	5.0	1.0
Total STEY	100.0	20.0

1.3 Private Debt

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

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

The purpose of this paper is to conclude the process for the appointment of private corporate debt managers.

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 private corporate debt is included at Appendix B.

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

Private real estate debt is dealt with in a separate paper.

3 Conclusion

15 valid tenders were received. 4 managers reached the final stage of the tender process. The scoring outcome can be summarised as follows.

- Alcentra: 94%
- Barings: 80%
- BlueBay: 67%
- Partners Group: 90%

Based on these scores, it is proposed that Alcentra, Barings and Partners Group be awarded private corporate debt mandates.

The Fund has existing allocations to Alcentra and Barings, but these are to specific funds raised by those managers. Neither currently has an open mandate with Strathclyde Pension Fund. There is merit in awarding both of them a mandate as part of the current exercise as this would give SPF greater capacity to invest with them. They have both made good progress with their existing allocations and also scored highly in the tender process.

Awarding a new mandate to Partners Group further increases the capacity and diversification of the Fund's private debt strategy.

Brief descriptions of Alcentra, Barings and Partners Group are included at Appendix D.

4 Implementation

Initial target allocations will be:

- **1.25%** each to Alcentra and Barings, recognising their existing allocations; and
- **1.0%** to Partners Group.

In line with existing practice for the Fund, the Investment Advisory Panel will monitor these allocations and they may be varied over time.

These mandate awards should allow SPF to achieve its private corporate target allocation of **3.5%**, 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

<i>Financial:</i>	As per the Alt 2 Strategy, funding of mandates will be from the Fund's equity portfolios. The majority of the necessary cash balance has already been raised from the Fund's equity portfolios.
<i>Legal:</i>	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.

Council Strategic Plan: Strathclyde Pension Fund aligns with the theme of a well governed city.

Equality Impacts:

Does the proposal support the Council's Equality Outcomes 2017-22

Equalities issues were addressed in the tender process within the Fair Work Practices assessment. Alcentra, Barings and Partners Group are all committed to fair work practices and maintain comprehensive policies on diversity and inclusion, wellbeing, and equality.

What are the potential equality impacts as a result of this report?

No specific impact from this proposal.

Sustainability Impacts:

Environmental:
Social:
Economic:

Alcentra, Barings and Partners group are all signatories to the UNPRI and embed Environmental, Social and Governance considerations into their investment processes.

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

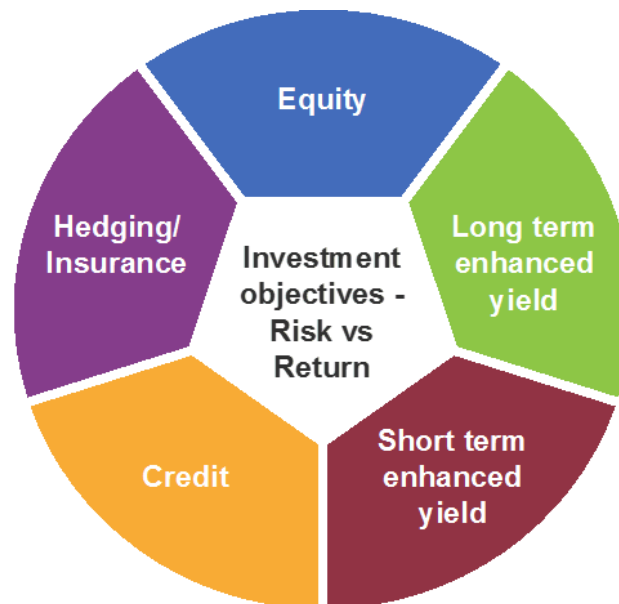
6 Recommendations

The Committee is asked to APPROVE the appointment of Alcentra, Barings and Partners Group to manage private corporate debt mandates with initial allocations respectively of 1.25%, 1.25% and 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
Equity	To generate return.	<ul style="list-style-type: none"> ▪ Listed equity in a range of strategies ▪ Private equity ▪ Equity derivative or options strategies
Hedging/Insurance	To reduce the exposure of the funding level to variations in interest rates and inflation.	<ul style="list-style-type: none"> ▪ UK Gilts and index-linked bonds ▪ Overseas sovereign bonds ▪ Interest rate and inflation swaps ▪ Cash held as collateral
Credit	To ensure additional yield, provide income and reduce funding volatility.	<ul style="list-style-type: none"> ▪ Investment grade sterling non-gilts and corporate bonds ▪ Synthetic credit
Short Term Enhanced Yield	To provide an income stream above the expected return on investment grade corporate bonds.	<ul style="list-style-type: none"> ▪ Absolute return strategies ▪ Asset backed securities ▪ High yield debt ▪ Non-sterling bonds ▪ Emerging market debt ▪ Senior loans ▪ Mezzanine loans ▪ Real estate debt ▪ Hedge funds
Long Term Enhanced Yield	To provide a long-term income stream and a degree of inflation protection.	<ul style="list-style-type: none"> ▪ UK and overseas property ▪ UK long lease property, ground rents and social housing ▪ Infrastructure debt and equity ▪ Timber and farmland ▪ Investment grade corporate bonds

Mandate Specifications

Private corporate debt

The Strathclyde Pension Fund is seeking to appoint an investment manager, or managers, to manage a private corporate debt mandate. The mandate size may range between £300 and £600m. The manager should be able to offer an implementation solution either through the construction of a segregated evergreen portfolio or through the management and allocation to a range of underlying debt managers.

The mandate will be focussed predominantly on senior secured direct corporate lending, either first or second lien, to corporate borrowers and could potentially include other forms of private debt. The loans should be viewed as equivalent to sub-investment grade credit risk. The strategy may also include allocations to unitranche, mezzanine (junior debt) and other forms of debt and potentially a small allocation to equity. Where investing directly, 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 4-6% 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 Private Direct Corporate Lending strategy.
- Must be appropriately regulated to manage a Private Direct lending Corporate Lending strategy for a UK Local Government Pension Schemes (LGPS).
- Must show superior default and recovery experience relative to the syndicated loans market (default and recovery statistics to be confirmed based on US syndicated loans indices).
- Must have multiple investment offices for your firm's Private Direct lending business.
- Already managed a Private Direct Corporate Lending mandate for a UK LGPS client.
- Already successfully raised capital and invested, within the stated investment period, a Private Direct Senior Secured Corporate Lending Fund.
- Must have either a European (including UK) or Global Private Direct Corporate Lending focus.
- Must have 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) for Corporate Private Debt on 19th December 2018. The deadline for submission of completed ESPDs and ITTs was 16th January 2019.

2 **Responses to Invitation to Tender**

In all, 15 valid responses were received from the organisations listed below with 1 candidate submitting more than 1 strategy.

- Alcentra
- Barings
- Beechbrook
- BlackRock
- Bluebay
- CVC
- GMO
- Goldman Sachs
- JP Morgan
- Mercer
- Nuveen
- Oakhill
- Partners Group
- Pemberton
- Permira

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. 8 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 4 of the 8 candidates met the minimum threshold score, and these managers proceeded to interview with the Strathclyde Pension Fund Committee Sounding Board.

4 **Strathclyde Pension Fund Committee Sounding Board**

Alcentra, Barings, BlueBay and Partners Group 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
	Sub Total	70
Sounding Board Interview	Suitability of investment proposal	10
	Likelihood of success	10
	Ability to add value	10
	Sub Total	30
	Total	100

Scoring Outcome

Top 4 Scoring Candidates	ITT	Sounding Board	Total
Alcentra	(68/70)	(26/30)	94%
Barings	(54/70)	(26/30)	80%
BlueBay	(49/70)	(18/30)	67%
Partners Group	(64/70)	(26/30)	90%

Manager Profiles

Alcentra

Alcentra is a specialist sub-investment grade credit manager. The firm was founded in 2002 and is majority (98%) owned by BNY Mellon, with employees owning the remaining share capital. In January 2013 Alcentra announced that the US high yield team at Standish (another BNY Mellon boutique) would join the Alcentra investment team, making it one of the largest global sub-investment grade debt investors, with \$32.5bn in assets under management (AUM), managed equally out of the firm's London and New York offices. Alcentra has been involved in mid-market direct corporate lending for over 10 years and in 2012 launched a dedicated Fund, supported by the UK Treasury to participate in the Business Finance Partnership.

The team consists of 21 investment professionals with an average of 13 years' experience. The team can leverage off the wider credit team of c50 based in the US and Europe and the dedicated team of 7 US direct lending investment professionals. Graeme Delaney-Smith heads the European Direct Lending team and is responsible for asset selection and portfolio management. The team has extensive restructuring experience and can leverage off a dedicated distressed debt team.

Barings

Barings manages c\$300 billion of fixed income, real estate, equities, multi-asset and alternative assets globally, with fixed income representing over 2/3rds of the total assets. The Barings Global Private Finance business is managed by the Barings Global Private Finance Group (GPF) which sits within the broader fixed income business and includes 70 investment professionals based in 7 offices with an average of 12 years investment experience. The team can leverage off a dedicated legal team and also the wider high yield credit group which has c40 sector-specialist analysts globally.

The GPF consists of 3 investment teams; the North American Private Finance team, the European Private Finance team and the Asia Pacific Private Finance team. The North American Private Finance team, led by Ian Fowler and Bob Shettle, co-Heads of North American Private Finance, consists of 35 investment professionals. The European Private Finance team, led by Adam Wheeler, Head of European and Asia Pacific Private Finance, consists of 15 investment professionals based in London. The team consists of native speakers of local languages in all major markets in Europe. The Asia Pacific Private Finance team, consists of 5 investment professionals and is located in offices in Sydney and Hong Kong.

Manager Profiles

Partners Group

Partners Group is an independent global private markets investment manager with a major ownership by its employees. The firm has €67.1 billion in assets under management. Since inception in 1996, the firm has invested over €85 billion in private equity, private real estate, private debt and private infrastructure on behalf of its clients. Partners Group's employees remain the largest shareholder through ownership of stock or options provided by the firm's equity participation plan owning over 40% of the total share capital. The firm has significant expertise in private debt, having made its first private corporate debt investment in 1999, and investing across various market cycles over the past nearly 20 years.

Partners Group employs a core team of 50 private debt investment professionals. The team has the ability to source, analyse and underwrite, execute, manage and monitor private debt investments on a global basis. The senior members of the team have a collective average of 16 years of industry experience including work-out capabilities. The firm employs an in-house team of sector specialists called the Industry Value Creation (IVC) team to support the investment team both pre and post investment selection. The IVC team is run independently from the investment team but works closely with the team throughout the entire life cycle of an investment. The IVC team is organized into six industry verticals and concentrates on executing operational value creation initiatives and providing industry expertise in the healthcare, media and telecommunications, information technology, financials, consumer and industrial sectors.

The private debt team also benefits from the firm's in-house resources in ancillary functions such as risk management, structuring, tax and legal services, and product management and product accounting.