Glasgow City Council

Strathclyde Pension Fund Committee

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Item 7(b)

26th June 2024

Direct Impact Portfolio (DIP)
Investment Proposal – Equitix Fund VII

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 Equitix Fund VII by DIP.

Ward No(s): Citywide: ✓

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

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 current structure did not provide access.

1.2 Review

The NOP strategy has been subject to 3-yearly reviews with the name changing to the Direct Investment Portfolio in 2015. The most recent review was concluded in November 2021. This made no change to the objectives, structure, overall size parameters, risk and return parameters, or governance structure, but did result in an increase in the individual investment size parameters and a further name change to the Direct Impact Portfolio (DIP).

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 2021 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.
Capacity	Target allocation of **5%** of total Fund (based on Net Asset Values). Range of **2.5**% to **7.5%** of total Fund.
Investment Size	Target: **£30m** to **£100m** Minimum: **£20m** Maximum: greater of **£250m** or **1%** of Total Fund Value
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	Existing co-investment programme should be extended in order to maximise its effectiveness, subject to development of a detailed proposal.

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	**Equitix Fund VII**
Investment vehicle	English Limited Partnership
Manager	Equitix Investment Management Ltd
Sector	Infrastructure
Investment objective	To create a portfolio of core infrastructure assets, mainly in the UK, to generate steady investment returns and cash yield to investors.
Term	25 years (subject to extensions)
Target size	£1.5bn (Hard Cap £2bn)
Proposed DIP investment	£50m
Target return	Internal Rate of Return (IRR) of 10% (Net) / Cash Yield 6% p.a.

2.2 Investment Summary

Equitix Investment Management Ltd ("Equitix") is a specialist infrastructure manager with extensive experience of originating, developing, acquiring and managing infrastructure assets through various business cycles.

Equitix is now raising its 7th infrastructure fund ("Fund VII" or "the fund"), which is seeking to raise total commitments of £1.5bn to fund the acquisition of a portfolio of 30 to 40 equity investments in the small to mid-market segment of the core infrastructure market. The fund aims to deliver stable, long-term, inflation-linked cash yields and capital protection to its investors.

DIP has previously invested £30m in Equitix's Fund IV, £50m in each of Funds V and VI, plus an additional £50m in a (DIP only) co-investment vehicle (Equitix MA19). Overall, the performance of these funds has been very satisfactory.

An investment of £50m by DIP in Equitix Fund VII is proposed.

More information on the Manager is included in **Schedule 1.**

2.3 Investment Rationale

Fund VII will seek to provide investors with a steady cash yield over its 25-year life by investing in lower risk (or "core") infrastructure assets. These would be expected to generate long-term, inflation-linked revenues underpinned by availability-based contracts with central/local government, other public sector bodies, regulated entities, or equivalent quality corporate bodies, with relatively low default and/or financing risk.

As with its previous funds, Equitix will focus on acquiring long term, core infrastructure assets which exhibit the following characteristics i.e. assets that:-

- provide essential or critical services to the UK population;
- are fundamental to a country's long–term economic growth;
- have a stable legal and regulatory environment;
- have high barriers to entry;
- have revenues which are contracted, inflation-linked and mainly availability based (i.e. not reliant on the level of usage of the asset); and
- are anticipated to demonstrate a relatively high degree of revenue stability and low volatility of returns.

The fund will target assets in the following sub-sectors of the infrastructure market:-

- **Social Infrastructure** (including hospitals, clinics, other healthcare facilities; schools/colleges; social housing; and student, military and/or other government accommodation, etc.);
- **Transportation** assets (e.g. rail and road maintenance concessions, train rolling stock, etc);
- **Renewable Energy** (e.g. wind, solar, OFTOs (Offshore Transmission Owners, grid infrastructure, etc);
- **Environmental Services** (e.g. recycling, waste/waste water treatment, energy from waste facilities, etc);
- **Data Infrastructure** (e.g. data centres and telecom towers, etc);
- **Network Utilities** (e.g. fibre networks, gas, electricity distribution, etc).

Fund VII will focus primarily on the UK market (minimum 90%), however with Equitix having previously launched a European infrastructure fund (and currently fundraising a second) the balance (up to 10%) will be deployed in certain other non-European, OECD countries such as the USA, Canada & Australia, on an opportunistic basis.

Equitix anticipates acquiring (and to a lesser extent also constructing) small to medium sized infrastructure assets which are too small for global infrastructure funds to be interested in, and which are therefore not subject to the same level of competitive pressure that exists at the larger end of the market, thereby facilitating the potential generation of relatively higher returns.

Fund VII completed its second close in Q1 2024 when it secured c.£200m in commitments from a variety of pension funds, insurance companies and other investors and has already acquired 5 assets at opportune price points / potential returns. The Manager is also engaged in advanced discussions with multiple other potential investors and remains confident of securing a minimum of £1bn of investor commitments.

Equitix has a well-established and active pipeline of potential opportunities for Fund VII which currently comprises 20+ identified opportunities, representing several £bn of value, due to complete in 2024 and/or 2025 alone. The Manager therefore remains confident in its ability to originate attractive opportunities and deploy funds at a strong pace.

Despite having investment periods typically of 5 years, to date all previous Equitix funds have been fully committed and cash yielding within c.2 years of their respective first closes.

Equitix (the firm) will be investing 1% of the total commitments raised.

2.4 Risks

The main risks of the proposed investment are considered to be as follows:

- Origination Risk;
- Construction/Operational Risk;
- Lifecycle Costs; and
- Risk of Termination of Project Agreements.

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

2.5 Projected Return

The targeted return for Fund VII is a net IRR of 10% with a cash yield of 6% p.a. This represents an increase on the targeted return compared with the predecessor fund (Fund VI) which targeted a net IRR of 8.5%. The uplift is mainly a result of the current excess of investment opportunities in relation to the reduced levels of available capital resulting from a challenging capital raising period in 2023. Equitix however was relatively unaffected by this, having raised £1.4bn of new commitments last year across a number of strategies.

The targeted return is attractive for a portfolio of mainly operational and lower risk UK infrastructure assets. From the projected returns for the seed assets acquired to date, Equitix has demonstrated that attractive opportunities currently do exist for managers with capital available. The level of volatility in potential returns for core infrastructure assets is anticipated to be relatively low.

2.6 Exit

Fund VII has a term of 25 years which may be extended with the agreement of investors. The fund will have a 5-year investment period.

2.7 Fees

The Management Fee is lower in some respects compared with the equivalent structure of the predecessor fund, and incorporates a discount in respect of the aggregated commitments of LGPS investors. The fee is weighted towards the invested capital, rather than the committed capital during the investment period.

Carried Interest provisions also apply and are modestly more challenging for Equitix to achieve than the equivalent structure applying under the prior fund.

Overall the fees are in line with DIP's experience in the infrastructure market and are considered satisfactory.

2.8 ESG and Impact

Equitix has developed strategies to meet and exceed environmental, social and governance ("ESG") expectations in the markets in which it operates. It does this by incorporating ESG considerations at each stage of the investment process from the initial appraisal and decision-making process to the regular consideration of ESG factors during the life of the assets.

In this way Equitix manages the corporate governance of the assets it owns while regularly reviewing its ESG investment policies to ensure they remain relevant, up to date, and aligned with the evolving needs of investors.

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

2.9 Investment Size and Cash Requirements

SPF Fund value at 31st March 2024	£30,245m
DIP allocation (target 5% of main fund) NAV	£ 1,512m
Current DIP NAV	£ 1,490m
NAV Range (Lower) 2.5%	£ 756m
NAV Range (Upper) 7.5%	£ 2,268m

2.10 Investment Strategy

The proposed investment falls within the Infrastructure sector and therefore the Fund's Long Term Enhanced Yield (LTEY) allocation. Infrastructure is a key area of investment focus for DIP.

Allocations following this investment, based on Fund values at 31st March 2024 and total DIP commitments to Infrastructure, would be as follows:

Infrastructure, £ in DIP	£610m
Infrastructure, % in DIP	28.9%
Infrastructure in DIP, % of Total Fund	2%
LTEY, % Total Fund (target 21%)	17.4%

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 Equality Outcomes 2021-25? Please specify.	Equalities issues are addressed in the Fund's responsible investment policy.
What are the potential equality impacts as a result of this report?	No specific impact from this proposal.
Please highlight if the policy/proposal will help address socio-economic disadvantage.	An element of the proposed fund is anticipated to be invested in healthcare, education and social housing assets.
Climate Impacts:	
Does the proposal support any Climate Plan actions? Please specify:	The fund is anticipated to undertake a number of investments in the renewable energy, energy from waste, waste recycling and/or other assets in the sustainability space. 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?	The above sustainable investments will result in the reduction or displacement of carbon emissions and waste products being sent to landfill.
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	N

as a result of this report Y/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 Equitix Fund VII by DIP.

Schedule 1 **Investment Manager: Equitix Investment Management Ltd**
Schedule 2 **Investment Specific Risks**
Schedule 3 **ESG and Impact**

Schedule 1

Investment Manager: Equitix Investment Management Limited

Equitix was established in 2007 to develop and manage portfolios of infrastructure assets for institutional investors. Since then it has invested or committed £8.7bn into 271 assets across the UK via 6 core infrastructure funds (plus an additional €558m in a European Fund and 30+ managed accounts). Including co-investment capital, Equitix now has Assets under Management (AUM) of £11.3bn.

The Manager has a proven track record of raising and successfully investing capital from local authority and private sector / corporate pension funds, insurance companies and other investors into core infrastructure assets.

The senior management team at Equitix are highly experienced infrastructure practitioners, having been actively involved in the sector since the inception of PPP in the UK. They have each previously held senior managerial positions with some of the largest global infrastructure institutions and have been key to the firm's successful record of securing, developing and operating more than a total of 340 core infrastructure projects across the UK, Europe and various OECD countries.

The broader Equitix team currently comprises over 190 multi-discipline infrastructure specialists located across 15 offices worldwide and organised along functional lines namely: primary bidding and development; deal origination; finance; asset management; investor relations; and support functions. The team comprises professionals from a variety of backgrounds including construction, project management, facilities management, banking & finance, property legal and the public sector. In this way Equitix believes it has the required in-house skillsets necessary to operate across the lifecycle of a core infrastructure project from origination and the due diligence process to the long-term management of the asset.

Equitix has a strong track record of creating multiple, diversified portfolios of high-quality investments in its core infrastructure funds, which are delivering strong cash yields to investors. Its asset management team continues to implement applicable post-acquisition asset management strategies across all assets to generate efficiencies and economies of scale in order to optimise investor returns over the respective fund lives.

Equitix Investment Management Limited is authorised and regulated by the Financial Conduct Authority.

Investment Specific Risks

Origination Risk
Equitix's extensive existing portfolio of 271 assets, and the firm's significant presence in the UK market results in its teams having an extensive network of contacts with government bodies, asset operators and co-shareholders and this, allied with their credibility in the market, results in a steady pipeline of new opportunities. Equitix currently has sight of over £5bn of investment future opportunities with a track record (and an expectation) of winning a good proportion of these at attractive prospective potential returns in the current market.

Construction / Operational Risk
With all infrastructure projects/assets, there is a risk that the contractual &/or warranty arrangements with the design and construction subcontractors may not be as effective as intended. Recourse may also be subject to liability restrictions or the insolvency of a main construction (or facilities management) contractor, as seen in recent years with both Carillion & Interserve. Measures such as performance bonds, contract retentions and latent defects provisions are always incorporated into the legal documentation, however the failure of these two companies serves to highlight the real risks in this respect as well as the level of contingency planning required to be undertaken by fund managers operating in the sector.

Lifecycle Costs
During the lifetime of each asset or concession, certain components of the facility will require replacement or refurbishment, the timing of which is based on forecasts. Shorter than anticipated lifespans or higher than anticipated costs, if not recoverable from the subcontractor concerned, may result in higher lifecycle costs for the asset holding entity. For this reason, full technical reviews of the lifecycle cost provisions (and optimisation strategies) for each asset are undertaken pre-acquisition.

Risk of Termination of Project Agreements
Under PPP projects, the employer and the project entity typically have the right to terminate a project agreement under certain circumstances, and the compensation payable (if any) depends on the reason. A full review of the termination provisions of each asset is undertaken as part of the due diligence process.

ESG and Impact

Equitix as a corporate entity and investment manager seeks to actively manage investments with the objective of enhancing returns both from a financial and sustainability perspective. It also recognises the moral obligation to invest responsibly by fully considering the risks and opportunities relating to ESG issues in respect of its underlying investments.

Equitix's mission is to facilitate the provision of high-quality infrastructure assets which are used to provide essential services to the UK's population,, and to contribute positively to the environment and to wider society. As a long-term investor it is aware that the decisions it makes will have an impact for decades and as a result, puts responsible investment at the heart of its investment process.

Equitix has incorporated a Responsible Investment Policy into its investment process which supports the identification of material ESG risks and opportunities before a final decision on whether to approve an investment is made. This assessment utilises a range of well-established approaches including both negative and positive screening, analysis of foreseeable climate-related physical and/or transition risks, and appraisals of ESG issues.

Equitix believes that:-

- ESG and long-term financial performances are not mutually exclusive and by applying a suitable framework, stronger outcomes can be achieved for all stakeholders;
- New regulatory frameworks, higher market expectations and stakeholder pressure to see investments deliver on environmental and social challenges are seen as a way to deliver value for both investors and the communities being served by its assets;
- An active approach to asset management is key to developing long-lasting partnerships which in turn support better outcomes;
- A firm commitment to conducting its business in a way which underpins its principles of honesty, integrity and sound moral principles.

Equitix has been a signatory to the PRI (UN Principles of Responsible Investment) since 2010 and is also a member of the UK Sustainable Investment and Finance Association.

Fund VII has been identified by Equitix as an Article 8 fund under the EU Sustainable Finance Disclosure Regulations (SFDR). This means that the fund will promote environmental or social characteristics alongside financial objectives and which will integrate sustainability into the investment process in a binding manner.