



Glasgow City Council

Strathclyde Pension Fund Committee

Report by Richard McIndoe, Director of Strathclyde Pension Fund

Item 6(b)

25th November 2020

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**Direct Investment Portfolio (DIP)
Investment Proposal – Man GPM RI Community Housing Fund**

Purpose of Report:

To set out a proposal for an investment of £30m within the Direct Investment Portfolio.

Recommendations:

The Committee is asked to **APPROVE** an investment of £30m in Man GPM RI Community Housing Fund by the Direct Investment Portfolio.

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 current structure did not provide access.

1.2 Review

The NOP strategy was reviewed in 2012 and in 2015. It was re-branded as the Direct Investment Portfolio (DIP) in 2015. The most recent review of the DIP strategy and operating arrangements was concluded in December 2018.

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 2018 review is summarised below.

Direct Investment 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: £20m to £100m Minimum: £10m Maximum: greater of £200m 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.

The following proposal has been assessed using this framework and is considered appropriate for review by the Sounding Board with a view to a recommendation being made to the Committee.

2 New Investment Proposal

2.1 Key Terms

Name	Man GPM RI Community Housing Fund
Investment vehicle	English Limited Partnership
Manager	Man Global Private Markets (UK) Limited (“Man GPM”)
Sector	Affordable residential accommodation
Investment objective	The Fund will build or buy a portfolio of mixed tenure affordable homes in the UK, predominantly leased to local councils and housing associations
Term	10 years (plus extensions of up to 5 years)
Target size	£400m
Proposed DIP investment	£30m
Target return	In full accordance with DIP’s indicative target return for housing sector investments (4%-10% Net IRR), including a satisfactory Cash Yield.

2.2 Investment Summary

The Man GPM (Global Private Markets) RI (Responsible Investment) Community Housing Fund (“the CHF”) aims to generate attractive long-term, risk adjusted investment returns by developing a portfolio of mixed tenure affordable homes in the UK residential housing sector, predominantly leased to local councils and housing associations (“HAs”) on long term, inflation-linked leases.

The Fund will employ a multi-channel and multi-tenure approach to create the broadest possible investment asset portfolio, to promote the creation of more robust and integrated communities thereby reducing the risk and impact of any single housing tenure.

A commitment by the Direct Investment Portfolio of £30m to the Man GPM RI Community Housing Fund is proposed.

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

2.3 Investment Rationale

The UK has experienced a long-term structural undersupply of housing across all tenures. Research has shown a requirement for 300,000 homes to be built annually, of which 150,000 are required for the affordable sub-sector. However with completions averaging only c.

50,000 p.a. this results in a shortfall of c. 100,000 affordable housing units each year.

The persistent undersupply of new housing stock has contributed to house price appreciation, which in turn has resulted in lower levels of owner occupation, a commensurate growth in the rental market and a decline in rental affordability.

The CHF's strategy seeks to contribute towards meeting the shortfall in the supply of affordable housing by developing (or acquiring) and then leasing affordable housing units to high credit quality Housing Partners (councils/HAs) under long-term, full repairing and insurance ("FRI") index-linked leases. The Housing Partners will, in turn sublet the properties to qualifying tenants.

The Manager will employ a multi-channel approach to creating a portfolio of properties, either by developing properties in-house or via acquisition in the marketplace. The tenure of the ultimate user of the properties however will be blind, in order to create a mixed tenure occupancy of developments. Up to a maximum of 30% (but anticipated to be 10-15%) of the units will be subject to private market sale or rent.

In terms of sourcing properties, the Manager anticipates:-

- i) 35-45% will be developed in-house (no planning risk assumed);
- ii) 30-45% will be acquired via bulk purchases from housebuilders at discounted prices (due to the cash flow benefit to the housebuilders);
- iii) 10-20% via acquisitions from housebuilders (of "Section 106" units);
- iv) 10-20% from sale and leaseback transactions (typically from/to councils/HAs where the properties require refurbishment).

Section 106 agreements (Section 75 in Scotland) require housebuilders, as part of the conditions of planning consent to build a certain number of affordable homes within each private residential development and to then sell them to a Registered Housing Provider regulated by the Regulator of Social Housing.

The CHF portfolio of homes will mainly be block leased to councils/HAs who in turn will sublease the individual units to qualifying tenants, on a mixed blend of social, affordable, keyworker (rented), shared ownership and rent to buy tenures, according to local council/HA requirements.

In terms of these head leases, HAs generally prefer 10-20 year operational leases (after which the units revert to the fund's ownership), while councils generally prefer 40 year finance leases (where ownership transfers to the councils at the end of the lease). A proportion of homes (the shared ownership units) will be part sold/leased direct to tenants under a management agreement typically with a local HA (but which

excludes the repairs and maintenance obligation).

The CHF will employ a leveraged strategy at the asset (rather than fund) level of up to:

- a maximum LTC (loan to cost) of 65% for developments under construction and
- a maximum LTV (loan to value) in respect of the operational assets of 35% (in respect of the 10-20 year HA leases) and up to 80% (re the 40 year, fully amortising, council leases).

The CHF investment team will use a combination of their own experience/networks in addition to a data driven origination and selection approach to assess the economic viability for such housing developments in certain towns/locations, in conjunction with discussions with local councils/HAs to determine their particular housing requirements in that area.

The Manager currently has an advanced pipeline of 8 development projects representing 1,038 units (gross cost £229m) either in exclusivity or agreed in principle. Numerous earlier stage opportunities are also under active consideration.

The Manager anticipates the Fund undertaking c. 6 developments annually (averaging £25-£40m each) and this volume of activity is comfortably manageable by the Fund's current investment team.

Homes England and Big Society Capital are intending to invest in the Fund's first close. Man Group will also be committing £10m to the Fund.

2.4 Risks

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

- Development / Construction Risk
- Site Origination Risk
- Tenant / Management Risk

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

2.5 Projected Return

The target (blended) return of the various user tenures of homes to be developed by the CHF fund is comfortably within DIP's target range for housing sector investments of 4%–10% IRR (Net). The return will incorporate an annual cash yield with effect from when the asset portfolio becomes stabilised (i.e. fully occupied - anticipated from year 6 onwards).

This target return and yield are considered fully satisfactory given the perceived risk of the CHF investment strategy.

2.6 Exit

The fund has a fixed term of 10 years, although it can be extended by 2 years at the Manager's discretion and thereafter with the consent of the investors.

2.7 Fees

The Management Fee is in line with DIP's experience in the current market for funds of this nature. The fee will be calculated on total commitments during the 5-year investment period and on the Gross Asset Value of the fund thereafter.

SPF will benefit from a number of negotiated discounts in the management fee on the basis of the amount of DIP's proposed commitment and for investing at first close.

Carried interest provisions also apply. These are structured such that Man GPM require to perform strongly before they benefit under these provisions. The fee structure, inclusive of the proposed discounts, is considered satisfactory.

2.8 Environmental Social and Governance Issues

The Manager recognises that responsible investment (RI) is fundamental to its fiduciary duty to clients and believes that the financial and social return of investments in the UK affordable housing sector are closely linked. Each of the fund's investments will be assessed against a set of social and environmental objectives prior to any investment. In addition an independent annual social audit of the Fund will be undertaken and distributed to investors.

Accordingly, the CHF has been designated as a Man Dedicated Responsible Investment ("RI") Fund with explicit social impact objectives linked to the UN Sustainable Development Goals.

Man Group became a signatory of the UN Principles of Responsible Investment in August 2017 and since 2014 has served on the PRI Hedge Fund Advisory Committee.

2.9 Investment Size and Cash Requirements

SPF Fund value at 30 th September 2020	£23.701bn
DIP allocation (target 5% of main fund) NAV	£1,185m
Current DIP NAV	£ 866m
Headroom v NAV	£ 319m

2.10 Investment Strategy

The proposed investment falls within the Property sector and therefore the Fund's long term enhanced yield allocation (LTEY). Allocations following this investment, based on Fund values at 30th September 2020 and total DIP commitments to Property, would be as follows:

Property, £ in DIP	£175m
Property, % in DIP	13.4%
Property in DIP, as % of Total Fund	0.7%
LTEY, % Total Fund (target 20.0%)	15.9%

3 Policy and Resource Implications

Financial: Investment of £30m to be drawn as required. Fee structure in line with 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: Strathclyde Pension Fund aligns with the theme of a well governed city.

Equality and Socio-Economic Impacts:

Does the proposal support the Council's Equality Outcomes 2017-22 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. The fund seeks to increase the provision of affordable housing within the UK.

Sustainability Impacts:

Environmental: See section 2.8
Social, including opportunities under Article 20 of the See section 2.8

*European Public
Procurement
Directive:
Economic:*

See section 2.8

**Privacy and Data
Protection impacts:**

To be fully provided for in the legal documentation for the proposed investment.

4 Recommendation

The Committee is asked to **APPROVE** an investment of £30m in Man GPM RI Community Housing Fund by the Direct Investment Portfolio.

Investment Manager: Man GPM (UK) Ltd

Man Group is a global investment management firm with \$113bn of funds under management. Man GPM is Man Group plc's private markets investment manager, which focuses on real and corporate assets across the capital structure and a range of differentiated strategies including residential property equity and debt, commercial property and corporate debt in the UK, Europe and US. Man GPM has Assets under Management of over \$3bn.

It has a particular focus on the development of residential property having acquired, developed or operated c.4,000 residential units and provided finance for a further 14,000 units for construction, refurbishment, development, long term rental or sale, although to date this has been throughout the US.

The strategy to develop the affordable homes platform in the UK is supported by the recruitment of a dedicated team of 3 senior real estate development professionals who have a combined 60 years' experience, at a senior level, in the development of affordable/social housing in the UK. The three senior members of the CHF investment team are Shamez Alibhai, Ian Jackson and Tom Shaw.

Shamez Alibhai (Head of Community Housing, Man GPM/member of Man Group's Responsible Investment Committee) – launched and managed the UK's first institutional affordable housing fund (the £240m Social Property Impact Fund) at his previous firm (Cheyne). He has 17 years' experience in UK residential property.

Ian Jackson (Investment Director) – has 27 years' experience in affordable housing development, latterly as Director Portfolio Investment at Longhurst Group, a large regional HA with 23,000 homes.

Tom Shaw (Investment Director) – has 15 years' experience in property investment and development, latterly as Managing Director (Development) at Hyde Group, a major London based Registered Provider of social housing which owns and manages c.50,000 homes.

Man GPM has also assembled an impressive Fund Advisory Committee including:-

Dame Kate Barker (former member of the BoE Monetary Policy Committee and author of the Barker Review of Housing Supply for the UK Govt);

David Gannicott (former Group Business Development Director of Hyde Group, a large London HA with 50,000+ homes);

Paul Beardmore (formerly Director of Housing and Residential Growth at Manchester City Council);

David Hutchison (CEO of Social Finance, which works with the Govt on tackling social problems in the UK and is a member of the UK National Advisory Board on Impact Investing); and

David Sheridan (former CEO of Keepmoat Group, a large housebuilder focused on brownfield sites in conjunction with councils and HAs

Investment Specific Risks

Development / Construction Risk

Planning consent will be in place prior to acquisition so no planning risk will therefore be assumed.

Experienced contractors will be engaged by the Fund on fixed price building contracts, with the risk of cost-overruns borne by the contractor and penalties payable by the contractors to the Fund for any delays in delivery. The contracts will incorporate performance bonds and/or parent company guarantees as applicable, to ensure an appropriate level of financial surety is available in the event of contractor failure.

The Fund's investment team has extensive experience in the property development process from site identification, planning, acquisition, through to the managing and monitoring of the construction process.

Site Origination Risk

The Fund's investment team have been actively working on the development pipeline for over 18 months and have created a significant number of opportunities which have evolved to the current advanced pipeline of 8 projects representing 1,000+ individual units all rated by the Manager with a likelihood of completing of 70% or more. Beyond this there are multiple other projects which are currently being assessed.

The risk of failing to identify sufficient development sites to deploy the fund is therefore considered low.

Tenant / Management Risk

The tenant occupancy/credit risk, as well as the repairs/maintenance obligation relating to the units leased to HAs/councils, will remain with the latter as head tenant.

HAs and councils in particular are generally considered to be relatively strong credit quality counterparties, although formal assessment on an individual case by case basis will be undertaken by the Manager in respect of each development/proposed lease.