



Glasgow City Council

Strathclyde Pension Fund Committee

Report by Richard McIndoe, Director of Strathclyde Pension Fund

**Item 4(a)**

3rd March 2021

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**Direct Investment Portfolio (DIP)  
Investment Proposal – RiverRock Sustainable Industry Finance Fund**

**Purpose of Report:**

To set out a proposal for an investment of £20m within the Direct Investment Portfolio.

**Recommendations:**

The Committee is asked to **APPROVE** an investment of £20m in RiverRock Sustainable Industry Finance 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	
<b>Objectives</b>	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.
<b>Strategy &amp; Structure</b>	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.
<b>Risk and Return</b>	Portfolio benchmark return of <b>CPI +3% p.a.</b> Individual risk and return objectives for each investment.
<b>Capacity</b>	Target allocation of <b>5%</b> of total Fund (based on Net Asset Values). Range of <b>2.5%</b> to <b>7.5%</b> of total Fund.
<b>Investment Size</b>	Target: <b>£20m to £100m</b> Minimum: <b>£10m</b> Maximum: greater of <b>£200m</b> or <b>1%</b> of Total Fund Value
<b>Decision Making</b>	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.
<b>Monitoring</b>	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 recommendation by the Sounding Board to the Committee.

## 2 New Investment Proposal

### 2.1 Key Terms

<b>Name</b>	<b>RiverRock Sustainable Industry Finance Fund</b>
<b>Investment vehicle</b>	Closed-ended investment fund incorporated in Luxembourg & regulated by the CSSF
<b>Manager</b>	RiverRock European Capital Partners
<b>Sector</b>	Credit
<b>Investment objective</b>	To provide secured finance for specialised equipment for sustainable projects
<b>Term</b>	6.5 years (plus up to 2x1 year extensions)
<b>Target size</b>	£150m (Hard Cap £200m)
<b>Proposed DIP investment</b>	£20m (subject to a minimum first close of £75m)
<b>Target return</b>	Internal Rate of Return (IRR) of 8%-8.5%% (Net)

### 2.2 Investment Summary

RiverRock (RR) European Capital Partners is an independent, partner owned alternative asset manager which focuses on niche, pan-European private debt strategies where competition is limited. Headquartered in London with offices in Paris, Milan and Madrid, the firm has c.50 staff and AUM (assets under management) of c.€1bn.

The RiverRock Sustainable Industry Finance Fund (RSIFF) aims to provide secured debt finance, mainly to UK based SMEs (small and medium-sized enterprises) for specialised equipment used in sustainable projects and focusing on renewables, recycling and offshore technology.

A commitment by the Direct Investment Portfolio of £20m (subject to a minimum first close amount of £75m) to the RSIFF fund is proposed.

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

### 2.3 Investment Rationale

RSIFF's investments will be in the form of debt funding which is fully secured against equipment which is clearly identifiable, revenue generating, vital to the borrower's business (or to the contract for which it is required) and aligned to the UN's Sustainable Development Goals (SDGs).

The Fund's strategy is to target that segment of the asset finance market (predominantly between £1m and £10m) which is underserved by traditional finance providers and where the limited competition allows for stronger risk adjusted returns.

Other providers such as the mainstream banks are active in the sub £500k finance market but have largely withdrawn from the £1m+ segment in the past decade or so. At the other end of the scale, there is a relatively active market for asset finance in amounts of £30m and above.

A large part of the asset finance sector, particularly at the lower value end of the scale is a commodity market, undertaken through broker intermediaries who have no underlying or long term relationship with the borrower.

With over 100 deals in the past decade, with many repeat borrowers (but spread over a number of years and subject to concentration limits) the Fund's origination team has a strong track record of sourcing good quality opportunities and building long-term relationships in respect of a relatively narrow range of specialist equipment of which they have a deep understanding. Their track record reflects a strong credit performance.

A strong emphasis is placed on a comprehensive assessment of the financial strength of each borrower, the asset to be financed and the level of reliance of the borrower (and the associated contract for which the equipment is required) on the asset concerned. The higher the level of reliance, the greater the likelihood of being able to assign the asset/debt to another entity if required.

Typical assets to be financed include the following:-

- **Renewable Energy** - wind turbines, landfill gas turbines, grid back-up solutions (i.e. batteries, generators etc);
- **Offshore Support Services** – underwater ROVs (remote operated vehicles) for subsea infrastructure including oil & gas decommissioning, geo-surveys for offshore windfarm projects (foundations/servicing/maintenance etc);
- **Waste Processing Equipment** - waste water treatment, industrial waste processing, anaerobic digestion and biomass plant (reducing waste to landfill);
- **Waste Management Equipment** – recycling equipment to reduce the disposal to landfill of electrical equipment/appliances (e.g. computers, hardware and domestic appliances such as fridges);
- **Specialist Offshore Seabed Equipment** – equipment (often ship-borne) used for specialist seabed services e.g. constructing/maintaining foundations for offshore wind turbines, cable and pipeline laying equipment etc.

The mix by sector of assets financed by the fund is anticipated to be 40%-50% offshore support (ROVs/ship borne assets); 25%-35% renewable energy assets; 15%-25% recycling and waste management plant.

The fund will target finance deals of between £500k and a maximum of £20m, subject to a maximum of 10% of the total commitments to any single *borrower*. The maximum *deal* size is therefore anticipated to be no more than £10m. The manager ultimately anticipates a portfolio of 50-60 deals averaging between £1m and £5m, assuming the fund reaches its targeted size of £150m. The RSIFF fund will be unleveraged.

## 2.4 Risks

The main risks of the proposed investment in RSIFF are considered to be:

- Origination Risk
- Credit Risk
- Default Risk

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

## **2.5 Projected Return**

RSIFF is targeting an Internal Rate of Return (IRR) of 8% - 8.5% (Net).

This target return is considered fully satisfactory given the relatively lower risk secured nature of the fund's investment strategy.

## **2.6 Exit**

RSIFF will have a 6.5 year term (i.e. 3.5 years following the expiry of the 3 year Investment Period), although may be extended by up to 2 years by the Manager. The underlying asset finance transactions however will typically have terms of between 3 and 5 years.

The investment will be repaid from a combination of the cash yield generated from interest and fee revenues, in addition to scheduled capital repayments.

## **2.7 Fees**

The Management Fee is modestly lower than DIP's experience in the current market for debt capital funds of this nature and will be calculated on the Fund's Net Asset Value both during and after the Fund's investment period. This is attractive as it is based on invested amounts rather than on total commitments. SPF will additionally benefit from a discount for investing at the first close.

A Carried Interest (or performance fee) also applies. This is structured such that RR require to perform strongly before they benefit under these provisions.

Overall the fee structure is considered attractive in relation to our experience of similar debt funds.

RR will be committing 1% of the Fund's total commitments, which reflects a satisfactory level of alignment with investors.

## **2.8 Environmental Social and Governance Issues**

RSIFF is specifically targeting the financing of assets which are sustainable in nature and integral to the development of sectors such as renewable energy (onshore and offshore) and waste recycling/processing.

The fund's impact strategy is aligned to the UN's SDGs (Sustainable Development Goals) and targets specific sectors/assets where a positive socio-economic impact is deemed achievable and will work with its counterparties to quantify and report on that impact. The SDGs targeted by the Fund include Clean Water & Sanitation; Affordable & Clean Energy; Industry, Innovation & Infrastructure; Climate Action; and Life Below Water.

RiverRock has been a signatory to the UN Principles of Responsible Investment since October 2017.

## 2.9 Investment Size and Cash Requirements

SPF Fund value at 31st December 2020	£25,460m
DIP allocation (target 5% of main fund) NAV	£ 1,273m
Current DIP NAV	£ 879m
<b>Headroom v NAV</b>	<b>£ 394m</b>

## 2.10 Investment Strategy

The proposed investment falls within the Credit sector and therefore the Fund's short term enhanced yield allocation (STEY).

Allocations following this investment, based on Fund values at 31<sup>st</sup> December 2020 and total DIP commitments to Credit, would be as follows:

Credit, £ in DIP	£195m
Credit, % in DIP	12.1%
Credit in DIP, as % of Total Fund	0.8%
STEY, % Total Fund (target 20.0%)	17.6%

## 3 Policy and Resource Implications

*Financial:* Investment of £20m to be drawn as required.  
Fee structure is 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.*

No specific impact from this proposal.

**Sustainability Impacts:**

*Environmental:  
Social, including opportunities under Article 20 of the European Public Procurement Directive:  
Economic:*

See section 2.8

See section 2.8

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 £20m in RiverRock Sustainable Industry Finance Fund by the Direct Investment Portfolio.

## Investment Manager

RiverRock European Capital Partners (RR) is a privately owned alternative asset manager specialising in financial advisory services and private debt solutions, mainly to European SMEs including the UK. Established in 2009, it has c. 50 investment staff and is headquartered in London with offices in Paris, Milan & Madrid.

RR also provides corporate banking services through its own specialist bank in Luxembourg, namely RiverBank. The firm has a mainly European/worldwide investor base (e.g. the German Federal Govt, EIB, other national public bodies, US endowments/pension funds/family offices etc).

For the RSIFF fund, RR are teaming up with Bridge & York Capital Partners (B&Y), a highly experienced firm of UK asset/lease finance originators to the SME market, also founded in 2009 and led by John Blanchflower. B&Y have a network of 6 senior field partners located across the UK with significant experience (average 30 years each) and have financed over 100 assets (totalling £180m) since 2010. Under the agreement with B&Y, RR will acquire a majority stake in B&Y at first close, and thereafter will have the right of first refusal on all asset finance/leasing opportunities.

The Investment Committee of the RSIFF fund will be Inder Bir Singh, Michael Lamont and John Blanchflower.

**Inder Bir Singh** (Co-Chief Investment Officer (CIO) & Partner) – joined RR in 2017 having previously been Head of Asset Management at IKB Deutsche Industriebank, an SME lender based in Dusseldorf and London between 2010-17. In this role, in 2011, Mr Bir Singh established (and became Chairman and CIO of) Valin Funds, a European direct lender of alternative finance to European SMEs. He holds an engineering degree and MBA from the Indian Institute of Management.

**Michael Lamont** (Co-CIO, Portfolio Manager & Partner) – also joined RR as co-CIO in 2017 having previously been a co-CIO and co-founder of Seer Capital, a New York based, globally focused structured credit asset manager between 2008-17. Prior to this Mr Lamont had credit roles at Deutsche Bank and Credit Suisse and was educated at New York, Harvard Law School, BA Rice and Cambridge universities.

**John Blanchflower** (Head of Origination / also Managing Partner, B&Y) – 25 years' experience of identifying and structuring finance opportunities and also of building multiple commercial asset finance platforms (x4) since 1992. He holds a degree in law from the College of Law.

## **Investment Specific Risks**

### **Origination Risk**

B&Y's team of specialist asset finance originators have a long track record of sourcing good quality opportunities and of undertaking comprehensive appraisals of the inherent commercial risks involved.

The origination risk is perceived to have two interlinked characteristics, namely can sufficient volumes of suitable opportunities be secured and secondly does the quality of those transactions stand up to scrutiny over an extended period of time (see Credit Risk below). Their steady and consistent track record of successfully originating opportunities over the past decade suggests that the origination risk is low.

### **Credit Risk**

An origination firm such as B&Y relies on the quality of the opportunities sourced over an extended period of time to protect and sustain their own future as a business. Their strong track record in respect of the credit performance of the transactions underwritten in the past decade affords them ongoing credibility with their network of funders. Conversely a weak credit performance would quickly leave them struggling to find funders willing to underwrite their opportunities.

The credit performance of the transactions originated by the B&Y team over the past decade or so has been strong with relatively few significant adverse repayment events, and even in those situations positive outcomes were ultimately achieved. This track record indicates that opportunities require to meet high standards in respect of risk evaluation, credit assessment, deal structuring and technical due diligence before being introduced to potential funders for formal underwriting.

### **Default Risk**

The Fund will have several layers of security protection in the event of the default of the borrower. These typically include security over the underlying contract for which the asset is being used, the ability to novate or assign the asset (and the related finance) to other commercial entities reflecting the essential nature of the assets concerned, financial guarantees and/or ultimately the right to repossess and realise the asset.

The finance agreements will be structured to be repaid over a much shorter timeframe than the useful life of the asset, thereby quickly creating equity in the asset, even allowing for relatively high initial loan to value ratios.

The majority of the finance deals undertaken by the fund will be traditional finance lease facilities, although a minority may be operational lease contracts, sale and leaseback contracts or other forms of secured lending. In all cases however, the funding will be secured by the asset concerned.