Annexe 1

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Surrey Pension Fund Committee

Private Markets – Renewables allocation

December 2024

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Attendees

Nick Harrison; Chair of the Pension Fund Committee

Neil Mason; Assistant Director – LGPS Senior Officer

Lloyd Whitworth; Head of Investment and Stewardship

Anthony Fletcher; Independent Adviser

Background

The purpose of this meeting was to receive an update from the selected Private Equity, Infrastructure managers specifically to focus on the amount money invested in "Renewables" and to comment on their performance.

To the extent these minutes contain the views of the adviser those views are intended as strategic advice to inform discussions around the strategic asset allocation. They are not intended as investment advice, nor should they be relied on as such.

In the paper I refer to the following terms which are commonly used when discussing Private market investments.

IRR = Internal Rate of Return, a measurement of performance based on cash flow analysis during the period of investment, especially when cashflows are variable in size and timing.

MOIC = Multiple on Invested Capital, a metric used to describe the value or performance of an investment relative to its initial cost, the length of time between purchase and sale is not considered.

TVPI = Total Value to Paid-in Capital, like MOIC time is not taken into consideration for estimating the value of the investment, it is the multiple on the total capital paid into the fund so far.

Investment review

Preface

The Surrey Pension Fund has been investing in Private market vehicles for over 20 years. Older investments, referred to as Legacy Investments, were selected directly by the Pension Fund Committee under advice from their Advisers at the time and tended to be Fund of Fund type investments in Private Equity and Infrastructure. More recently and most likely in future, Private Markets allocations will be channelled through Surrey's pooling partner BCPP, and they will be responsible for Manager Selection in Private Equity, Credit, and Infrastructure. BCPP have also created themed portfolios covering all types of private markets asset classes, called Climate opportunities and UK opportunities.

The first part of my report will cover an overview of the total value of all the outstanding Private Markets investments as of the 30th June 2024. I will then drill down and quantify those investments than can be described as investments in "Renewables", and where possible I will present and comment on the performance of these investments.

Total committed capital to Private Markets

Over the last 20 years Surrey has committed just under £1.878 billion to private market investments. Of that money £1.027 billion has been invested and £850 million has still to be invested. The Surrey Pension Fund has received £419 million of income and capital distributions from the investments it has made over that time.

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At the 30th June 2024, the fair value of remaining investments was £1.003 billion or 16.8% of the total asset value of the Fund. Of this current invested capital approximately £200 million or 20% of the private markets portfolio is invested in renewables. A further £100 million of the outstanding £850 million is expected to be invested in renewables in future. The expected net rate of return from these renewable assets is around 8% per annum. But as I will show in the detailed analysis below, the performance of individual investments can be highly variable.

Total committed capital to Renewables in the Private Markets Allocation

Table 1, Carve out of Renewables investments in Surrey's Private Markets allocation, 30th June 2024.

Private Markets renewable investments	Original Committed capital	Estimated current investment in Renewables		Expected over investment period	
Legacy investments	£m	%	£m	%	£m
Capital Dynamics	24.8	100	14.3	100	24.8
Pantheon GIF III	48	19*	10*	~20	10
Glenmont	45	100	55.4	100	55.4
BCPP					
Infrastructure series 1	300	13	37.4	30	90
Infrastructure series 2A	100	0	0	30	30
Climate opportunities 1	233	32	72.4	30	70
Climate opportunities 2	50	20	10	30	15
UK opportunities	90	0	0	~30	27
Total	800		200		322

*19% renewables at peak invested capital value of £60 million.

Table 1, above show the portion of Surrey's private markets allocation that can be described as directly invested in renewables. Three of these are Legacy investments made directly by the committee. The

Capital Dynamics and Glenmont funds are 100% invested in Energy Infrastructure assets, roughly 50% of the Capital Dynamics fund was invested in wind farms located in the UK and the US and nearly 100% of the Glenmont fund is invested in portfolios of wind generation assets across continental Europe. Pantheon Global Infrastructure Fund III is a generalist infrastructure fund which had at its investment peak 19% invested in renewables.

The rest of the allocation to renewables has been selected by BCPP as part of their Infrastructure investment series 1 and 2, and their Climate opportunities funds 1 and 2 and the newly launched UK opportunities fund. These funds are still in their investment phase and have currently allocated between 10 and 30% of Surrey's committed capital to renewables, once fully invested BCPP expect the allocation to rise to 30% of committed capital.

Legacy Investments

The Legacy funds are fully invested and are in or about to enter the harvest and disposal period of their life cycle.

Capital Dynamics Clean Energy Infrastructure Fund II (vintage 2013)

Surrey's committed capital to this fund was £24.8 million. At its peak value, this fund owned 6 assets, 1 portfolio of onshore wind generation assets in the UK, 3 in the US, based in Texas and 2 combined cycle natural gas power stations. The wind assets were all development assets with a plan to build and operate and then dispose via a secondary sale.

The UK portfolio was sold in April 2022 and the sale proceeds resulted in a gross exit IRR of 11.3% equivalent to 2.4 times, multiple on invested capital (MOIC). Due to construction, operational and electricity price trading issues the 3 US wind assets have been written down to zero. Of these 3 assets Briscoe is now operationally revenue positive, but Green Pastures I and II remain operationally and financially challenged. The losses to date on all 3 of these assets means that there in unlikely to be any asset value recovered for investors, even if they were to become fully operational. Fortunately the electricity trading issues have been resolved and the liabilities are also zero.

The remaining natural gas generators in the fund have also experienced some operational and trading issues and due to relatively unfavourable market conditions (high interest rates, low energy/capacity prices), there was limited interest from the sponsor groups to start the exit process during 2023. As a result, their value has also been written down. However, more recently conventional power assets are regaining some interest from the investors due to the reliability of generation compared to wind and solar generators.

At the end June 2024 the IRR of the whole fund was -5.6%, equivalent to 0.63 times, MOIC.

Pantheon Global Infrastructure Fund III (vintage 2017)

As of 30th June 2024, of the US$ 60 million committed to Pantheon by Surrey, US$ 54.1 million or 90% has been committed to investments. The NAV of Surrey's investments is US$ 56.5 million, and a further US$ 18.5 million has been returned to Surrey via distributions on the disposal of assets. This means that on the invested capital the fund has delivered a net IRR of 10.4% or 1.4 times, multiple on invested capital (MOIC).

Pantheon Global Infrastructure Fund III, as mentioned above is a generalist Infrastructure fund and their definition of renewables in their 19% allocation is wider. Therefore only 8% is directly invested in renewable energy split between solar, wind and biomass, with a larger allocation of 11% in energy efficiency. In terms of geography 50% is invested in Europe, 38% in USA and 11% in Asia Pacific and the rest of the world.

Pantheon highlighted some of the assets in the fund, Project Sullivan, a portfolio of operational assets 40% of which are renewable energy. This project has currently achieved an IRR of 16% and 1.9 times MOIC and Pantheon are preparing some of the wind assets for a trade sale. The fund is close to the end of its investment phase, so it only has a few full exits to report one of these is Project Inti, a portfolio of solar assets in Italy where they managed to achieve an exit IRR of 30% and a 2 times MOIC. There are a few problem assets in the fund where the investment thesis has not completely played out as expected, but they reported none of these were in their renewable energy allocation. Pantheon confidently expects to maintain the fund's overall expected IRR of 10% as the fund seeks to liquidate its portfolio of assets over the next 3 to 4 years.

Glennmont Clean Energy Fund (vintage 2018)

Mandate summary

Glennmont Partners Fund III (GPF III) is a single strategy fund that invests directly in renewable infrastructure in Europe, the total fund size is Euro 850 million. At inception the deployment of capital is expected to be 60% to 80% offshore and onshore wind, 15% to 25% solar with the balance in biomass electricity generation. Geographic distribution is targeted to be 20% each in UK and France, and 25% each in Germany and Italy, with the balance in other EU countries. Surrey have committed capital of Euro 45 million to this fund.

Performance update

When we met Glenmont in November 2023 they said that operating and financial conditions had worsened for wind and solar investments. As a result they expected that future returns would be lower.

In this report which they presented in November 2024, based on the most recent valuation of the fund on 30th June 2024, the fund's net IRR has fallen to 5.1% compared to 6.5% in the year to 30th June 2023, the TVPI has fallen slightly from 1.12x to 1.1x, and the distribution yield has fallen from 7% to 4%.

Over the last two and half years, with the majority of the fund in its construction phase, higher costs, have had an impact on profitability. Weaker energy prices, higher interest rates and reduced government support has also depressed valuations. Glenmont pointed out that the price of most of their generation capacity has been contractually agreed and while some of the prices are capped, they are aligned to inflation which will increase the value of future revenues. Glenmont reminded us that the strategy of the fund was to buy and develop clusters of energy generating assets that have sufficient size that could then be sold on to other investors who want to benefit from a long term inflation aligned cash flow, with low operational and maintenance costs. They expect the range of buyers to be quite diverse including utilities and manufacturers who are looking to replace legacy high carbon generation, Sovereign Wealth and Pension funds for the inflation aligned cash flows, energy distribution companies and even Oil companies, who are emerging as a buyer in order to diversify their businesses. They also noted that in the last year high net worth and Family office investors were becoming interested in these assets. Now that the fund is fully invested the balance of activity has switched from origination to asset management and gradually the resources of the "exits team" are being increased.

Investments to date

The fund is now fully invested and has delivered its first sale, a wind farm at Goudelancourt in northern France. With the investment phase completed the shape of the actual portfolio of assets can be seen, it is slightly different to expectations at launch but not materially. The fund is well diversified by stage of development, geography and technology. The stage of development split is operational assets 36%, assets under construction 57% and under development 7%. All projects are in the Euro-Area, by country Finland 17%, Germany 21%, Italy 17%, Portugal 7% and Spain 38%. Solar is the dominant source of generation at 43%, onshore wind 34%, offshore wind 21%, and other 2%.

BCPP Infrastructure, Climate and UK opportunities funds

Infrastructure investments (vintage 2019 onwards)

Preliminary valuation data to 30th June 2024, for Infrastructure series 1, suggests a net return of 8.5% (ranging between -10% and +27%) and a TVPI of 1.1, (ranging between 0.7 and 1.8). No data is currently available for Series 2A.

In Series 1 BCPP appointed 25 different GPs. At the sector level BCPP are around the middle of the expected range of deployment with slightly more Core plus and slightly less Core and Value Add strategies. In terms of the regional distribution, the GPs appointed are expecting to find more opportunities in the USA and fewer in Europe, Asia and the rest of the world. Across the 3 sub-series, on average 80% of committed capital is invested and around 11% of capital has been distributed.

The Series 2A appointment phase began on 1st April 2022, in total 9 GPs were appointed representing over 99% of Surrey's commitment. The only change in strategy between series 1 and 2 is the regional allocation where the USA has been increased from 20-40% to 30-50% and Asia has been changed from 10-30% to 0-30%. At the moment 52% of committed capital is invested and 1.5% of capital has been distributed.

Renewables Investments to date

Infrastructure series 1 and 2

Like Pantheon BCPP is a generalist Infrastructure investor looking to build a portfolio of investments across the whole infrastructure universe not just in renewables. BCPP's target allocation to renewables is 30% of invested capital. Series 1 infrastructure is 80% invested with about 13% in 3 renewable energy funds, these investments were made in 2019/20. Series 2A (2022) has no investments in renewables at the moment but only 52% of the committed capital has been invested. The failure of the team to make any more recent investments in renewables reflects the availability of reasonably priced assets. The difficulties the sector has had in recent years, coping with over-valuation and the impact of higher interest rates, inflation and regulatory change, as reported by the specialist managers reviewed above.

Preliminary performance data provided by Northern Trust suggests that the 3 renewable investments in aggregate have achieved a net IRR of around 10% and a TVPI of 1.2x.

Climate Opportunities (vintage 2021 onwards)

The objective of the Climate opportunities 1&2 is to invest in "Transition Alpha". This means not just operational renewable assets such as power generation but also the companies that are leading the development and rollout of new technologies that will be part of the transition of the "built economy" enabling a resilient and sustainable lower carbon future.

At the end of June 2024 BCPP have committed all the series 1 capital of which 40.5% has been invested and 0.9% distributed. For Climate opportunities series 2, 24.5% of the capital has been drawn and 19.6% invested. At the moment 32% of series 1 capital is invested in renewables and 20% of series 2. The objective is to have about 30% of capital invested in renewables.

It is too early in the life of these funds to have any meaningful performance data for either of the Climate opportunities funds.

UK Opportunities (vintage 2024)

BCPP's Infrastructure and Climate opportunities funds are looking invest globally, whereas the objective of the UK opportunities fund is to invest a in portfolio of Private markets investments that are domiciled solely in the UK. BCPP have indicated that between 20% and 60% could be invested in UK infrastructure of which 50% of that allocation could be in renewables, meaning that 30% of this fund could also be invested in renewables.

Adviser view

The review above shows that the Surrey Pension Fund has invested significantly in renewables as part of its investment in private markets. At the end of June 2024 the whole Fund was valued at £5.85 billion, of this 16.8%, approximately £1 billion, was invested in all types of private market assets.

The invested allocation to renewables had an estimated value of £200 million, or 3.4% of total assets. Based on the investment thesis of the BCPP private markets investment programme this should reach a capital invested value of approximately £300 million, or 5.5% of total assets. It is important to note that this is the value of the invested capital and that the Fund will not realise the full value created for some time and with no certainty until the assets are sold.

The review shows that investment in renewables is not a guarantee of success, because these investments are subject to the same uncertainties as all other types of private and public market investment. As the Capital Dynamics fund shows it is possible to lose all your capital by investing in wind farms. Glenmont's portfolio has seen its returns decline due to changes in costs, valuations, macro and regulatory issues. While the expected return from the Glenmont fund is likely be reasonable, provided they are able to execute their exit strategy, it is unlikely to be as high as expected during the offer period. Pantheon were able to report some significant successes but even they pointed out that conditions had become less favourable and expected lower returns from renewables in future. BCPP have also found it difficult to buy reasonably priced renewable assets in recent years and when pressed in the recent promotion period for Series 3 of their Private Markets programme they were unwilling to increase the expected return forecasts.

I believe that in the current market conditions the Fund's allocation to renewables is about right and if valuations improve BCPP have enough flexibility to take advantage of the opportunity through increased allocations via their Infrastructure funds, Climate opportunities funds, and the most recently launched UK opportunities fund. As can be seen in the 12th November press release below with respect to the first investment for their UK opportunities fund.

"Border to Coast has committed £48.5m to Capital Dynamics' Clean Energy UK Fund which will finance the build of onshore solar and wind farms as well as battery storage. The investment will be put to work constructing four wind farms in Scotland, set to add some 193MW of energy to the UK grid, enough to power 46,000 homes, with further sites in the pipeline."

Anthony Fletcher – Independent Adviser to the Surrey Pension Fund

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