

**SURREY COUNTY COUNCIL**

**PENSION FUND COMMITTEE**

**DATE: 14 SEPTEMBER 2018**

**LEAD OFFICER: KEVIN KILBURN, ACTING SECTION 151 OFFICER**

**SUBJECT: PRIVATE EQUITY INVESTMENT: PERFORMANCE REVIEW**



**SUMMARY OF ISSUE:**

The Surrey Pension Fund has a commitment to invest 5% of the fund in private equity. This is achieved by investing in funds of funds and direct funds, managed by a number of private equity specialists.

The Pension Fund Committee reviews the private equity strategy. This report is a review of the investment performance of the private equity portfolio.

**RECOMMENDATIONS:**

It is recommended that:

- 1 The Committee note the Fund's Private Equity holdings, respective funds investment performance and review from the Funds investment consultant and independent investment adviser.
- 2 The Fund continue to commit to drawdowns of the existing private equity schemes, and consider new opportunities to the Pension Fund Committee for approval as and when they arise.
- 3 Approve the recommendation of the Fund's investment consultant, Mercer, to invest a further £30-40m in new private equity fund with its defined characteristics.
- 4 Approve for officers to work with Mercer and the independent advisor to research the market for appropriate private equity providers with these defined characteristics and bring a further recommendation to the pension fund committee.

**REASON FOR RECOMMENDATIONS:**

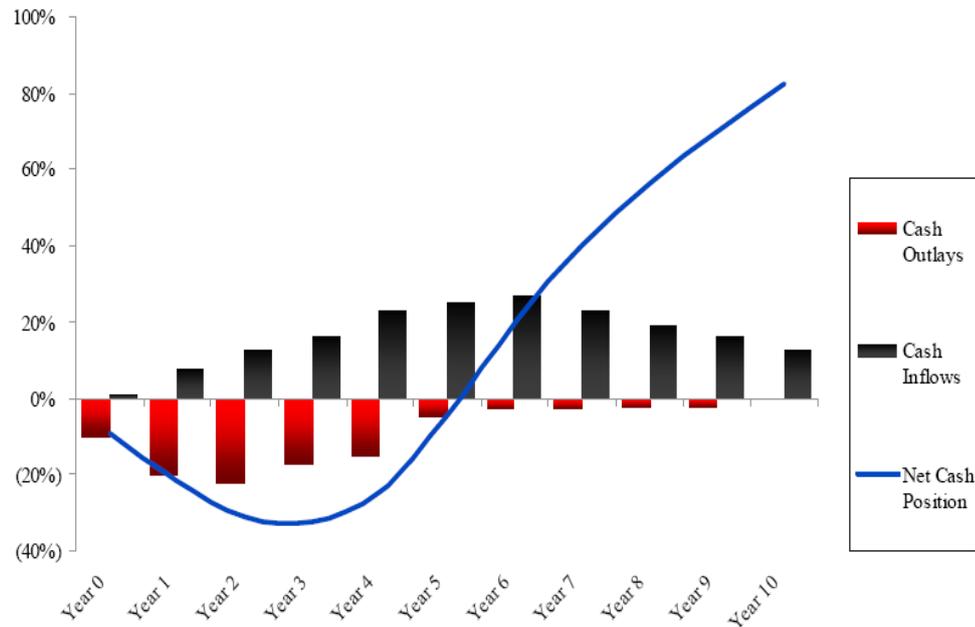
A solid framework of review is required in order to benefit from this long term asset category.

**DETAILS:**

**Background**

- 1 Private equity investments are equity investments in private companies.

- 2 It is a long term investment to provide capital to privately traded companies to fund growth or liquidity to certain shareholders.
- 3 The typical lifetime of a private equity fund in the region of ten years plus from an investment (drawdown) phase to the final distribution phase, with the returns weighted to the second half of the fund life.
- 4 Returns in the early years tend to be negative as capital is paid out to make investments, cover associated transaction costs and pay management fees, leading to the J-Curve effect (see graph below):



### Current Position

- 5 The detailed position on commitments and cash invested as at 31 March 2018 is shown in Annex 1 and is summarised as follows:

	Value (£m)	% of Fund
Total Commitment	444	11.0%
Investment drawn (paid in capital)	300	7.4%
Commitment Outstanding	144	3.6%

	Value (£m)	% of Fund
Distributions Received	175	4.3%
Fair Value of Remaining Investments	245	6.1%
Distributions + Remaining Investments	420	10.4%

Where relevant valuations converted to £ equivalent as at 31 March 2018

- 6 Based on investment assets of £4,030m as at 31 March 2018, 9.5% of the Fund is committed to private equity investments. The actual level of investment (based on the Fair Value of the remaining investments) is 6.1% of the Fund versus the asset allocation target of 5.0% but this will gradually fall back in line with the allocation target, when future distributions are received from existing holdings.

- 7 The Fund's independent advisor has produced a summary of the Fund's existing private equity holdings and an analysis of the benefits. This is shown as Annex 2.

### **Performance Measurement**

- 8 An updated Public Market Equivalent (PME) calculation for each scheme's asset value to 31 March 2018 is shown in Annex 3.
- 9 As at 31 March 2018, the calculated internal rate of return (IRR) for the private equity cash flows portfolio of partnerships currently active is 7.7% versus a benchmark from the MSCI World Index of 12.4%, an underperformance of 4.7%. The current target performance return against the benchmark is +5%.

### **New private equity investment**

- 10 In order to ensure that the Fund remains consistent to its target asset allocation of 5% to private equity it should make regular investments. This is to ensure that a time / vintage diversification is achieved and that the Fund is positioned to take advantage of opportunities in a structured way.
- 11 In addition, as the Fund is currently in the process of receiving distributions from its existing private equity holdings, the value of the private equity portfolio will erode over time and fall below the target allocation of 5%.
- 12 The Fund's investment consultant, Mercer, have produced a report (included as Annex 4) which recommends a theme of private equity for new investment, within the context of its existing holdings.
- 13 The recommendation defines the following characteristics as being desirable:
- Global
  - A preference for infrastructure
  - A focus on sustainable or renewable energy
  - Consider complementarity with strategies being implemented by Border to Coast partner funds

### **CONSULTATION:**

- 14 The Chairman of the Pension Fund has been consulted on the report.

### **RISK MANAGEMENT AND IMPLICATIONS:**

- 15 Risk related issues are contained within the report.

### **FINANCIAL AND VALUE FOR MONEY IMPLICATIONS**

- 16 Financial and value for money implications are contained within the report.

### **DIRECTOR OF FINANCE COMMENTARY**

- 17 The Acting Section 151 Officer is satisfied that all material, financial and business issues and possibility of risks have been considered, and that private equity has been a good performing asset class for the pension fund.

#### **LEGAL IMPLICATIONS – MONITORING OFFICER**

- 18 There are no legal implications or legislative requirements associated with this report.

#### **EQUALITIES AND DIVERSITY**

- 19 The review of the Fund's private equity programme will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

#### **OTHER IMPLICATIONS**

- 20 There are no potential implications for council priorities and policy areas.

#### **WHAT HAPPENS NEXT**

- 21 The following next steps are planned:
- Officers to work with Mercer and the independent advisor to research the market for appropriate private equity providers with these defined characteristics and bring a further recommendation to the pension fund committee
  - Continued monitoring of private equity fund partnerships and a performance review report to be brought to the committee on an annual basis

#### **Contact Officer:**

Neil Mason, Head of Pensions

#### **Consulted:**

Pension Fund Committee Chairman

#### **Annexes:**

Annex 1: Detailed position on commitments and cash invested at 31 March 2018

Annex 2: Summary report from the Fund's Independent Advisor

Annex 3: Public Market Equivalent (PME) calculation for each scheme's asset values to 31 March 2018

Annex 4: Mercer recommendation report

#### **Sources/background papers:**

Private equity manager reports