



Report of: Corporate Director of Resources

Meeting of:	Date	Agenda item	Ward(s)
Pensions Sub-Committee	21 st June 2021		n/a

Delete as appropriate	Non-exempt	
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Appendices 1 and 2 attached are exempt and not for publication as it contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: Information relating to the financial or business affairs of any particular person (including the authority holding that information).

SUBJECT: PRIVATE DEBT PROCUREMENT OPTIONS

1. Synopsis

- 1.1 This is a further update report on outcome of the due diligence of three managers included in the LCIV private debt offering and Project Monument-a collaboration of LA procurement of private debt.
- 1.2 MJ Hudson were commissioned to conduct an investment and operations due diligence on the three managers and the summary opinions and recommendations are attached as Exempt Appendix 1 and 2 for consideration.

2. Recommendations

- 2.1 To consider and note the due diligence summary report of Key terms and performance comparison attached as exempt Appendix 1
- 2.2 To consider the consolidated summary opinions report attached as Exempt Appendix 2.
- 2.3 To agree with the report's recommendation of the preferred two managers (one European and one US private debt manager) that best delivers value for money, meet the fund's mandate specification and will deliver returns to keep contributions sustainable.
- 2.4 To agree to allocate 50% of the fund's total allocation of 10% in this first tranche of appointments to give diversification

- 2.5 To agree to delegate to the Corporate Director of Resources, in consultation with the Acting Director of Law and Governance , authority to negotiate and agree terms and conditions of the fund management agreement(s) with the recommended and agreed manager(s).

3. Background

Introduction

- 3.1 The 2019 actuarial valuation was completed in March 2020 and as part of the process, preparatory work was undertaken to determine the funding position and an investment strategy review that could support sustainable contributions from employers. The agreed target investment return of CPI+3.2% was re-evaluated in the light of Covid-19 impact on markets. The risk and return target options were discussed and a new target investment return of CPI +2.8% was proposed with asset allocation changes that would support the short to medium term net negative cashflow position of the Fund and also achieve our decarbonisation and governance goals.
- 3.2 Private Debt asset class is privately negotiated debt typically used when public loans are not available to the borrower, and usually used to finance privately owned companies. Some of the characteristics include direct loan contracts with strong covenants secured by the firm assets if your loan is a senior debt. The main risks include defaults and illiquidity.
- 3.3 Members agreed an Islington Private Debt mandate specification at their December meeting. Three processes of procurement were explored at the March meeting; a fiduciary manager, LCIV and existing Project Monument (a private debt offering secured through the collaboration of five local authorities in 2018). Members agreed to proceed with LCIV and Project Monument. Officers were instructed to conduct a due diligence on the managers covered under the LCIV private debt offering and Project Monument.
- 3.4 Three managers had to be scrutinised because one US manager is common to both offerings and the European Managers are different. MJ Hudson were commissioned to conduct the due diligence and have provided a summary report on the key terms and conditions of all three managers attached as Exempt Appendix 1 and a consolidated summary of opinions on the three managers also attached as Exempt Appendix 2.
- 3.5 The Key terms and conditions report-Exempt Appendix 1 covers summarised investment objectives, fees and key fund terms and track record. A snapshot of commonalities concludes that all three managers have the same target return, two of the managers target Europe and one targets US. The record of accomplishment between the 2 European managers show there is no material differences in performance even though one has a longer track record. There are however, differences on the baseline fees quoted as shown in table 2.
- 3.6 Exempt Appendix 2 – Consolidated summary of opinions gives more details of each of the managers' firm structure, overall assessment that covers operations, ESG and points to consider.
- 3.7 **Summary**
- The LCIV has a Private debt offering of a US and European manager. It is a fund of fund model and all investments require an equal split to both managers on the platform. The LCIV will charge a second layer of fees for management of 0.075% and,

have not reached scale for better fee structure discount. Total commitment for LCIV is currently £290m equally split between the two managers.

- The Project Monument's private debt also offers a US and European manager. Existing LA commitments means fees negotiated are as competitive and both managers are willing to allow Islington to group their investments with other London Monument investors for fee discount purposes. Current commitment is US manager £250m, European £350m.
- Since both proposals have the same US manager and base fees fairly the same, the decision to be made is between the two European managers. The due diligence report makes a recommendation and members are asked to consider the summary opinions and agree to allocate to the preferred European manager.

3.5 Members also need to take into consideration the following issues;

- that Private debt can take 3 to 5 years to reach full allocation
- a plan needs to be in place on how soon we want to reach full strategic allocation of 10%
- cash flow matching of these commitments
- manager vintages for diversification
- availability of managers because investments are generally in closed funds.

4. Implications

4.1 Financial implications

4.1.1 The cost of providing independent investment advice is part of fund management and administration fees charged to the pension fund.

4.2 Legal Implications

The Council, as the administering authority for the pension fund may appoint investment managers to manage and invest in a private debt portfolio on its behalf (Regulation 8(1) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended)).

A competitive tendering exercise has been undertaken for the appointment of a private debt manager in accordance with the requirements of the Public Contracts Regulations 2015 and the council's Procurement Rules. The council has conducted an independent due diligence to ascertain its own assurance of the appointed managers. The sub-committee may appoint the highest evaluated manager as recommended in Exempt Appendix 1, provided that it is satisfied that their offers represents value for money and is satisfied as to the matters set out in paragraph 4.2.2.

The sub- committee must

- (i) reasonably believe that the recommended investment manager's ability in and practical experience of financial matters makes them suitably qualified to make investment decisions for the Council
- (ii) have proper regard to the advice of the Corporate Director of Resources and its external advisers, in relation to the proposed appointment.

4.2.2 In considering the recommendations in this report, members must take into account the information contained in the Exempt Appendices 1 and 2 to this report.

4.3 **Environmental Implications and contribution to achieving a net zero carbon Islington by 2030:**

Environmental implications will be included in each report to the Pensions-sub committee as necessary. The current agreed investment strategy statement for pensions outlines the policies and targets set to April 2022 to reduce the current and future carbon exposure by 50% and 75% respectively compared to when it was measured in 2016 and also invest 15% of the fund in green opportunities. The link to the full document is <https://www.islington.gov.uk/~media/sharepoint-lists/public-records/finance/financialmanagement/adviceandinformation/20192020/20190910londonboroughofislingtonpensionfundinvestmentstrategystatement.pdf>

4.4 **Resident impact assessment**

None applicable to this report. The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The council must have due regard to the need to tackle prejudice and promote understanding.

5. Conclusion and reasons for recommendation

5.1 Members are asked consider the options of procurement and consider the recommendations in Exempt Appendix 1 and 2 and if in agreement then powers should be delegated to the Corporate Director of Resources, in consultation with the Acting Director of Law and Governance, authority to negotiate and agree terms and conditions of the fund management agreement with the two managers.

Background papers:

None

Final report clearance:

Signed by:



Corporate Director of Resources

Date 18 June 2021

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