**Summary**
- LGPS pooling has enabled schemes to more actively invest in private equity, private debt and infrastructure.
- Investing in listed equity and fixed income was the first priority for the pools, but now attention is turning to private assets.
- LGPS is turning to private assets for for illiquidity premia, diversification and yields, especially as many are now facing a cashflow-negative situation.
- Illiquidity, fee structure and performance monitoring are some of the concerns when investing in private assets.

# Going private

**Pooling has given local authority pension schemes the scale to invest in private markets, but progress remains slow. Sara Benwell explores**

When the Local Government Pension Schemes (LGPS) were compelled to pool their assets, the government suggested that there were several compelling reasons.

Of course, the main premise was to cut costs, improve funding and achieve economies of scale. But there was also an underlying political motivation to increase schemes' ability to invest in UK infrastructure, boosting the UK economy.

And several of the pools announced ambitious plans to cut costs in other private markets too.

A whitepaper from Northern Trust highlights that some pools have already outlined plans to build in-house investment teams for private equity, private debt and infrastructure.

It says that many have invested in building multi-billion private market portfolios, giving them more capital to access attractive deals.

All of this suggests that investment in private markets generally, and infrastructure in particular, is on the up.

This is borne out by some of the recently reported activity across the LGPS pools.

The Local Pensions Partnership (LPP), which manages funds for the LPFA, LCPF and Berkshire, says that its members are definitely shifting more capital towards private markets.

LPP deputy CIO Richard J Tomlinson explains: "LGPS is quite different to private-sector corporate DB. When I joined, I thought these are punchy assets. But corporate DB is all about risk management and meeting long-dated cash liabilities. Most of the schemes are closed to future accrual, but the LGPS is still open.

"*[Our clients]* have all gone down the route of private assets, allocating in the 40 to 50 per cent range. That's a significant amount… a material proportion, and certainly our clients aren't the only ones investing."

**Slow and steady wins the race**

Despite the widespread appetite for

pensions pools to invest in private markets, much of the activity thus far has been centred around getting listed equity and fixed income vehicles up and running.

A trawl of the websites for each of the LGPS pools shows that getting these asset classes off the ground is moving quickly.

But there is plenty of evidence that many pools are gearing up to start more private asset investments.

For instance, the Border to Coast Pensions Partnership is committed to alternatives in general and private market assets in particular.

When it hired its first permanent CIO in September last year, CEO Rachel Elwell said: "Daniel *[Booth]* brings a strong understanding of the investment world, and in particular in private markets, an area of focus for us."

She has confirmed that such investment strategies remain a priority; investment activity so far has been centred around opening sub-funds for both internally and externally managed equity funds with the launch of alternatives capabilities planned for Q2 2019.

Brunel Pensions Partnership manages the investments for the pension funds of Avon, Buckinghamshire, Cornwall, Devon, Dorset, Environment Agency, Gloucestershire, Oxfordshire, Somerset, and Wiltshire.

Its private market portfolios consist of property, infrastructure, secured income, private debt and private equity.

Since it was set up, the pool has invested in a dedicated private markets team of five investment professionals, working across those asset classes.

It is developing its real estate proposition to have the capability to provide capacity for 10 per cent infrastructure allocations. In its autumn report, it said that current allocations to infrastructure stand at £1,450 million, or circa 5 per cent of total assets, with £843 million invested and a further £210 million committed but undrawn.

It also reported that it had received new money commitments of £398 million to its infrastructure portfolio.

A Brunel spokesperson says: "Pooling has transformed Brunel's capacity and capability to invest in infrastructure. The scale of invested AUM in infrastructure and dry powder at the pool's discretion has attracted interest from international pension funds and investment managers alike."

Of course, while the pools can create opportunities for local authority schemes to invest in alternatives, the strategic decisions remain firmly in the hands of the schemes themselves, meaning total allocations will vary on a fund-by-fund basis.

**The quest for yield**

The case for private-asset investment is well documented, with many schemes turning to the class in the hunt for illiquidity premia, diversification and yields.

Tomlinson highlights that many LGPSs are heading into a cashflow-negative situation. This means that they are thinking about two main sets of challenges, the need to generate yield and the importance of protecting against inflation.

As such, investment in real estate and infrastructure makes sense, as schemes are trading liquidity for yield.

Northern Trust SVP business development pensions, fiduciary managers, sovereign entities EMEA, Ian Hamilton, explains: "Alternatives – particularly direct real estate and infrastructure – have desirable characteristics in terms of providing investment alpha but also in demonstrating liability-matching characteristics such as generating income and being inflation-linked.

"The introduction of pooling and the associated economies of scale generated has provided some funds with the opportunity to access these asset classes at a more attractive pricing point than in the past."

**Getting the governance right**

While there are obvious benefits to investing in private markets, the asset classes are not without their challenges.

Tomlinson argues that his biggest concerns are around what might happen if a scheme needs to access funds quickly. For instance, if high allocations to illiquid private assets meant that a scheme needs to sell off equities that are down 30 per cent.

He says: "Going back historically people were worried about leverage, but it's liquidity I worry about… In a few years we'll have a liquidity shock that will make people open their eyes."

Increased oversight and governance are the most important considerations for LGPS going down the alternatives route. Illiquidity concerns can be overcome with good planning, but schemes need to carefully consider the future strategies they may need to adopt.

Tomlinson adds: "The better your planning before the event the better. Schemes need to ask: "If we have to raise cash what are the options? Do you want a credit facility in place? What collateral can you pledge to the lending bank? If you go and talk to the high street when there's a crisis it's too late.

"If you have illiquid assets, you could move that to a derivative position and free up probably 80 per cent of the cash, but you need a framework and plan. You'll need infrastructure and people who are deeply experienced to manage these things in place and ready to take action."

Fee structure and transparency of reporting is another potential hurdle for schemes.

Hamilton argues that alternatives present monitoring challenges, because private market investment strategies do not usually offer the same level of transparent reporting that are seen in public markets.

This means schemes can struggle to get hold of the kind of information such as performance data, strategy and risk analytics.

Hamilton explains: "Obtaining clarity over fees can present challenges as even standard industry practices for alternative investment fees can lead to misunderstanding. The way the LGPS is addressing these challenges is influencing how they build out their alternative asset allocations.

"And schemes need to make sure that the pricing is right, to make sure that they are taking advantage of any illiquidity premium. If demand is too high, the pricing can get so expensive that this trade off between illiquidity and yield is lost."

**Written by Sara Benwell, a freelance journalist**

**The shift towards ESG**

One of the implications of pooling in the UK has been a shift towards more direct investment.

This is a trend that is already well established in the Netherlands and gaining traction in the Nordics.

According to Nothern Trust's UK institutional investor group head Mark Austin: "The Dutch market in particular is well evolved in in terms of having the size and scale to turn up to deals with enough firepower at the table and enough people with the skills to make it happen.

"In the Nordics, there is a lot of interest in increasing allocation to alternatives and making a difference with those investments, such as investment in infrastructure and environmentally-sustainable projects."

Earth Capital UK managing partner Jim Totty agrees that private assets, and in particular private equity, can help schemes to develop their sustainability plans.

He says: "Growth capital private equity is an attractive asset class to provide LGPS investors with exposure to the sustainable investment sector.

"Growth capital provides the patient, long-term capital needed to bring investee companies through to profitability and to deliver sustainable investment returns."