ITEM NO: 5(c)

GREATER MANCHESTER PENSION FUND

ALTERNATIVE INVESTMENTS WORKING GROUP

19 April 2013

Commenced: 9.30am **Terminated: 11.00am**

Present:	**Councillor Cooney (Chair)**	
	Councillor Pennington	
	Councillor Ricci	
	Councillor Ward	
	Councillor Houle	
	Mr Mulryan	**UNITE**
	Steven Taylor	**Head of Pensions Investments**
	Daniel Hobson	**Pension Fund Investments Group**
	Nigel Frisby	**Pension Fund Investments Group**
	Raymond Holdsworth	**Pension Fund Investments Group**
Apologies for Absence:	**Councillors Bretherton and Lambert**	

18. DECLARATIONS OF INTEREST

There were no declarations of interest.

19. MINUTES

The Minutes of the proceedings of the Alternative Investments Working Group held on 1 February 2013 were approved as a correct record.

20. CAPITAL DYNAMICS – ANNUAL REVIEW

Messrs J Gripton and M Drugan of Capital Dynamics Ltd attended the meeting to present the annual review of the Private Equity (PE) portfolio to 31 December 2012. Mr Gripton began with an overview of developments at Capital Dynamics and then updated members on how the Private Equity environment continued to build on the progress that had been made since the tentative economic recovery began. It was considered that 2006 – 2008 vintage funds would probably prove the most challenging.

With regard to GMPF's Private Equity portfolio, the return for 2012, at 5.0%, was a small improvement on the return achieved in 2011. Although the pace of drawdowns and distributions increased from the levels seen in 2011, they remained below those levels seen between 2006 and 2008.

It was reported that GMPF had made seven new fund commitments totalling £67.7m in 2012, increasing total active commitments to £659.5 million at the year end. One further commitment, of £15.0 million, had been made in Q1 2013.

It was reported that the portfolio return since inception had remained relatively stable, at 16.7% and, although uncertainty remained with regard to the global economic situation, the prospects for long term Private Equity returns were considered to remain attractive.

RECOMMENDED
That the report be noted.

21. PRIVATE EQUITY – REVIEW OF STRATEGY AND IMPLEMENTATION

The Executive Director of Pensions updated the Working Group on private equity activity during 2012/13, described the current private equity policy, described the current holdings position and briefly outlined the strategic position of the private equity portfolio and the proposed investment programme.

It was reported that despite a difficult fund raising environment for private equity funds and mixed investment /exit activity in various markets, GMPF remains on track to fully invest the target annual allocation, together with the backlog, by the end of 2013.

The estimated value of GMPF's private equity portfolio is now £291m, which represents approximately 2.4% of the value of the Main Fund, versus the target of 4.0%. In terms of geographic exposure, the portfolio is currently underweight the US and Asia.

Officers firmly believe that, despite weaker short and medium term performance, private equity remains an attractive asset class and accordingly it was recommended that the medium term strategic allocation for private equity remains at 4% of the Main Fund value.

The issue of 'stage exposure' of future new commitments was discussed and, on balance, an equal exposure of 40% large buyout and 40% to mid-market funds was recommended, with the 20% balance allocated to "Venture/Other".

There is an increasing range of "specialist funds", which have historically exhibited consistent and attractive returns and which may be of interest to GMPF in the future. This is in contrast to returns from venture capital funds, which are particularly volatile and which may be of less interest to GMPF going forward. Accordingly, it was recommended that the stage allocation be amended so as to include a combined allocation to "Venture/Other" funds.

In terms of the geographic spread of future new commitments, both Capital Dynamics and GMPF agree that a limited degree of 'home bias' may continue to be appropriate. On balance, it was recommended that the geographic allocation be amended by reducing the allocation to Europe by 5% and increasing the allocation to Asia by 5%.

In reviewing the implementation of current strategy in 2012, it was recommended that the annual average rate of commitments be increased from £80 million to £100 million. It would take a number of years for this increased rate of annual commitments to have a notable effect on the valuation of the private equity portfolio and thus no further change was recommended in the report.

RECOMMENDED
That:
(a) The medium term strategic allocation for private equity remains at 4% by value of the total Main Fund assets,

(b) The target geographical diversification of the private equity portfolio is amended as follows, to reflect a smaller bias toward Europe and an increased exposure to Asia:-

Geography	Target Range
EUROPE, inc UK	**45% to 50%**
USA	**40% to 45%**
ASIA	**10% to 15%**

(c) The investment stage diversification of the private equity portfolio is amended as follows, to reflect a more equal exposure between mid-market and large funds, recognition of the increasingly global nature of the large buyout space and to enable modest commitments to specialist/other types of fund:-

Geography	Large Buyout	Mid Market Buyout	Venture/Other
EUROPE, inc UK	**35% to 45%**	**40% to 45%**	**15% to 20%**
USA		**30% to 35%**	**25% to 30%**
ASIA	**45% to 50%**	**45% to 50%**	**0% to 10%**

(d) The scale of commitment to funds is maintained at £100 million per annum.

(e) The Fund continues to implement the revised private equity strategy via 3 year programmes as detailed below:-

Geography	Large Buyout (£m)	Mid Market Buyout (£m)	Venture/Other (£m)	Total Number of Funds
EUROPE, inc UK	**5 – Direct/FoF**	**4 - Direct**	**2 – FoF**	**8/9**
USA		**3 – Direct/FoF**	**3 - FoF**	**8/9**
ASIA	**3 FoF**			**3**
				20

Geography	Large Buyout (£m)	Mid Market Buyout (£m)	Venture/Other (£m)	Total (£m)
EUROPE, inc UK	**105**	**59**	**24**	**139**
USA		**40**	**34**	**124**
ASIA	**37**			**37**
				300

(f) It continues to be recognised that the portfolio may not fall within the target ranges at (b) and (c) above for a number of years, because of transitioning from the previous target ranges.

22. INFRASTRUCTURE – REVIEW OF STRATEGY AND IMPLEMENTATION

The Executive Director of Pensions updated the Working Group on infrastructure activity during 2012/13 and described the current infrastructure policy, the current holdings position and briefly outlined the strategic position of the infrastructure portfolio and the proposed investment programme for 2013/14.

It was reported that this immature portfolio, valued at £74 million as at 31 March, 2013, was 0.6% of the estimated value of the Main Fund and that it would take time to build towards the 3% target allocation. In terms of geographical and investment stage diversification, it was reported that new fund commitments would work towards achieving targets over time.

The report detailed a review of current strategy which concluded that the target allocation of 3% to infrastructure should remain unchanged and no changes to the geographic or investment stage allocation targets were proposed at this time.

A review of the implementation of the infrastructure programme was given in the report and it was concluded that the annual average allocation to new commitments to infrastructure should be maintained at £75 million per annum to work towards achieving the 3% allocation over time. In order to maintain a degree of flexibility within any single year of the 4 year programme, it was recommended that target new commitments be maintained within the range of £50 million - £100 million per annum (averaging £75m per annum) across between 2 and 4 new funds per annum (averaging 3 new funds per annum).

It was reported that, as the scale and geographic spread of investments within the Infrastructure portfolio increased, there would be a need for a periodic review of staffing levels. Potential recruitment was planned within the Investments Group to cover overall staffing levels and any further such resource issues would continue to be considered as part of future annual strategy reviews, or otherwise, if this proved necessary.

RECOMMENDED
That:

(a) The medium term strategic allocation to infrastructure funds remained at 3% by value of Main Fund assets.

(b) The target geographical diversification of the infrastructure portfolio remains as follows:-

Geography	Target Range
EUROPE, inc UK	40% to 60%
N AMERICA	30% to 40%
ASIA-PACIFIC/OTHER	0% to 20%

(c) The split of total portfolio commitments remains as follows:-

Investment Stage	Relative Risk	Target Split
PRIMARY/EVERGREEN	HIGHER	67%
SECONDARY	LOWER	33%

(d) The scale of new fund commitments is maintained at between £50 million - £100 million per annum (averaging £75m per annum) across between 2 and 4 new funds per annum (averaging 3 new funds per annum), to work towards achievement of the strategy over the coming years,

(e) It continues to be recognised that the portfolio may not fall within the target ranges at (b) and (c) above for a period of years, because of transitioning from the current portfolio composition.

23. SPECIAL OPPORTUNITIES PORTFOLIO: APPROVAL OF INVESTMENT

Consideration was given to a report of the Executive Director of Pensions, which sought the Working Group's endorsement of officers making an investment of £35 million each in two Absolute Return Funds as part of SOP.

Members were informed that in October 2011, a report was presented to the Working Group seeking support for a potential investment in an 'appropriate' Absolute Return Fund. A copy of which was appended to the report.

The Working Group supported the recommendation, however, concerns were expressed about Hedge Funds and in particular the risks of the types of activity and approach taken by Hedge Funds. The Head of Pensions Investments had advised Members that officers would only invest in Absolute Return Funds which used such approaches/tools as leverage, shorting and derivatives to a limited degree. Furthermore, he had stressed the degree of Adviser support for Absolute Return Funds and had pointed to the fact that two Advisers had suggested that officers should look at Absolute Return Funds. In addition, the Fund's Actuary suggested that GMPF should invest at the 'top end' of the range of typical SOP investment size.

The characteristics of an 'appropriate' Absolute Return Fund were detailed within the report.

After an extensive process of reviewing available funds in the market, officers had selected two funds for commitments of £35m each.

The Executive Director of Pensions then explained that during the course of the selection process, it became apparent that some of the investment activities and approaches undertaken by one of the selected funds would not sit comfortably alongside the Head of Pensions Investment's undertaking given to the Working Group on 21 October 2011 when 'Type' approval for an Absolute Return Fund was endorsed.

An overview of the proposal regarding the fund in question was detailed and it was explained that, as the officers had come to understand the approach in greater detail and become more familiar with it, it was considered that the risks were not as great as was perhaps believed in October 2011. Officers remained strongly of the view that an investment in the fund should proceed.

RECOMMENDED
That the officers' decision to invest £35 million in each of the two funds detailed in the report as part of the Fund's Special Opportunities Portfolio, be endorsed.