



## COMMENT

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## Appetite for infrastructure?

The private equity investment landscape is a healthy one as local government pension funds increase their allocations to private equity investments. This LGC Investment reader survey has revealed that the number of local authorities with more than 6% of their portfolio value in private equity has increased in excess of 15% over the past year.

In addition to a more positive outlook for private equity, the survey highlights that we are at an inflexion point for infrastructure allocations. Local government pension funds need and want to increase their exposure to these assets but issues around how to achieve this and increasingly uncertain regulatory frameworks are holding back significant commitments. This is detrimental to investors, infrastructure managers and the broader economy.

Just over a third of the local government pension funds surveyed are invested in infrastructure and, positively, more than 75% will be in the future. This evidence of increased appetite is supported by recent successful infrastructure fund raisings, the majority through unlisted funds.

The concern over structures and the regulatory framework reflects two things. First, frustration among investors that the industry has applied the private equity closed end fund structure, with fees on commitments, a carried interest component

and a 10-year life, to infrastructure assets.

These investments are inherently longer term in nature and steady performance rather than outperformance is the objective. A new solution needs to be found. Second, increasing uncertainty around regulatory regimes for infrastructure across many jurisdictions has undermined investment propositions. Interestingly, in the most stable and reliable infrastructure markets this has highlighted the real regulatory risks many infrastructure assets carry.

Investors have a clear preference for inflation protection and long-term liability matching that has led to the favoured nature of equity investment in UK demand-based assets. It is no surprise market activity over the past 12 months has been directed towards UK utilities with significant premiums paid over regulated asset value for water and gas distribution assets. With the improving economic outlook, it is possible more economically sensitive infrastructure assets will become more attractive given their scope for higher returns with a limited increase in risk.

Overall, we find local government pension funds are positive on the future for unlisted investments. Allocations to private equity are on the increase and there is a willingness to commit to infrastructure if solutions to the key issues can be found.

# Surveying you

LGC Investment's latest reader survey, in association with SL Capital Partners, questioned local authorities and fund managers about their current investment strategies and their attitudes to certain asset classes

**R**ecent research from LGC, commissioned by SL Capital Partners, has identified how the agility and flexibility of local pension fund authorities has assisted funds in adapting to a challenging economic environment to maximise investment income, at a particularly volatile time for all investors.

As part of the research, local authority councillors, officers, advisers and fund managers were surveyed about their current statutory investment strategies and the components of their asset portfolios. The research also explored the attitude towards certain asset classes, including private equity and infrastructure investments, and the appetite for increasing allocation to them.

The helpful responses, taken with the results of previous LGC surveys, again demonstrate the skill and professionalism of councillors, officers, advisers and fund managers to adapt to complex and ever-changing investment environments within challenging local authority and economic contexts.

### Overview

Interestingly, equities were ranked highest among the asset classes by local authority

pension fund professionals, though this was closely followed by private equity and real estate. Infrastructure was placed fourth with bonds and fixed income viewed as the least attractive. These rankings across the Local Government Pension Scheme enable further scope for analysis on a broader platform.

### Private equity

Responses to the survey about private equity indicated that more than 70% of fund authorities were invested in this asset class. Significantly, the research showed that among the 78% of those invested in private equity, the asset class made up between 3% and 10% of their portfolios' total value. How universally representative this finding is remains an interesting question.

Equally as significant is the confidence shown by respondents to the level of expected returns from their exposure to private equity, with 65% anticipating returns between 11% and 20%.

A further 30% of respondents anticipated returns of up to 10%. Effectively, more than 90% of responses demonstrated a strong level of market

Continued overleaf

# Investment strategies for investment

FIG 1: WHAT PROPORTION OF YOUR PORTFOLIO VALUE IS MADE UP BY PRIVATE EQUITY?

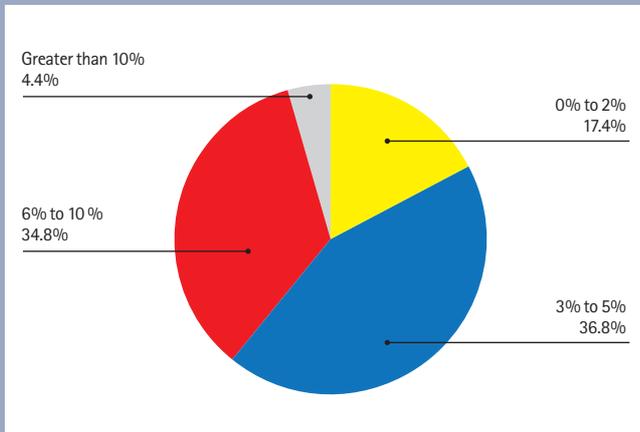


FIG 4: DO YOU BELIEVE THE PRESENT MARKET PRESENTS A GOOD TIME TO INCREASE ALLOCATIONS TO PRIVATE EQUITY INVESTMENTS??

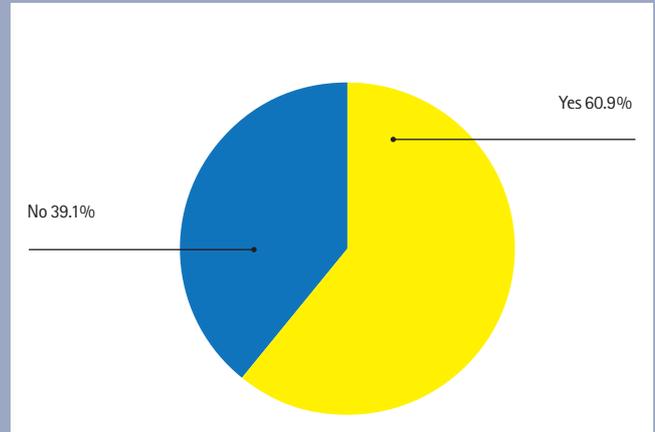


FIG 2: WHAT RETURNS ARE YOU LOOKING FOR FROM YOUR PRIVATE EQUITY INVESTMENTS OVER THE NEXT FIVE YEARS?

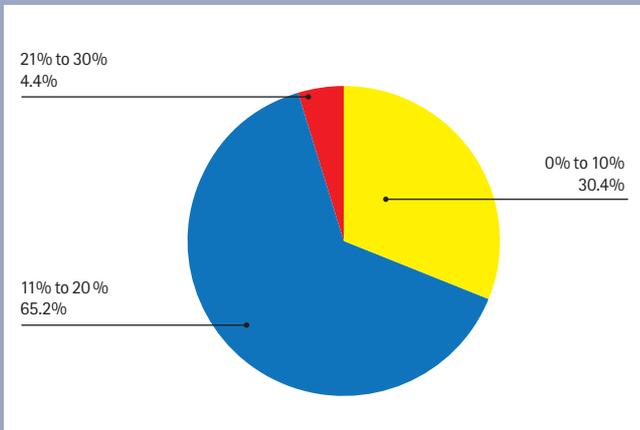


FIG 5: ARE YOU GOING TO INCREASE YOUR ALLOCATION TO PRIVATE EQUITY?

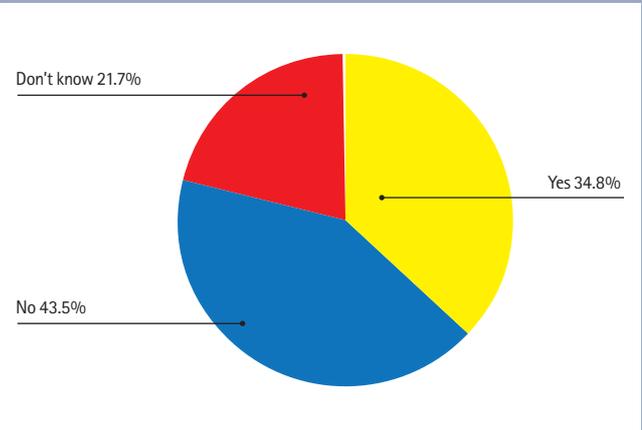


FIG 3: IS YOUR ALLOCATION TO PRIVATE EQUITY AT THE LIMITS SET BY YOUR ADVISORS /TRUSTEES?

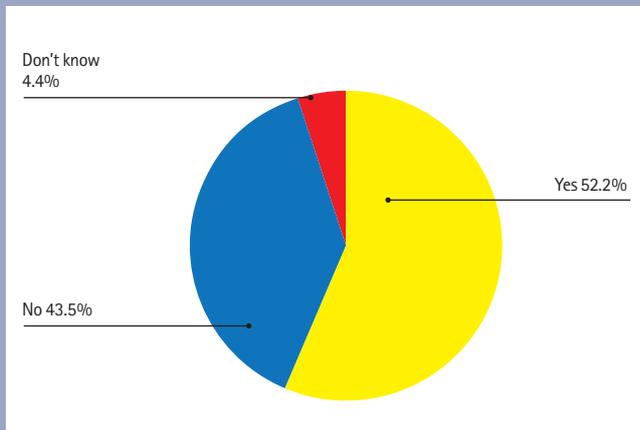
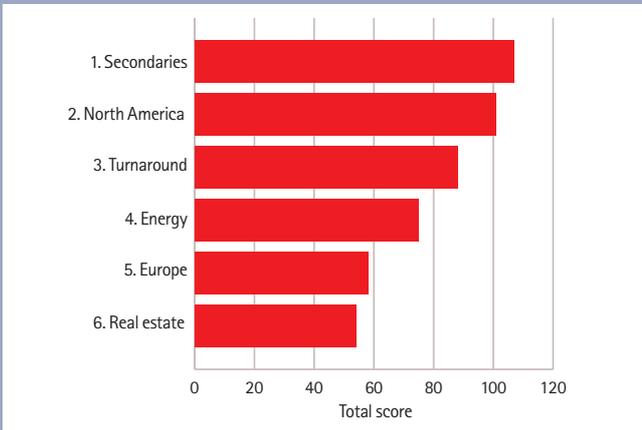


FIG 6: RANK IN ORDER OF ATTRACTIVENESS THE FOLLOWING SUB-SECTORS OF THE PRIVATE EQUITY MARKET





“We are very encouraged by the increasing importance that local authority pension funds are placing on allocations to private equity

FIG 7: DOES YOUR PENSION FUND AUTHORITY CURRENTLY INVEST IN INFRASTRUCTURE ASSETS?

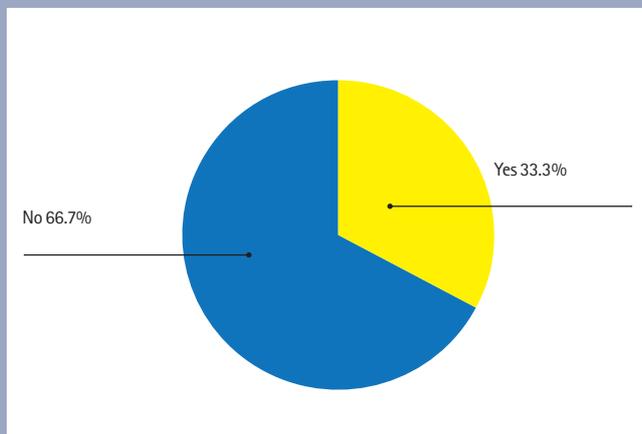


FIG 8: WHAT IS YOUR CURRENT INVESTMENT STRATEGY ALLOCATION IN INFRASTRUCTURE INVESTMENTS?

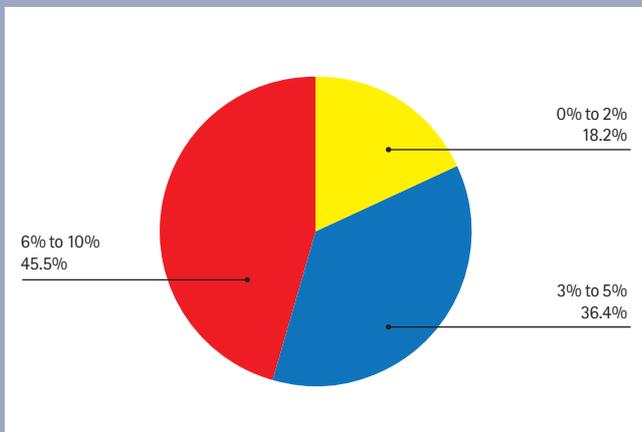
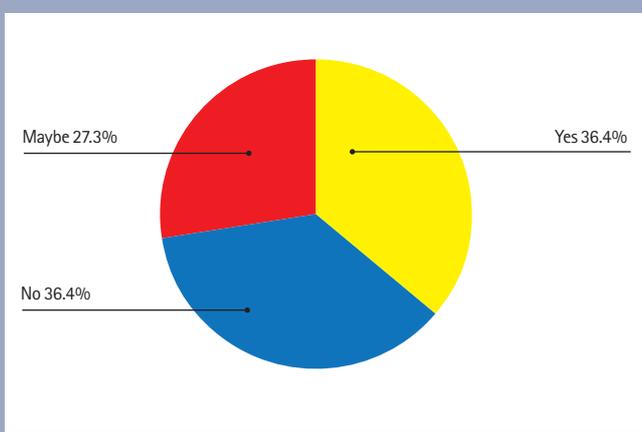


FIG 9: ARE YOU PLANNING TO INCREASE OR DECREASE YOUR ALLOCATION TO INFRASTRUCTURE INVESTMENTS?



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confidence. More than 50% of survey participants confirmed that their allocations were set by a combination of trustees (councillors) and advisers.

Further confidence in private equity investments was again expressed, as 61% of fund authorities reported that the present market provided a good opportunity to increase existing investment levels, though just over a third of the respondents indicated that such a step had not yet been realised.

Peter McKellar, chief investment officer of SL Capital Partners, comments: “We are very encouraged by the increasing importance that local authority pension funds are placing on allocations to private equity. It reflects the continued relevance of this form of company ownership that can deliver positive results and returns for all stakeholders.”

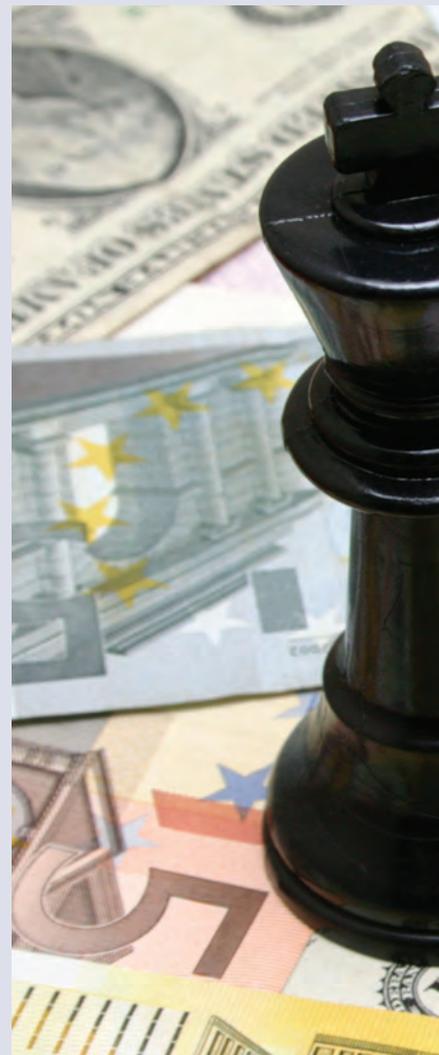
**Infrastructure**

The topicality of infrastructure investment provides a timely context to this element of the survey, particularly given the importance attached by the government to its relevance within growth policies for the UK economy.

While the government’s prime focus is on private sector pension funds to further their policies, there is some belief that there are opportunities for local government pension fund authorities to engage in this objective as well.

The survey responses suggest that 33% of local authorities are currently invested in infrastructure and, on average, there was a high level of satisfaction with this decision, and indeed a reasonable level of satisfaction with the extant regulations.

Current allocations within



investment strategies were predominantly within the range of 3% and 10%, with none in excess of 10%. Interestingly though, 63% of survey participants expressed immediate or likely intent to increase their allocations. Once again, this indicates a latent, if not actual, degree of confidence in the infrastructure asset class and its expected returns.

As to the type of infrastructure investment, the range of opportunities in Fig 10 best illustrates funds’ positions.

Target returns envisaged by fund authorities were equally as variable. Significantly, 50% expected returns to fall within a healthy 5% to 8%, with another 17% of respondents



**Strategic move: survey participants intend to increase their infrastructure allocations**

indicating it to be up between 9% and 12% (see Fig 11).

In terms of geographic sector allocations, responses showed that the UK was most favoured, with global investments a very close runner. Infrastructure debt was least favoured.

More specifically, investments by type favoured exposure firstly to equity in PPP demand assets (such as water companies and rail) followed by equity in PPP availability assets (such as hospitals and schools) and equity in economically sensitive assets (such as airports and regional ports).

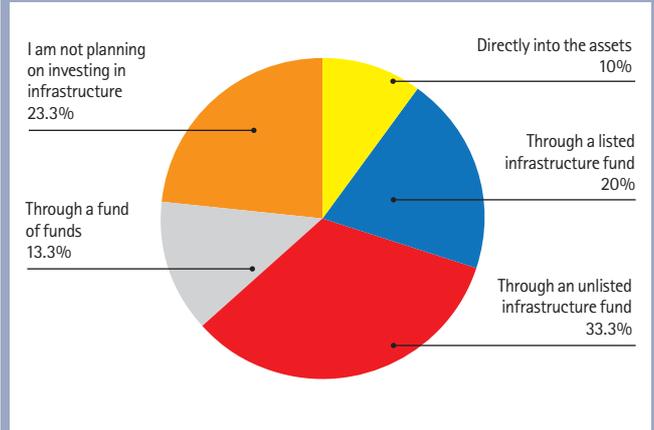
Fund authorities were invited to rank key attractions when making decisions about infrastructure investments,

with long term investments and inflation hedging being the standout attractions for making an investment in infrastructure in order of preference.

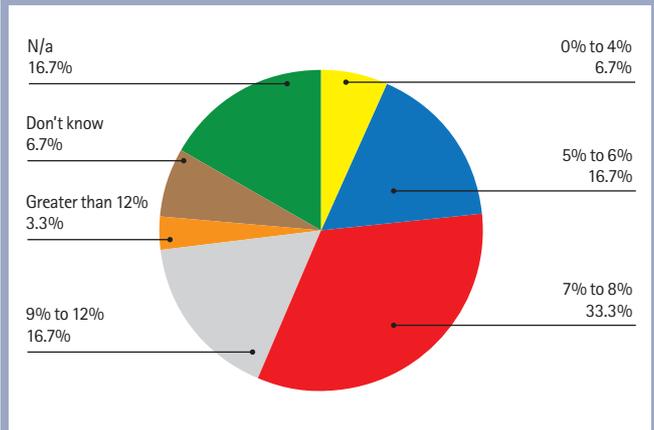
“Infrastructure investing has, to date, not fully delivered on its potential as an asset class,” says Dominic Helmsley, managing director, infrastructure, at SL Capital Partners.

“Given the positive characteristics of the assets for all pension funds, there is a clear incentive for all parties to create an improved model of ownership and risk management in the future. It will be important for both the investment returns and the UK economy in general,” he adds.

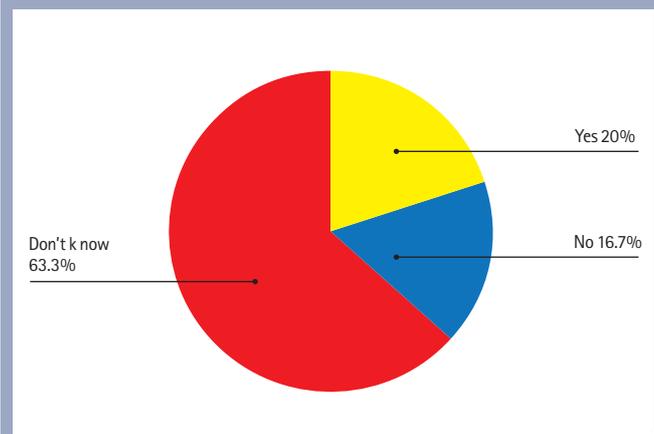
**FIG 10: HOW DO/WILL YOU INVEST IN INFRASTRUCTURE?**



**FIG 11: WHAT ARE YOUR TARGET RETURN EXPECTATIONS FROM INFRASTRUCTURE?**



**FIG 12: ARE YOU LIKELY TO INVEST IN/SUPPORT THE NAPF'S INFRASTRUCTURE INITIATIVE, THE £2BN PENSIONS INFRASTRUCTURE PLATFORM?**



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