

National Framework

A cross pool working group on infrastructure has been formed, with representatives from all the Pools. The working group has met over 3 days so far.

The officers representing the Pools agreed they are committed to working together, to determine current capacity and capability, share and develop experience and skills in infrastructure development, and explore options for a more formal National Initiative on Infrastructure Investing.

Discussions identified significant shared common ground and some key starting considerations:

- Pools and individual Funds within Pools are at different stages in terms of current strategic allocations to Infrastructure. Most Pool allocations range from 3 – 5% but individual Fund's range between 0 – 10%.
- Current internal resources and capability varied across Pools. Majority of Pool's exposure is in funds managed by external managers. Exceptions are the Joint Venture between GMPF & LPFA and a few co-investments, club deals and bespoke funds made by some Funds.
- The range of funds invested in also varied across geographies (UK, Global), managers, and most significantly risk / return budgets (ranging from low risk, cash flow based investment to more development based, value added opportunities)
- Funds also have different environmental expectations in infrastructure
- Funds are generally increasing exposure to Infrastructure and see a National Initiative as providing access to the asset class for Fund's who have previously seen barriers to investing, providing the risk / returns were in line with each of the Fund's expectations.
- Pools, whilst committed to the principle of a National Initiative for use when appropriate, may have additional requirements (e.g. risk appetites) for Infrastructure investments, either at a Fund or Pool level, and would not want to avoid being forced into specific investments. Thus different Fund appetites will probably require different solutions.
- Pools will not support any initiative that did not exclude political intervention (either local or national) in making investment decisions.

Market research

The Cross pool group has taken evidence from a range of infrastructure fund managers and from other large investors with experience in infrastructure.

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| • Hermes | UK closed and open ended. |
| • Macquarie | Global closed ended. |
| • JP Morgan | Global open ended. |
| • Partners Group | Direct & Funds global closed ended. |
| • PiP | UK Infrastructure Platform |
| • GMPF/ LPFA Joint Venture – GLIL | UK direct |

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| • Telstra | Australia Pension Fund |
| • PGGM | Dutch Pension Fund |
| • Ontario Pension Board | Canadian Pension Fund |

Although the managers and funds were all different, many of the following themes were repeated in their presentations.

- There is an excess of capital in the market. The challenge is in deploying the capital well given the competition for deals.
- To be treated seriously by vendors, you have to prove you are a competent and credible partner, which requires committed capital and governance structures that allow you actively engage and deploy capital at speed.
- Infrastructure investing requires a considerable amount of time and expertise. Significant resources and capabilities are required to manage direct.
- Replicating the scale and expense of specialist managers' resources and expertise is not a credible option even over the medium term; knowledge transfer and greater involvement is however, both possible and desirable, as dedicated capital and resource are built.
- Many investors have gained experience by partnering with a fund manager and gain access to co investments through that manager.
- Advantages to co investments through fund managers include full access to due diligence and legal documents, as well as enhanced governance rights such as a seat on boards.
- Nonetheless, co-investors should not underestimate the level of time and commitment involved in the process.
- Experience has shown the path from investing with funds through to the capability of investing direct can take 10-15 years.
- Given the excess of capital any initiative should seek to collaborate with, and avoid competition with other managers as much as possible, particularly across the LGPS.
- There are concerns about the structures used by some infrastructure managers which can be relative short term and poorly aligned with investors' objectives. However, many managers are looking at alternative vehicles which will offer a better fit, including "open" funds and "long term, buy and hold" vehicles.

The managers were generally clearly interested in working with a National Initiative, potentially seeing it as an important strategic client/partner. A number of ways of structuring this relationship would be possible. Managers are happy to share knowledge and experience with the Initiative, helping the initiative to build up their own expertise, and they would understand (and even expect) the National Initiative becoming more independent after a period of time.

7. Interim Conclusions

After discussions, the working group felt it considerable progress had been made and it was possible to identify some key conclusions and considerations to take forward to the next stage.

- It was felt that infrastructure investment by the Funds should be directed through the Pools. The Pools would have the responsibility to determine the arrangements which would suit their members the best, include the extent of any participation in the National Initiative. However, all Pools would at the very least benefit from sharing knowledge and would explicitly seek not to compete against each other.
- It is immediately evident that collaboration will be greatly facilitated through working as a small number of Pools rather than 89 Funds (indeed, collaboration on a particular opportunity was facilitated by one of the meetings!)
- It is also apparent that, when appointing external managers or investing in infrastructure funds, there will be considerable scope to achieve significant cost savings through collaboration, and this should be an early priority for the National Initiative. The difference between an individual Fund investing £20m in an infrastructure fund and the Pools working together to put £500m in the fund could see fee savings of 30% to 50%.
- Furthermore, as such a key investor, there will be considerable opportunity to improve governance rights, negotiate better/more appropriate structures (e.g. longer term vehicles, greater UK investments) and gain priority access to co-investment opportunities.
- In terms of direct investment in infrastructure, leading on deals is not considered an option outside the UK, and would only be feasible in limited circumstances within the UK, such as smaller or simpler projects, given current and near term future levels of appropriately skilled resources.
- Furthermore, given the level of interest in infrastructure, adding to the number of primary market participants and increasing competition would not be advantageous, and instead it is better to work in partnership with others as much as possible.
- Thus, working actively with other investors and investing directly as a co investor, is regards as the appropriate mechanism for the LGPS to make direct infrastructure investments. It is consistent with the experience of other investors as they built up expertise in infrastructure. As co-investor we would seek to be proactive and be of sufficient capability to ask and challenge – i.e. to be an intelligent shareholder / partner. Investing as a co-investor would enable us achieve considerable reductions in overall fees as well as greater control over the selection and management of our investments. The approach would enable us to build on and leverage existing resources in the market.
- Overall we expect a “hybrid” model to emerge across the Pools, with some investment in funds and some direct investment through co-investments and other bespoke structures, with widespread collaboration to reduce costs and increase capacity. Funds would remain important, particularly in areas such as international exposure, specialist funds and development exposure.

- There will be a need for sufficient resources at both a Pool level and a national level to support more direct investment effectively, and we are aware that experienced infrastructure professionals are in high demand and expect to be well remunerated.
- It is important that appropriate delegations are in place to ensure decisions can be made quickly when opportunities arise. Individual Fund's may have specific Investment criteria but typically will be managed by the Pools in association with the National Initiative, and any referrals back to Funds would be at an early stage and on a strategic basis rather than about detailed terms.
- There are a number of possible approaches and structures for a national initiative, and several market participants that we could work with. It is anticipated that the National initiative will need to procure the services of a number rather than just one in order to access all relevant areas of the asset class to satisfy the risk/return requirements of individual Funds and Pools.

Next steps

The cross pool working group as agreed to continue meeting through the rest of the year to develop a National Initiative further. Key next steps are likely to consist of the following:

Options Identification	Identify the various specific options which could in theory provide the capacity and capability we need.
Options analysis	Determining requirements in terms of legal structures and vehicles, regulatory requirements, governance etc., to support the options, together with analysis of costs, advantages and disadvantages.
Option selection	Identification of key criteria to assess options. Determination of the preferred options to take forward, including possibly combining options.
Initial Implementation	Developing the necessary structures to take the Initiative forward and start implementation.
Partnership procurement	Selecting the partners to work with going forward, which may involve a formal EU procurement or other structured search.
Operation	Start using the established initiative to make investments in this space.

One challenge for the National Initiative is that we cannot go too far until such time as the Pools themselves are properly constituted and regulated. These means that development of the national

Initiative may lag the development of the Pools by some months, however we will seek to go as far as we practically can subject to these limits.

Summary

The cross pool group has examined various options for investing in infrastructure and has developed a practical way forward which recognises market realities but would support an enhanced capacity and capability in infrastructure. The group considers there to be exciting opportunities to collaborate and increase capability so the LGPS can identify good infrastructure investment opportunities which meet the financial and other needs of the individual Funds while helping to contribute to the UK economy and build a stronger Britain.

Northern Pool is very supportive of the work of the cross pool group and looks forward to the group continuing to develop collaboration and work towards a national initiative in the next stage.