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PRIVATE MARKETS CLUB

Welcome to portfolio institutional's first dedicated private markets section. To kick-off our bio-monthly coverage, we analyse the various alternative asset classes to discover if the investment case measures up and look at how institutional investors are managing the illiquidity.

THREE PENSION FUNDS, A CHARITY AND A SHORTAGE OF AFFORDABLE HOUSING

The LGPS leads the charge on cutting social housing waiting lists. *Andrew Holt* reports.

As an indication of ESG investing in action, the Local Government Pension Scheme (LGPS) has been busy investing in a number of affordable housing projects.

The largest LGPS fund – Greater Manchester – has invested £100m into an investment fund developed and managed by Legal & General (L&G) to deliver affordable homes across the Northwest of England.

This new regional vehicle is a structured extension to L&G's Affordable Housing fund, launched in July to develop high-quality, sustainable affordable housing nationally.

It is tailored specifically for the Northern LGPS, of which Greater Manchester is a member, to allow them to deploy capital into affordable housing development specifically in the area.

Councillor Eleanor Wills, chair of the Greater Manchester Pension Fund, said: "We are proud to continue our longstanding partnership with Legal & General to launch a specific vehicle for Northern LGPS that supports the government's plan to provide much-needed affordable homes for hardworking families while ensuring strong, low-risk returns to secure the pensions of our members."

This is part of institutional investment from pension capital playing an increasingly important role in unlocking more homes across the UK, with the sector offering secure inflation-linked returns alongside positive social impact within local communities.

The fund has a strong identified pipeline of new homes which will be developed and operated by Legal & General Affordable Homes, with £1bn invested in affordable housing and more than 8,000 homes in operation or development to date.

The second scheme, the Gloucestershire Pension Fund, has invested £30m in social impact property fund manager Resonance's National Homelessness Property Fund 2.

A £20m slice of this will be invested into buying and refurbishing around 90 properties in Gloucestershire to reduce the number of households in unsuitable temporary accommodation.

Attracting capital

Resonance said that the homelessness property funds model operates by attracting capital from institutional investors, such as pension funds, to acquire properties, refurbish them to a high standard, improve their energy efficiency and lease them to housing partners, such as homelessness charities and housing associations.

For this project, social inclusion charity Developing Health and Independence (DHI) will lease the properties from the fund.

DHI will provide tenants with healthcare support, wellbeing and in finding employment and training opportunities.

Chris Cullen, head of homelessness property funds at Resonance, said he is grateful for Gloucestershire Pension Fund's place-based investment into the fund. Adding that this "illustrates the difference that local government pension funds can make to the area in which their members live".

Thirdly, London CIV, the LGPS pool that serves all London boroughs and the City of London, has teamed up with The Church of England to make a combined £104m "anchor" commitment into Man Group's Community Housing Fund 3.

The initial capital investment in the shortened and trendily named Man CoHo 3, is to enable more than 350 energy efficient, affordable family homes to be built in areas of constrained affordability across the UK.

It is the first step towards an initial capital raise of £300m, funding the delivery of 1,000 homes during the next few years.

This latest investment in affordable housing is the fifth since the LCIV UK Housing Fund was launched in March 2023.

The LCIV UK Housing Fund was launched by London CIV to enable its 32 partner funds to invest in affordable housing, which can reap benefits such as income that typically tracks inflation, high occupancy, low void rates and low correlation compared to other real estate sectors.

Christopher Osborne, head of real estate at London CIV, said: "We look forward to Man CoHo 3 driving returns for our underlying partner funds and through its impact framework accelerating the delivery of much needed new and quality affordable homes in the UK."

In addition, The Church of England's Social Impact Investment programme, managed by the Archbishops' Council, was established in 2020 to respond to the growing need for investment-based models to tackle social challenges in England, including the housing crisis and the need for a just energy transition towards net zero.

These moves by institutional investors come as many councils grapple with mounting financial pressures, with £2.29bn spent last year on providing emergency temporary accommodation to homeless households, an increase of 29% from the previous 12 months, according to homeless charity Crisis.

INTERVIEW – VANESSA SHIA

"Private markets offer so much."

The head of private markets at London CIV talks to *Andrew Holt* about the attraction of alternative assets, gearing investment plans to client needs, the ESG backlash and the importance of believing in yourself.

How do private markets fit into London CIV's investment portfolio?

Our committed assets in private markets stand at about £3.5bn. That is within an asset pool of £33bn across London CIV and means that private markets are about 10% of our total assets. They are clearly a key growth area of focus for our partner funds.

What have London CIV's partner funds asked for on the private markets front?

Currently, there is a tilt towards income generation over more growth-orientated opportunities. That has been across real estate, private credit, infrastructure and natural capital.

Each partner fund has different holdings across different asset classes and has different views on asset allocation. But the commonality amongst most of our client base is a focus on deployment, liquidity, diversification, investing with impact as well as achieving value for money.

Which private markets do your partner funds want exposure to and why?

There is certainly a range of attractive segments across private markets that we are well positioned in.

I'll start with infrastructure, which has tailwinds coming from digitalisation and decarbonisation. It is also being fuelled by artificial intelligence adoption, which makes renewable energy investing more compelling.

There will be a rise in infrastructure secondaries. That is obviously a way for investors to recycle capital and to obtain liquidity where it's required.

In a lower interest-rate environment, we can expect multiples to go up with improvements in valuation, creating a more attractive deal environment. And a more positive macro outlook is clearly positive for assets which benefit from GDP growth.

Fundamentally, infrastructure has that inflation linkage, which is attractive in a high-inflation environment. The uplifts in valuation and the more positive macro backdrop are certainly supportive of this.

Moving on to real estate, we are seeing demand definitely picking up. There continues to be a shortage of properties, which support rent and revenue growth. We are seeing a stabilisation in valuations as well as opportunities, whether that is across logistics, the residential sector or affordable housing.

This aligns with structural trends: whether that is ageing demographics or the need for more energy-efficient buildings.

There are certainly some regional differences. Leasing activity in London has certainly picked up more than in other European cities. There is continued demand for high-quality office space with good amenities, good infrastructure, good transport links and good ESG credentials. The real estate sector will also benefit from lower financing costs.

Logistics is an area that could be attractive. With the trend more towards re-shoring, we are seeing strong rental growth in logistics. Within these sectors, there is a strong linkage to inflation. There is also resilient cashflows and typically less exposure to market volatility.

Moving to private credit, this is an area that will continue to benefit from the pullback of traditional bank lenders in private lending. It has performed well in a high interest-rate environment, and there is strong growth across asset-backed finance and middle-market lending.

In private equity, deal activity is reviving. That has been supported by a more favourable interest-rate outlook and in a more favourable rate environment, as we hope to see more M&A and IPO activity.

And then with increasing artificial intelligence adoption and integration, this is definitely driving a lot of investment within private equity.

Do you, therefore, have any new private markets investment plans?

Our investment plans are typically shaped by our clients' requirements and our desire to invest across different thematics.

But this is in conjunction with the private markets' investment team and with our views on where we think the most attractive opportunities are given the market backdrop.

The missing gap in our product offering is private equity. So it is an area we have been thinking about, to come up with a structure and a potential solution – along with any potential strategic partners that can help us deliver this.

And there is that greater government push for pension schemes to invest more directly in the UK. We are continually engaging with managers, various government departments and industry groups to identify where those opportunities are and how we can invest in them.

There is an obvious need for more local investment to help support environmental and social impacts, but also now with a greater focus on biodiversity.

Our partner funds, along with the wider strategy, determine where the asset allocation is. And, coupled with the Mansion House reforms for the LGPS, we expect them to direct how we will invest in the years to come and what solutions and funds we need to help meet them.

You mentioned it, but what do you think about the government pushing pension schemes towards private markets?

There is under-investment in the UK, whether that is in infrastructure or real estate, so we need to invest in the UK. It is not unreasonable.

We are supportive of doing more in the UK. Having UK investments has always been a core allocation for us.

How important is ESG within your private markets investments?

Absolutely essential. It is integral throughout our investment process – our due diligence process and the ongoing monitoring of our managers. It is also fundamental to long-term value creation and risk management.

Within our due diligence process, we assess the ESG credentials not only of the manager, but also of the fund and the underlying assets. And to the extent that they are very much aligned with our sustainability goals, but also ensure they generate the financial returns we require.

And, with a sizeable investment in private markets, we have a fiduciary duty to shape the ESG practices of our underlying managers. Getting managers to improve their provision of ESG metrics and reporting also helps to evolve best practice.

Presumably, it was in line with your ESG approach that London CIV was quick to launch a renewable infrastructure fund.

We launched our dedicated multi-manager Renewable Infrastructure fund in March 2021, as we forecasted that we would reach the sector limit within our core infrastructure fund of 30%. So we maxed-out our renewable infrastructure allocation, and at that point, given the expected growth, we saw an attractive opportunity set within renewables.

A number of our partner funds had asked us to launch a separate renewables fund that can invest across renewable energy generation, transmission and distribution, but also opportunistically invest in other enabling technologies in the energy transition, whether that's battery storage, electric vehicle charging or green hydrogen development.

Has it proved popular?

It has. It is our largest private markets fund constituting more than half of our overall commitments in private markets, with 56% of that portfolio invested in renewables. The number of investors in our Renewable Infrastructure fund stands at 16.

Is the backlash against ESG a worry? Will it have an impact on private markets?

There has been a backlash, but it hasn't impacted us directly. The fact is the whole world is decarbonising, with most countries having set some sort of net-zero target. Whether it's done in six years' time, 20 years or 30 years, that's the path. That trajectory is only going one way.

I genuinely don't think this backlash is going to have any material impact on the growth of, for example, the renewables market.

Why, in your view, are private markets so popular with institutional investors?

First and foremost, private market investments are uncorrelated with public markets. There's more stable pricing and valuations. And, in a low interest-rate environment, it provides much higher yields.

It allows greater diversification in terms of how you can invest to address any specific investment needs and objectives. You can invest across the risk spectrum of asset classes like infrastructure and private credit.

So there are predictable stable income streams that's obviously tilted towards income generation, or you can invest in private equity, which enables you to invest in high-growth private companies.

In terms of impact and sustainability, there is definitely that real world direct impact. Private market investing aligns well with institutional investors like pension funds and insurance companies that have long-dated liabilities that private markets investments have.

Will private markets continue to enjoy such popularity?

Absolutely yes. Given all that I have just outlined, private markets offer so much. The fundamental drivers underpinning the overall opportunity will certainly remain.

> **There will be a rise in infrastructure secondaries.**

What are the flaws of investing in private markets?

Liquidity risk certainly is high on the list when investing in private markets, so you have to acknowledge that you will be locked up for extended periods in terms of deployment.

In terms of the cost of investing, your private markets investment funds are more expensive than public-market funds.

And a challenge, not necessarily a flaw, is accessing private markets. Such investments are also complex, requiring a lot of knowledge.

You have been in your role for more than four years. What has been your biggest challenge and greatest achievement?

In terms of greatest achievement, we have been acknowledged for building a successful multi-manager platform. We have built the platform from scratch and it continues to grow.

From where we were four years ago and the relationship we have with our partner funds, there has been a lot of positive engagement. That has certainly built the trust and credibility with the partner funds and with the broader investment community.

What objectives have you set yourself and London CIV?

As we approach a new era for the LGPS, it is difficult to set specific objectives. Our over-arching objective is to be our partner funds' pool of choice and to continually deliver funds or solutions that meet their long-term investment objectives.

What has been the biggest lesson that you have learnt during your career?

Believe in yourself and believe in your team. Have conviction in your ideas and to see them through. To think through the logic and to be strong in that rationale when you are delivering on those ideas. It is also important to always take a step back and map out what you need to do and where you want to get to.

PRIVATE MARKETS

BUILDING RESILIENT PORTFOLIOS

London, 5 March 2025

PRIVATE MARKETS CLUB CONFERENCE

THE RISE AND RISE OF PRIVATE MARKETS

Andrew Holt dissects one of the biggest trends in institutional investing.

Private markets are very much the zeitgeist investment. Just take a look at the numbers. Alternative assets under management totalled $13.1trn (£10.6trn) in June 2023, having grown by nearly a fifth in each year since 2018, according to McKinsey. Industry estimates now expect this to expand by more than $20trn (£16trn) by 2030. These impressive numbers present a strong narrative for private assets.

Emmanuel Deblanc, chief investment officer of private markets at M&G Investments, says the growth of private markets is likely to remain strong, driven by structural and cyclical factors.

"The expansion is supported by the democratisation of private markets, with new products and regulatory changes allowing a wider range of investors to access these assets," he adds.

One of the key appeals is that private markets play a critical role in addressing long-term global challenges, such as infrastructure upgrades, climate finance and sustainable food systems.

"The resilience of private markets during periods of volatility also enhances the appeal, positioning them for sustained growth in the coming years," Deblanc says.

More specifically, the popularity of private markets comes from the obvious benefit of such investments being less correlated with their public asset portfolios. For Deblanc, this is not the only attraction. "Investors are drawn to the ability of private markets to align with impactful themes, such as the energy transition, financial inclusion and climate resilience, which can deliver financial and societal returns," he says.

This hasn't always been the case. There has been something of an evolution here. "If you go back 20 years it was quite difficult to invest in private markets," says Richard Tomlinson, chief investment officer of Local Pensions Partnership Investments (LPPI). "But in that time, the architecture and eco-system around private markets has developed dramatically."

The approach to private markets therefore has changed. "There was this view, which I reject whole heartedly, that you only invest in private markets if it gives you a return uplift – a premium compared to public [investments]. While I understand that, it is not a universal truth for everyone," Tomlinson says.

"That comes from if you are liquidity constrained," he adds. "Whereas, if you are not liquidity constrained, there is a slightly different conversation. It means you can invest in private markets because you like the asset or a pure play to exposure to a certain theme, or it has different sustainability characteristics."

Within LPPI's private markets approach it has a focus on UK infrastructure, which is backed by GLIL, a pension scheme-funded investor. It also has a large chunk of private credit, as well as a private equity portfolio.

Long-term benefits

What should not be overlooked, and alluded to by Deblanc, is the strong case for private markets over the longer term. In an example of its resilience, a study by Schroders highlights the proven track record of private equity to outperform during downturns.

"Global private equity outperformed the MSCI ACWI Gross index during each of the major disruptions with an average annualised excess return of 8%," says Verity Howells, investment research manager private equity at Schroders Capital.

"Even in the depths of the dotcom crash, where private equity was challenged due to its exposure to early-stage technology companies at the heart of the bubble, it still fared better than public markets," she adds. And stressing the point further, amidst the uncertainty surrounding Covid, private equity achieved annualised returns of 18%, while public markets delivered only a 2% return.

This resilience, Howells attributes to something of a different industry sector mix compared to public equities, and long-term capital structures that allow investors to hold investments and continue to deploy through market disruptions. This bodes well for investors into the future.

In addition, private equity firms typically target less cyclical industries, such as healthcare, business services and technology, while limiting exposure to banks and heavy industry. They favour less volatile cash-generating recurring revenue business models.

"The nature of private equity returns, which partly reflect unrealised gains, contributes to less volatile reported returns," Howells says. "These unrealised gains are based on changes in portfolio valuations and are guided by fair-value accounting. Post-reporting period developments can influence these valuations, as firms may incorporate recent positive events into their assessments."

Therefore, one big proviso in looking at a more long-term outlook for private equity is, it should be noted, that the industry

Private markets are not one homogenous blob.

Richard Tomlinson, Local Pensions Partnership Investments

> **New structures will continue to rapidly evolve as new investors enter the market.**
>
> Brent Patry, Blackrock

changed considerably between the dotcom crash in the early 2000s to the return of inflation in 2022, in terms of regulatory and accounting considerations, which could impact historical comparisons.

The financial crisis served as a catalyst for introducing more rigorous fair-value assessment practices, potentially resulting in private equity valuations having had less frequent mark-to-market assessments prior to that period.

But private equity should not just be seen as a positive investment in a past tense. In 2025, spurred by a more supportive rate environment and a restart of M&A and IPO activity, private equity is set to get a boost, says Brent Patry, head of equity private markets at Blackrock. "In our opinion, this will lead to a lot more activity across private equity, as firms look to deploy dry powder," he adds.

Positive trends in deal activity support this opinion. While still below the pandemic peak of 2021, deal activity in 2024 was up by 21% compared to the previous year and outpacing the pre-pandemic average by 45%.

There will also be further developments.

"New structures will continue to rapidly evolve as new investors enter the market. These investors are largely accessing private assets through evergreen fund structures and European long-term investment funds," Patry says.

Private lending

Going forward, Blackrock believes private debt and infrastructure will grow the fastest within the private markets arena.

As private debt continues to cement its status as a sizable and scalable asset class for a range of long-term investors, what is of interest is there is plenty of room for growth. At $1.6trn (£1.3trn) in global assets under management, the asset class accounts for 10% of the $16.4trn (£13.3trn) alternative investment universe. The momentum behind the growth of private debt is being driven by a few major factors.

"Private debt is taking on more funding previously executed in the public markets, which increasingly focus on deals that are prohibitively large for most middle-market companies," says Adam Ryan, chief investment officer of multi-alternatives at Blackrock.

"Companies are also relying on private lenders more for financing as they stay private for longer," Ryan says. "And they have come to value the certainty of execution and flexibility that private debt provides. At the same time, banks are more selective in how they use their capital. Lastly, investors have an increased comfort and familiarity with the asset class."

In addition, the definition of private debt continues to expand as private debt investors start to participate more in asset-backed finance, Oliver Wyman believes.

The market share of asset-backed finance held by private lenders is estimated at roughly 5% today, and private lenders are poised to fill in the gaps left by banks, as they have within corporate credit and real estate. "We expect this trend to accelerate in 2025, alongside growing appetite for such private-debt investments globally, most notably from US insurers," Ryan adds.

Private debt is also becoming more global. While North America represents more than 60% of total private debt assets under management, Europe and the Asia-Pacific have been growing. Today, these regions are more reliant upon bank financing, suggesting a noteworthy opportunity for private debt to expand, similar to the diversification that has taken place in the US.

But there are other factors sparking investor interest. Blackrock has identified a trend that could help shape investor appetite in a number of asset classes.

"Investors can access the transformative possibility offered by artificial intelligence through infrastructure, as well as debt, private equity and real estate," says Adebayo Ogunlesi, chair and chief executive of Global Infrastructure Partners, which is part of Blackrock.

A political animal

Another factor driving private markets is politics. Politically, private markets are hot investments. Governments around the world have taken a great deal of interest in nudging defined contribution pensions towards investing more in alternatives. The UK government is at the forefront of this development, wanting pension funds to back more private assets.

In addressing the government's private markets push, Tomlinson cites two sides to it. "It is now known that the government is looking closely at the supply side, on infrastructure anyway, associated with the likes of planning. My personal view is that they will push that through.

"On other areas, the government has made it clear that they want more investment," he adds. "That is a little bit more challenging. I certainly get the aspiration. It is a little bit harder on the venture capital side. For that, it is more about creating the pathways to move forward from."

In another initiative, chancellor Rachel Reeves announced in her Mansion House speech that the government is committed to establishing PISCES – the Private Intermittent Securities and Capital Exchange System – a platform for trading unlisted company shares, providing shareholders in eligible companies with liquidity and a route to exit.

What this will all mean only time will tell. But the investor industry has hardly been enthusiastic about this initiative thus far.

Inevitably, this governmental push is another contributing factor in boosting alternative assets. "Private markets are evolving rapidly and becoming more accessible to a broader range of investors," Ryan says. "Governments and regulators around the world have taken an interest in giving defined contribution plans more access to private markets."

This so-called democratisation of private markets nevertheless comes with challenges that investors need to be aware of. "Ensuring that private markets are effective within the portfolios of these new investors calls for portfolio construction expertise to build diversification, while providing a degree of liquidity" Ryan adds.

The usual suspects

Given the expansive nature of private markets, how can, and should, institutional investors take a step back and use private markets within a portfolio? "Private markets play a critical role in institutional portfolios by offering diversification and supporting long-term strategic goals," Deblanc says.

"They are particularly well-suited for funding essential projects like the energy transition and infrastructure, which can deliver stable, inflation-linked returns," he adds. "Private markets also serve as a hedge against short-term market volatility, allowing for a focus on sustainable value creation."

When it comes to the appealing segments within private markets, it is a case of what you would call the usual suspects. "Long-term themes such as infrastructure due to the energy transition and impact-focused investments in areas like climate finance and financial inclusion. These align with structural trends and investor demand for sustainability and long-term value creation," Deblanc says.

But there are others. Another area of growing appetite for sophisticated investors, but one not part of the usual suspects, is significant risk transfers (SRT), which allow banks to offload their credit risk while offering investors attractive returns. "We expect interest in SRTs to broaden over time, with significant opportunities in Europe driven by recent regulatory changes," Deblanc says.

> **Private markets are evolving rapidly and becoming more accessible to a broader range of investors.**
>
> Adam Ryan, Blackrock

Re-shaping economies

Other forces are helping to shape private markets. "A new wave of investment into the real economy should help transform markets, as more companies stay private for longer," Patry says.

Bill Hughes, global head of private markets at Legal & General, says that with the rise of private markets as a major investment theme, there is an increasing demand from institutional investors for investment strategies that are not only commercially competitive, but also sustainable and impactful.

"We have developed a long-term structural framework to guide our investment strategy around four powerful mega-trends that we believe are reshaping the global economy: demographics, decarbonisation, digitalisation and deglobalisation," he says.

"These trends will be positive for a number of sectors and that portfolios embracing them may see outsized risk-adjusted returns," he adds. "We see these mega-trends as particularly beneficial for infrastructure supporting the energy transition, residential real estate, urban logistics and assets or companies associated with the digital economy."

Sustainability and its related issues are therefore major themes driving private markets. "There is significant, persistent demand for solutions to society's biggest challenges, such as the climate crisis, housing crisis, socio-economic regeneration – and this presents a huge opportunity for investors," Hughes says.

Another key factor driving growth in private markets can be attributed to the rise of illiquidity budgets as the UK looks to increase investment into productive finance and mobilise pension capital to drive domestic growth.

To unearth investor trends, Legal & General undertook a comprehensive study of UK institutional investors' attitudes to private markets. The study explored how institutional investors are planning their future private markets portfolios, highlighting key allocation drivers and the increasing importance of impact and sustainability mandates.

The survey found that more than 70% of institutional investors are investing in each of the main private asset classes – private equity, private credit, infrastructure and real estate. However, the key thematic trends most institutional investors seek to address through private markets are climate transition/decarbonisation, digital transformation/AI and digital infrastructure.

Of the four main private markets assets surveyed in the UK institutional survey, asset owners are looking to increase their allocation the most in the following order: infrastructure, venture capital, private credit and real estate.

Interestingly, the research showed that institutional investors are increasingly targeting clean energy/renewable energy – believing that it offers the best investment opportunities.

Reasons to be cautious

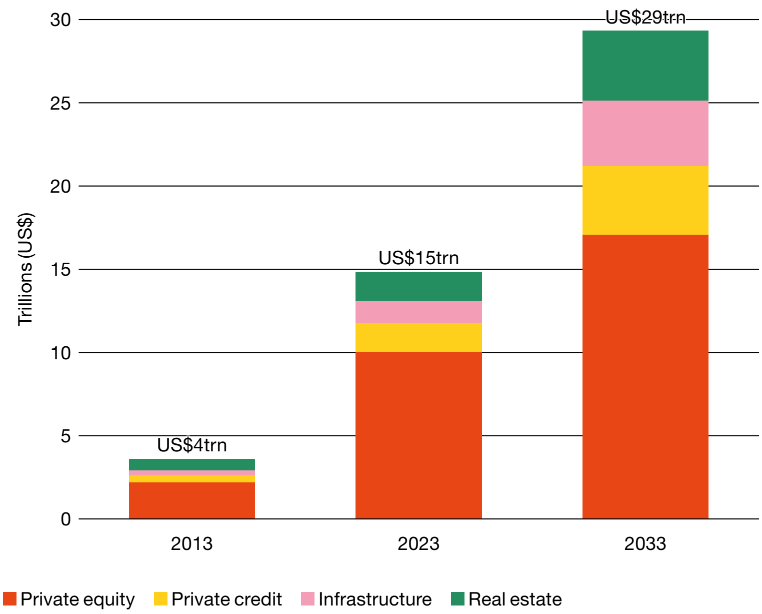
There are though reasons to be cautious about some aspects of private markets. "The scale of patient capital required for projects supporting the energy transition and infrastructure is immense, and these are often complex to execute and requires specialist skills," Deblanc says.

"It underscores the importance of due diligence, combined with depth of experience, which helps us identify and mitigate risk effectively," he adds. "This is where a proven track record of active management matters."

Moreover, private markets are not one big whole. "Private markets are not one homogenous blob," Tomlinson says. "Trading in the equity of private corporations is one thing, or originating private credit is different from classic private equity and infrastructure." An important point investors should be, and no doubt are, fully aware.

But for all that, private markets are set to grow further and become even more important to institutional investors.

Poised for growth: Private capital is forecast to continue its rapid growth into the next decade



Source: Partners Group analysis of Preqin data as of Q1 2023. Private Equity inclusive of Venture Capital.