City of Westminster

Committee Report

Decision Maker:	**PENSION FUND COMMITTEE**
Date:	**19 October 2023**
Classification:	**General Release (Appendix 1 Exempt)**
Title:	**CVC Credit European Direct Lending Fund IV**
Wards Affected:	**All**
Policy Context:	**Effective control over council activities**
Financial Summary:	**There are no immediate financial implications arising from this report, although investment performance has an impact on the Council's employer contribution to the Pension Fund (the Fund) and this is a charge to the General Fund.**
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1. EXECUTIVE SUMMARY

1.1 This paper provides a summary of the CVC Credit European Direct Lending Fund IV and provides an analysis of options should the Committee wish to maintain the current 6% strategic asset allocation to CVC Credit.

2. RECOMMENDATIONS

2.1 That the Pension Fund Committee:

- consider the views outlined by Isio, attached at Appendix 1, and agree on a suitable strategy for the private debt allocation going forward.

- approve that Appendix 1 to this report is not for publication on the basis that it contains information relating to the financial or business affairs of any particular person, including the authority holding that information, as set out in paragraph 3 of Schedule 12A of the Local Government Act 1972 (as amended).

3. BACKGROUND

3.1 At the Pension Fund Committee meeting on 10 March 2022, the Committee agreed to commit a 6% / £110m allocation to the CVC Credit European Direct Lending Fund III (EDL III), across its main and co-invest funds. The portfolio invests across sectors including media, healthcare, consumer, financial services, telecommunications, business services and technology.

3.2 Private debt strategies provide loans direct to businesses requiring capital, typically mid-market companies who are unable to raise debt through bond markets. The returns typically consist of an upfront fee and floating rate interest payments, which are usually priced at the Sterling Overnight Index Average (SONIA) rate plus a margin. Private debt instruments usually offer higher yields than traditional fixed income investments. The asset class also provides additional diversification within the fixed income allocation, with returns displaying a low correlation to traditional markets.

3.3 Generally, direct lending can be either secured, unsecured or unitranche:

- Secured debt is backed by an asset, whereby the lender takes ownership of the asset if a default occurs.
- Unsecured debt is not asset backed and therefore, in the event of default, the lender's recovery will depend on the debt seniority.
- Unitranche debt combines a mix of both secured and unsecured debt into one single loan term.

3.4 As at 30 June 2023 the EDL III fund was 64% drawn with the remaining commitment expected to be called by Q3 2025. The EDL III fund has a close-ended structure with the investment period to finalise during Q4 of 2025. From 2026 onwards, EDL III will begin to return capital to investors as the underlying assets are realised. Therefore, the allocation will continue to reduce and CVC expects to return all capital to investors by Q3 2028.

4. CVC CREDIT EUROPEAN DIRECT LENDING FUND IV

4.1 The CVC Credit European Direct Lending Fund IV (EDL IV) broadly exhibits the same characteristics as EDL III, with a similar investment process. The fund has a six-year, close-ended structure, investing primarily within senior secured loans, including unitranche, and capped junior debt. As with the EDL III fund, CVC Credit have confirmed that a co-investment vehicle will also be made available for EDL IV. The co-investment vehicle consists largely of the same investments as the main fund, but without the position concentration restriction and on a no-fee basis, therefore diluting the total management fees payable.

4.2 CVC Credit has provided modelling to set out the expected drawdown and run-off timelines for both EDL III and EDL IV. As part of this analysis, Isio have proposed two scenarios:

- **Scenario 1: No Growth Assumption**
  Maintain a net asset value of 6% (£110m) across EDL III and EDL IV, assuming the Fund's investment portfolio valuation remains relatively static; and

- **Scenario 2: 5% p.a. Investment Portfolio Growth**
  Maintain a net asset value of 6% across EDL III and EDL IV, assuming a 5% annual growth rate of the Fund's investment portfolio valuation.

4.3 To avoid being under or over exposed to the Fund's 6% allocation range over a long period of time, Isio have set out three potential commitment amounts:

- **£110m:** 6% of the current total Fund value.

- **£150m:** reflects the smallest commitment that would improve the projected time to reach the 6% target allocation under scenario 1, across EDL III and EDL IV.

- **£220m:** reflects the smallest commitment that would improve the projected time to reach the 6% target allocation under scenario 2, across EDL III and EDL IV.

4.4 Under each of the proposed commitments, the combined allocation is expected to exceed the target allocation by mid-20025 for all scenarios. Therefore, the Committee should consider both the time spent above target allocation, and the extent to which the Fund may be over exposed.

NEXT STEPS AND RECOMMENDATIONS

5.1 Isio has prepared a report, attached at Appendix 1, which outlines the EDL IV fund, including return objectives, fee structure, track record, ESG credentials and scenario modelling.

5.2 The Pension Fund Committee is recommended to:

- Discuss the proposals, as set out within Appendix 1, and the suitability of EDL IV, alongside the investment strategy and actuarial funding level; and

- Agree a suitable strategy going forward for the private debt allocation, with Isio recommending the Committee commit a further £110m to EDL IV, to maintain the 6% strategic asset allocation.

If you have any questions about this report, or wish to inspect one of the background papers, please contact the report author:

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BACKGROUND PAPERS: None

APPENDICES:
Appendix 1: Isio CVC Credit European Direct Lending Fund IV (Exempt)