Public Pension Plans & Alternative Assets

Public pension funds are important and experienced investors in alternatives, and on average allocate 5.5% of their capital to private equity, with significant commitments also existing to hedge funds, private real estate and infrastructure. Preqin data shows that the 20 largest public pension funds have a total of $224 billion allocated to private equity, and their high levels of assets under management make fund managers keen to attract this type of investor. The long term, high risk nature of alternatives are well matched to long term liabilities of pension plans, providing diversity to investment portfolios, and giving potential to yield high returns. Allocations to alternative asset classes have been steadily rising over the past ten years, while new entrants to the alternatives asset classes have emerged among public pension plans – especially during the boom era of 2005 – 2008.

Preqin examined the financial statements of over 150 public pension funds from North America, Europe and the UK to ascertain how well their investments across various asset classes were performing. Private equity and fixed income are the only investment types to have generated positive horizon returns across the one-, three-, five- and ten-year periods as of Q2 2010; other asset classes fall into the red for at least of one the periods.

Fig. 1 shows the median returns across the one-, three-, five- and ten-year periods earned by pension funds from listed equity, fixed income, private equity, hedge funds and real estate investments, as well as the median returns of the entire portfolio. As of Q2 2010, fixed income, hedge funds, listed equity and private equity are showing positive one-year returns. Real estate returns, however, are in the red. All asset classes show positive returns across five and ten years (where available), but across the three-year period only fixed income and private equity show positive returns, at 7.6% and 0.6% respectively.

US Pension funds making private equity commitments have most frequently chosen vehicles managed by Blackstone Group. 61 pension funds have made investments in the firm’s funds. The New York-based firm typically carries out leveraged buyout acquisitions of seasoned companies, transactions involving growth equity or start-up businesses in established industries, minority investments, corporate partnerships, distressed debt, structured securities and industry consolidations in a wide variety of industries and geographies.

Fig. 2 shows the one-year returns by quarter from December 2008 to June 2010. One-year private equity returns increased during the second quarter of 2010 from 10.6% to 15.4%. During the same period, listed equity one-year returns fell from 55.2% to 14.8%, while the total investment portfolio returns also decreased from 31.9% to 13.3%.

For the next part of this report, Preqin focused on US-based public pension funds and sought to establish which were the most popular fund managers amongst pension funds investing in alternatives, and which pension funds’ portfolios have performed the best.

The most popular fund managers amongst US pension funds investing in alternatives are shown in Figs. 3, 4, 5 and 6. Six pension schemes have invested in funds managed by Alinda Capital Partners, making it the most popular infrastructure manager amongst the sample group. The firm, which is based in New York, focuses on brownfield and greenfield projects and favours investments in assets including waste management, natural resources and water with a European or North American focus.

Fig. 2: One-Year Median Returns to 30 June 2010: Private Equity vs. Total Investment Portfolio and Listed Equity

Source: Preqin

FIG. 1: MEDIAN RETURNS OF PUBLIC PENSION PLANS BY ASSET CLASS AS OF 30 JUNE 2010

Source: Preqin
84 pension systems have invested in real estate funds managed by Pramerica Real Estate Investors, making the firm the most popular real estate fund manager amongst pension systems. The firm, also known as Prudential Real Estate Investors, is the real estate investment management business of Prudential Financial. The firm offers a broad range of investment opportunities and investment management services in the US, Europe, Asia, and Latin America.

21 US pension funds have made hedge fund commitments to vehicles managed by Bridgewater Associates, putting the firm at the top of the hedge fund league table. It manages portfolios for pension funds, endowments, foundations, foreign governments, and central banks for over 180 clients from the US and 19 other countries.

The top performing US pension fund portfolios are shown in Fig. 7. The results are based on five-year returns. Omaha School Employees’ Retirement System is at the top of the list, having achieved a return of 5.6% on their overall portfolio. A defined benefit scheme, the retirement system covers all employees within the Omaha public education system. It has 17.9% and 10.4% allocations to private equity and real estate respectively.

All of the US pension funds appearing in the top 10 have set allocations to real estate apart from State of Delaware Board of Pension Trustees, which has generated the third highest returns of all systems considered. The only alternative asset class in which the pension fund currently has commitments is private equity, with 9.6% of its assets under management being invested in the sector as of February 2011. The pension fund consists of nine retirement plans and three commingled pension funds. Each plan has a separate membership and differs accordingly.

Of all the top ten pension funds, Washington State Investment Board currently has the largest allocation to alternative assets. 38.4% of its AUM is invested in the sector, with private equity commitments accounting for 24.9% and the remaining 13.5% invested in real estate funds. The pension system has achieved returns of 4.08% on its portfolio, placing it sixth in the league table. The retirement system conducts its investment activities in accordance with policies and procedures designed to maximize return at a prudent level of risk.

New Jersey State Investment Council is the only US pension fund in the table that currently has an allocation to infrastructure, with 0.4% of its capital is committed to the sector as of February 2011. The retirement system is among the 50 largest public or private money managers in the US and represents the retirement plans for over 600,000 active and retired employees. The pension fund is also the only one in the top ten to have current allocations to all four alternative asset classes, with 6.4%, 3.0% and 5.0% of AUM invested in private equity, real estate and hedge funds respectively. Its portfolio has generated returns of 4.18% over the five-year period. Only experienced infrastructure investors tend to have dedicated allocations to the asset class, with most investing opportunistically via wider allocations to private equity, real assets, alternatives and inflation-linked asset classes.

Missouri State Employees’ Retirement System has the largest allocation to hedge funds of all the firms in the top 10; 25% of its AUM is currently invested in the asset class. With an overall portfolio return of 4.2%, the pension fund is fourth in the performance table.
## Fig. 7: Top Pension Funds over a Five-Year Period

<table>
<thead>
<tr>
<th>Investor</th>
<th>Five-Year Return: Overall Portfolio</th>
<th>Allocation By Asset Class %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Allocation to Private Equity</td>
</tr>
<tr>
<td>Omaha School Employees' Retirement System</td>
<td>5.60%</td>
<td>17.9%</td>
</tr>
<tr>
<td>El Paso Firemen &amp; Policemen's Pension</td>
<td>4.95%</td>
<td>0.03%</td>
</tr>
<tr>
<td>State of Delaware Board of Pension Trustees</td>
<td>4.30%</td>
<td>9.6%</td>
</tr>
<tr>
<td>Missouri State Employees' Retirement System</td>
<td>4.20%</td>
<td>10.0%</td>
</tr>
<tr>
<td>New Jersey State Investment Council</td>
<td>4.18%</td>
<td>6.4%</td>
</tr>
<tr>
<td>Washington State Investment Board</td>
<td>4.08%</td>
<td>24.9%</td>
</tr>
<tr>
<td>Los Angeles County Employees' Retirement Association</td>
<td>4.00%</td>
<td>8.6%</td>
</tr>
<tr>
<td>Public Employees' Retirement System of Idaho</td>
<td>4.00%</td>
<td>7.9%</td>
</tr>
<tr>
<td>Iowa Public Employees' Retirement System</td>
<td>3.97%</td>
<td>13.0%</td>
</tr>
<tr>
<td>Arkansas Teacher Retirement System</td>
<td>3.70%</td>
<td>7.1%</td>
</tr>
<tr>
<td>State of Wisconsin Investment Board</td>
<td>3.70%</td>
<td>5.5%</td>
</tr>
</tbody>
</table>

Source: Preqin
Preqin private equity provides information products and services to private equity and venture capital firms, fund of funds, investors, placement agents, law firms, investment banks and advisors across the following main areas:

- Buyout Deals
- Fund Performance
- Fundraising
- Investor Profiles
- Fund Terms
- Fund Manager Profiles
- Employment and Compensation

Our customers can access this market intelligence in four different ways:

- Hard copy publications
- Online database services
- Consulting and research support
- Tailored data downloads

Preqin regularly releases research and information on fundraising and all other aspects of the private equity industry as both research reports, and as part of our monthly Spotlight newsletter. To register to receive more research and analysis, please visit www.preqin.com/spotlight

If you have any comments on this report, please contact: info@preqin.com