



Private Credit's Role in LGPS

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Introduction

Funding levels at 2025 valuations are expected to show LGPS Funds in a healthy position, with more funds above 100% than in previous valuations¹. However, cashflow management is becoming an area of increased strategy focus as negative cash flows are predicted to feed through over the coming years.

This requires a re-think of growth, income and protection. Many LGPS Funds are looking to tilt from growth assets towards income, especially through assets that have a link to inflation. Although the 2025 scheme valuation will inform future investment strategy and contribution rates, careful monitoring of cash flows will be critical.

Private credit typically offers:

- Higher yields than those on offer from similarly rated public fixed income assets.
- A diversified income streams by geography and sector.
- Implicit linkage to inflation due to the floating rate nature of most loans because interest rates tend to rise in inflationary environments.
- Strong downside protections. This reflects the greater control private lenders have over the underlying cash flows of the assets backing their loans.

Within private credit, Europe is a particularly attractive choice. Its private credit market is fragmented by geography, regulation and language – inbuilt complexity that limits competition, allowing local lenders with deep networks to maintain pricing power and underwriting standards. Relative value is also excellent at the moment, with spreads of sterling investment grade credit over gilts historically tight.

The Maturing of the Asset Class

European private credit has grown strongly since the financial crisis as banks retrenched, due to regulatory changes requiring additional capital to be lent to sub-IG companies. This has created a funding gap for mid-market and smaller companies. At the same time, increasing private equity investment drove growing demand for alternative ways to fund buyouts. Private credit has expanded into this gap, creating opportunities for investors who select managers with in-depth experience of the leveraged finance industry.

European mid-market companies are a major engine of economic growth, employing nearly one in six people and generating around 17% of economic output. Targeting finance at these companies, as private credit funds do, helps drive economic growth and innovation.

From the investor's perspective, these mid-market businesses are also relatively less exposed to US tariffs than larger global companies because they export less of their production to the US.

Today, private credit is seemingly no longer just a high-yield proxy but a mature asset class. Evergreen fund structures have emerged, enabling investors to maintain constant allocations and private credit now spans multiple strategies with differing risk/return profiles. This delivers a more diverse set of income streams, including a growing share of investment grade assets.

¹See: <https://www.room151.co.uk/local-government-pension-scheme-investment/lgps-valuation-funding-level-rises-diverge-in-early-results/>

European Private Credit's Appeal for Investors

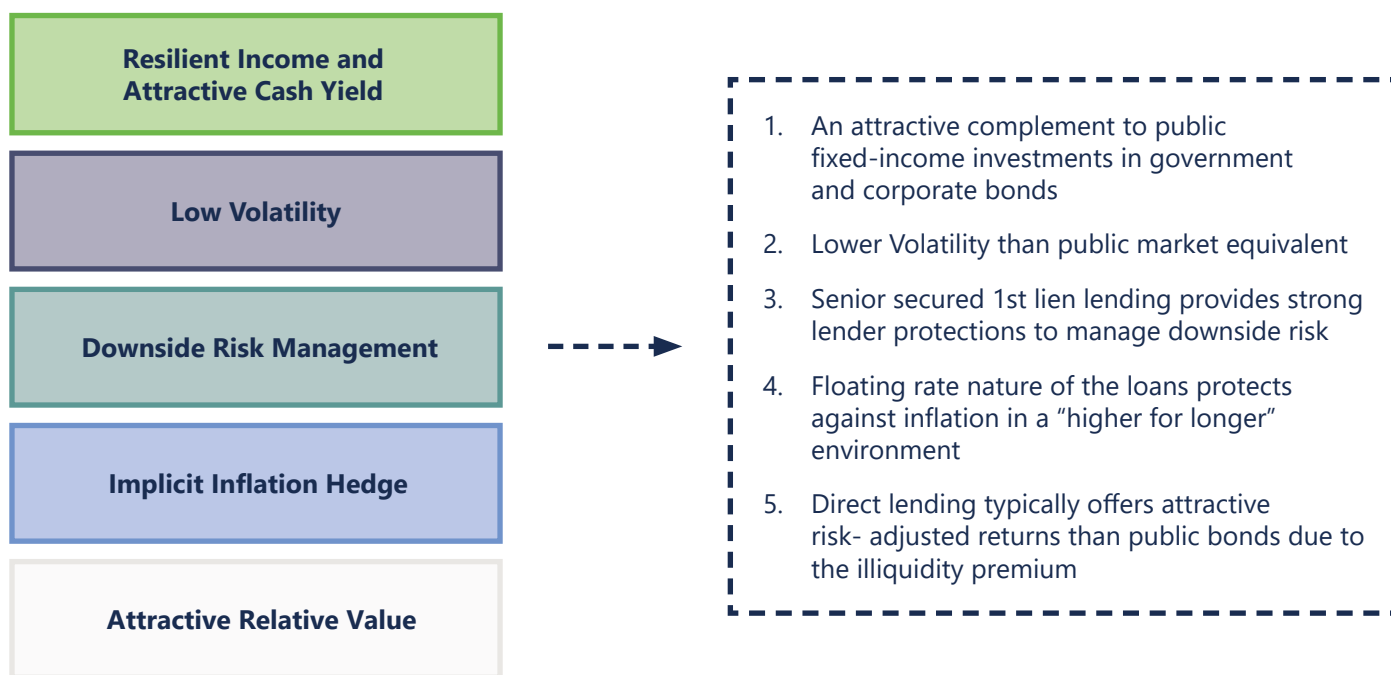
Europe's private credit market has significant growth headroom. Penetration of private credit in Europe is much lower than in the US, due to the maturity of the asset class and the breadth of the market. Non-bank lending in Europe and the UK, including corporate bonds and direct lending, makes up just 12% of the corporate finance market, versus 75% in the US². However, with far fewer European private credit funds than in the US, competition for deals is less intense and returns remain strong. In the US, by contrast, private credit is becoming saturated, and some large LPs have started to pull back amid concerns that underwriting standards have slipped as funds compete to secure deals³.

In Europe, private credit offers net returns typically range from around 6% up to 13% in GBP⁴, depending on the strategy.

Direct lending to mid-market companies currently offers c. 8%-10% net in GBP⁵, coupled with much stronger protections than on loans to larger private companies. Instead of covenant lite deals, mid-market loans are generally well covenanted with lender-friendly documentation, which allows early intervention from a private credit manager to negotiate further equity support, liquidity injections or greater control should it be needed in the case of a company restructure.

And in cases where borrowers underperform, private credit funds, including Pemberton's, are typically in a strong position as the sole lender. This gives them good visibility and enables them to pursue a favourable outcome for both clients and the borrower, protecting their LPs' capital.

Private Credit as a Pillar of LGPS Asset Allocations⁶



²Source: Securities Industry and Financial Markets Association www.sifma.org

³See for example: See: US public pension funds pare allocations to private credit, FT.com <https://www.ft.com/content/0d41ac73-f8a7-4be3-8594-625a72524afb>

⁴Based on Pemberton's understanding of the market.

⁵Based on Pemberton's understanding of the market.

⁶Risk and return characteristics are different to cash products. Based on Pemberton's internal analysis of the market.

Why Pemberton?

For over 10 years, Pemberton's European Mid-Market strategies, including allocations from LGPS Funds and their pools, are in line or above benchmark⁸. This is the result of having experienced leveraged finance teams and local origination in offices across Europe, which is key for building relationships and seeing deals before they reach London. Our broad network is complemented by conservative underwriting and loan documentation that includes strong downside protections.

We offer a range of direct lending strategies within private credit including Mid-Market Debt (with an average credit rating at opening of B), Senior Loans (average rating B) and Strategic Capital (average BB-). Alongside these we provide investment grade products including NAV Financing to LBO funds in the mid to upper mid-market, GP Solutions for PE firms and Risk Sharing, which helps European banks unlock capital tied up in their balance sheets.

Since December 2019, when the Sustainable Finance Disclosure Regulation (SFDR) was published, all of Pemberton's Direct Lending strategies have been Article 8 certified. Responsible Investment is an integral part of the investment approach, with a focus on key ESG risks across the companies we back, including improved reporting of carbon metrics, an area that is important for LGPS clients.

Between them, we believe these strategies offer a range of risk/return profiles that can deliver the strong cash yields and link to inflation that LPs find attractive to address their increasing cash flow requirements.

⁸Past performance is not a reliable indicator of future results.



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