Kentucky Retirement Systems
Special Called Investment Committee Meeting
September 6, 2024 at 10:00 a.m. ET (9:00 a.m. CT)
Via Video Teleconference and Facebook Live

AGENDA

1.	Call to Order	Prewitt Lane
2.	Opening Legal Statement	Legal Services
3.	Roll Call	Sherry Rankin
4.	Public Comment	Sherry Rankin
5.	Real Return Investment Recommendation*	KPPA Investment Staff
6.	Adjourn*	Prewitt Lane

* *Committee Action May be Taken*

KPPA
Kentucky Public Pensions Authority

KRS Investment Committee

Real Assets Recommendation

September 6, 2024

KENTUCKY PUBLIC PENSIONS AUTHORITY

INVESTMENTS

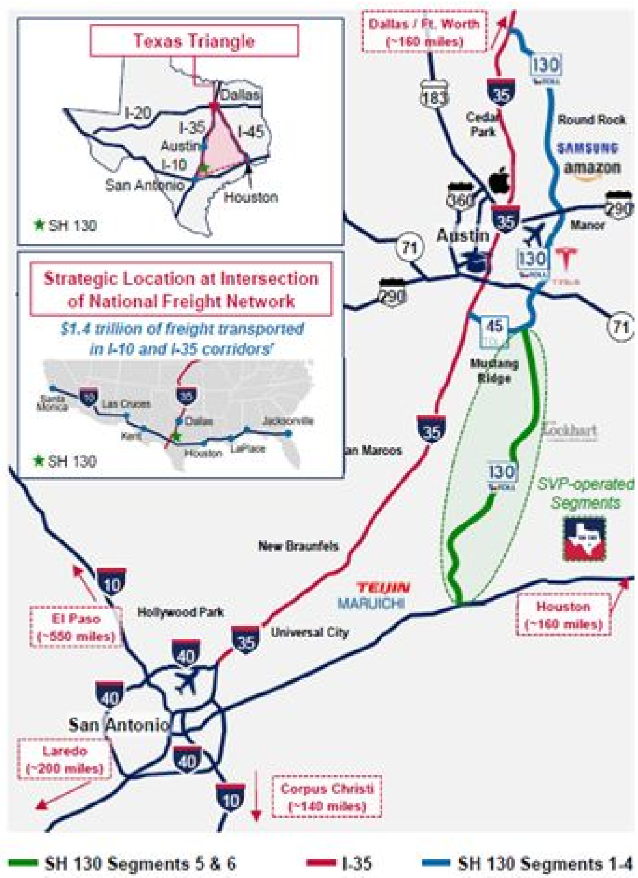
To: KRS Investment Committee

From: Anthony Chiu, Deputy CIO

Date: September 6, 2024

Subject: Investment Recommendation – Project Spurs

KPPA Investment Staff is proposing an investment with Strategic Value Partners ("SVP" or the "Firm") in a continuation vehicle ("CV") for Project Spurs ("Spurs"). As of 2Q 2024, Spurs is a 9% position in Strategic Value Special Situations IV ("SVSS IV" or "Fund IV"), a 2017 vintage fund with $2.85 billion of committed capital. This includes $65 million from KPPA, which was less than the approved $75 million due to the fund being oversubscribed.



Spurs is a 41-mile toll road asset in Texas between Austin and San Antonio that SVP acquired directly from lenders in a 2017 restructuring. Today the Firm controls 65%, with the remainder held by the US Department of Transportation through its Build America program.

SVP has created a CV structure as they see compelling value in owning Spurs for several years beyond Fund IV's term, which expires in 2025. They believe Spurs remains well-positioned for growth because of Texas's continuing economic expansion; Spurs' market share gains from the more congested and less reliable I-35; and proposed development initiatives that could significantly boost Spurs' earnings and extend the current concession (which has 38 years remaining) by an additional 20 years.

This investment opportunity is a time-sensitive one that is expected to have significant investor demand. Two large investors have committed to anchor the CV with $500 million of the $1.45 billion that SVP is raising. SVP's Partners are also rolling their Fund IV proceeds from Spurs into the new CV and contributing new capital for a total internal investment of approximately $100 million, further aligning their interests.

Staff believes Spurs will provide an attractive risk-adjusted return with low correlation to KRS' existing overall portfolio and provide complementary exposure within the Real Return allocation. Following the recent asset allocation update, KRS' target portfolio weight for Real Return is 8% or 10% depending on the individual plan. This proposed investment would help the plans continue moving toward the target weight and will be fully invested during the 4th quarter of 2024.

Investment Process and History:
Spurs was originally constructed by a subsidiary of Spanish company Ferrovial, who was awarded a 50-year concession from the Texas Department of Transportation (TxDOT) in 2006. Ferrovial's subsidiary Cintra partnered with Texas-based Zachry American Infrastructure to construct the road, which opened for traffic in October 2012.

However, a combination of overly optimistic traffic projections, excessive leverage, and an ill-fated interest rate swap caused Spurs to file for bankruptcy in March 2016. Road construction flaws also appeared shortly after opening, for which Ferrovial and Zachry were sued and resulted in a settlement.

Through its direct sourcing relationships with European banks, SVP was able to buy enough of Spurs' discounted debt to become its control owner, restructure the debt, and bring the company out of bankruptcy in June 2017. After taking control, SVP replaced the Spurs management team and board; remediated the road construction flaws; recovered proceeds through litigation from Spurs' original contractors; and repaired relations with key stakeholders like TxDOT and local chambers of commerce and foundations where Spurs passes.

Spurs has benefited from Austin and Texas's recent economic and population growth, which is expected to continue through the duration of this investment. Combined with SVP's execution of its value creation plan, Spurs' revenue and EBITDA have both doubled from 2019 to 2023 - even amidst the COVID pandemic. Traffic grew more than 60% over the same timeframe, even as toll rates also increased nearly 30%, suggesting low demand elasticity and a significant value placed on the reliability of transit time on Spurs compared to the increasingly clogged I-35.

Business / People:
As Spurs exited bankruptcy in 2017, SVP engaged transportation facility management specialist Louis Berger Services to operate and manage the asset. The CEO and COO also had previous experience as Deputy Commissioners of two states' Departments of Transportation. Additionally, a former chairperson of the Texas Transportation Commission as well as two infrastructure investors with experience from Abertis and Global Infrastructure Partners were named as independent directors.

Over SVP's 7+ year investment, management and board members have cycled through and now feature several executives with experience at Transurban, a $40+ billion Australia-listed operator of toll roads in the US, Canada, and Australia. As shown below, the executive team continues to have construction and government relations experience which should aid Spurs' continued operations, growth, and potential additional concession.

Adam Hesketh
Chief Executive Officer

20+ years experience

- Joined SH 130 as CFO and subsequently appointed CEO
- Former Managing Director at KPMG's Infrastructure Advisory Practice
- Former CFO, North America and Vice President: Development at Transurban

Manish Jain
Senior VP, Revenue and Analytics

20+ years experience

- Currently leads the traffic, revenue, and data analytics functions
- Former Specialist Leader at Deloitte
- Former Principal and Senior Manager at Transurban

After investing over $160 million to remediate and repave Spurs from 2017-22, Spurs is well-positioned to maintain and even grow margins with minimal capex needs until 2031.

Besides additional population growth and economic development, a potentially significant return driver for Spurs is a non-tolled connector road to I-35 that could drive additional traffic and gain a 20-year extension of Spurs' concession to 2082.

This would require state-level legislation and has broad support that helped it pass the Texas House in 2023. SVP is hopeful the bill will pass during the next legislative session in 1H 2025 and projects that the additional concession would boost net multiple and IRR by [redacted] respectively.

Notably, this is not incorporated in SVP's original base case projected returns of [redacted]. Subsequently, Spurs' performance in the first half of 2024 has been above forecast across the board and has increased SVP's base case to [redacted]

Proposed I-35 Connector to Drive Traffic to SH 130

While this growth would of course be welcome, Staff is viewing Spurs as an attractive infrastructure asset that will likely (1) have steady cash flows that grow with inflation and (2) retain value as a scarce, essential, and difficult to replicate asset.

Even in Wilshire's low scenario that discounts SVP's traffic volume growth by 50% and assumes a below-market exit multiple of 20x EBITDA, Spurs' expected return would be [redacted] at the end of the investment's term in 2032. For reference, one of KPPA's managers who has also previously invested in Spurs' debt viewed typical toll road valuations to be in the 30-45x range. Additionally, the Northwest Parkway toll road near Denver with slower growth dynamics than Spurs traded at over 65x in May.

Performance:

SH-130 in Fund IV	Invested ($ MM)	Realized ($ MM)	Unrealized ($ MM)	Total Value ($ MM)	Gross Multiple	Gross IRR
1Q 2024	$ 152	$ 93	$ 316	$ 409	2.7x	22%

*Exiting Fund IV investor returns expected to be [redacted]
Source: Strategic Value Partners

Conclusion: Given the attractive asset, compelling market opportunity, and current Real Return allocations, Staff is recommending an investment of $60 million to be shared among all CERS plans pending successful legal negotiations. When fully funded, this would represent an additional ~0.3–0.4% of plan assets (depending on fluctuations in market value). It is anticipated this investment would be funded by existing cash or the unwinding of proxy positions based on the specific needs of each plan.

<u>Investment and Terms Summary</u>

Type of Investment: Real Return

Structure: Continuation Vehicle

Term: 8 years, with 3 one-year extensions (2 at GP discretion, 1 with Advisory Committee consent)

Management Fee: 1% on invested cost

Profit Sharing: 10% of profits above a 10% compounded annual return
12.5% of profits above a 12.5% compounded annual return
20% of profits above a 15% compounded annual return

Purpose: Provide CERS with exposure to a unique, long-lived real asset with steady and growing cash flows

Risks: Inaccurate traffic and revenue projections, leverage, regulatory / legal, illiquidity

Exp. Net Return: 7% - 10%

*No placement agents have been involved or will be compensated as a result of this recommendation.

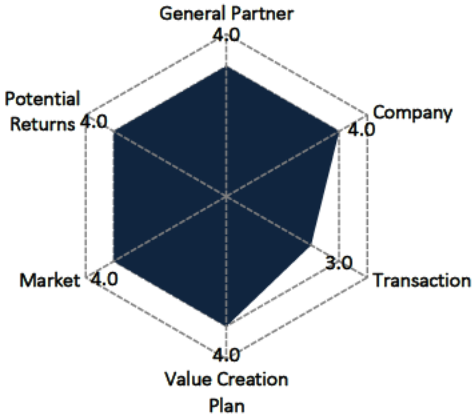
Wilshire

Project Spurs

Final Diligence

General Partner	SVP
Vintage Year	2024
Timing	August 2024
Strategy	Core-Plus Infrastructure
Sector	Generalist
Investment Structure	Continuation Vehicle
Region	North America
Purchase Price (EV, $M)	[redacted]
Capital Structure	74% Equity, 26% Debt
Fund/LP Co-Inv. Equity ($M)	$1,220
LTM Revenue (2023A)	$72.7M
LTM Adj. EBITDA (2023A)	$60.5M
Base Case Returns	[redacted]
Base Case Hold	8 years
Fee / Carry* / Hurdle*	1% / 10% / 10%

*Tiered carry/hurdle = 10%/10%, 12.5%/12.5%, 20%/15%



Key: 5 = Top Decile; 4 = Top Quartile; 3 = Average;
2 = Bottom Half; 1 = Bottom Decile; 0 = No Information

Past performance is not indicative of future results.

General Partner

Founded in 2001 by Viktor Khosla, Strategic Value Partners ("SVP" or the "Firm") is a global investment manager specializing in opportunistic credit, distressed debt, and special situations. The Firm currently manages $18.4 billion in AUM across asset classes through a combination of both open-end and closed-end investment vehicles. Known for its expertise in stressed and distressed investments, SVP also has an established real asset track record, including $3.5 billion of invested capital in infrastructure assets, which includes 11 toll road investments. Notably, Wilshire has a longstanding relationship with the Firm, including allocations to various SVP strategies, the most recent being the Strategic Value Capital Solutions Fund II in 2023.

Company & Transaction

State Highway 130 ("SH 130" or the "Asset") is a toll road servicing the fast-growing Austin-San Antonio corridor in Texas. The Asset was originally built by Spanish transportation infrastructure company Cintra and opened in 2012. Despite SH 130 performing well since opening, in 2017 the Asset became over-levered and was struggling to service the $1.6 billion of debt on its balance sheet, which SVP acquired for ~50% of face value from two European commercial banks. SVP ultimately led SH 130's restructuring and emerged as the control equity owner in 2017, allocating $348 million across its Special Situations Fund III and Special Situations Fund IV and $452 million across two SMAs (the "Existing Funds"). SH 130 is currently owned by SVP (~65%), U.S. Department of Transportation (~32%), and others (~4%).

Currently, SVP is seeking to transfer its ~65% ownership interest in SH 130 Concession Company, LLC (the "Company"), which owns and operates the Asset, from the Existing Funds to a single-asset continuation vehicle ("CV") that will be managed by SVP. The transaction is taking place at 97.6% of NAV as of March 31, 2024, which implies total equity for the CV of approximately $1.22 billion. The proposed entry enterprise value for the Asset is [redacted], which implies a valuation of [redacted] EV/2024E EBITDA. Anchor investors for the CV are [redacted] who are responsible for setting the entry price and terms.

Value Creation Plan

SVP's anticipated value creation plan for the Asset includes various growth drivers, including government-mandated toll escalations, organic traffic volume growth, existing excess road capacity to absorb additional demand, I-35 connector development and associated 20-year concession extension, industrial development along the traffic corridor, and trucking partnerships

Track Record

Since the strategy's inception in 2008, SVP has raised approximately $10.2 billion in total commitments across five Strategic Value Special Situations Funds ("SVSS"). Funds I-IV have generated strong returns and Fund V, while relatively early, is tracking well.

Fund	Vintage	Size ($M)	Net ROI	Net IRR
SVSS V	2021	5,089	1.3x	16.0%
SVSS IV	2017	2,500	1.8x	15.2%
SVSS III	2013	1,310	2.3x	13.7%
SVSS II	2010	918	1.9x	12.6%
SVSS I	2008	346	1.9x	15.0%

Source: Strategic Value Partners as of May 31, 2024.

Investment Merits

- Marquee, difficult to replicate toll road asset
- High-quality general partner and management team, both with an extensive history in the space
- Attractive risk-adjusted return profile

Investment Concerns

- Traffic volume risk
- Elevated entry multiple
- Management fees and carried interest

State Highway 130 Overview

Vital toll road providing a high-speed, congestion-free route in the heart of the Texas Triangle

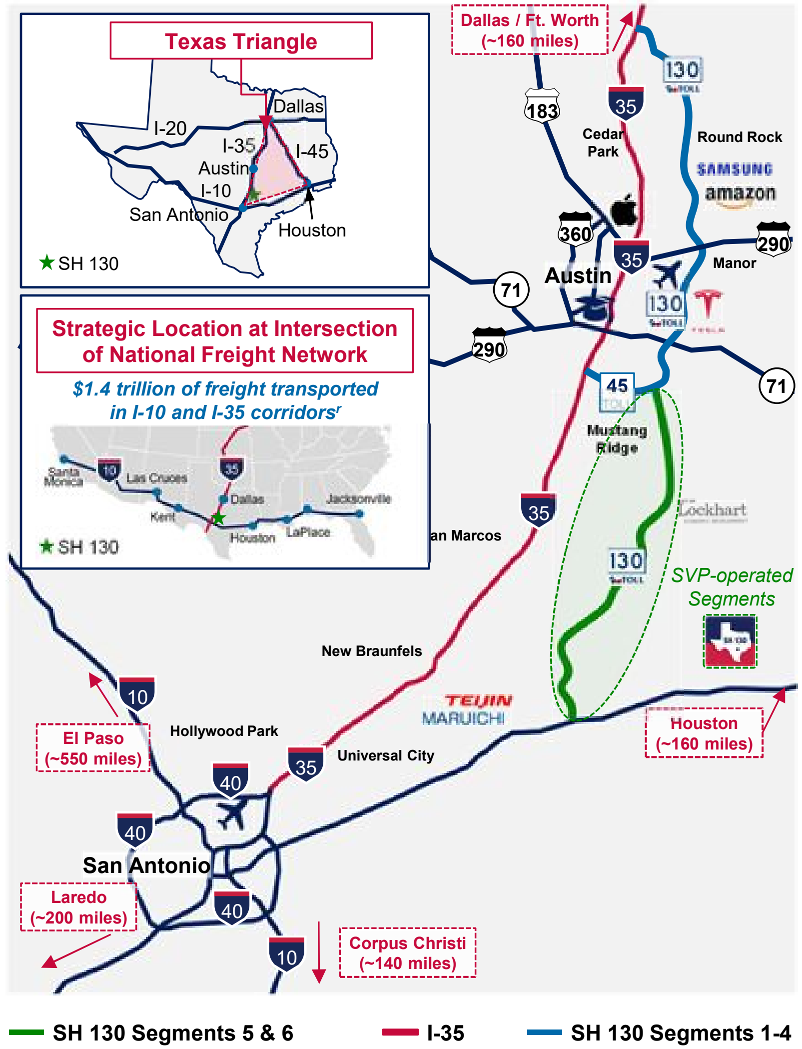
SH 130 segments 5 & 6 is a 41-mile, 4 lane toll road in Texas serving as critical link between Austin and San Antonio metropolitan areas, facilitating local and long-distance travel

- SH 130 manages, operates and maintains SH 130 Segments 5 & 6 under a 50-year concession agreement (**~39 years remaining**) with Texas Department of Transportation ("TxDOT")
- Significant customer value proposition, allowing users to bypass heavily congested traffic on I-35 **providing meaningful time savings and reliability**[k]
  - **Substantial unutilized capacity to absorb demand growth** in the corridor and continue taking share from capacity constrained competing route (I-35)[w]
  - **99% of trips with on-time arrivals on SH 130** compared to **20% of trips with on-time arrivals on I-35**[l]
- Vital asset connecting **two of the fastest growing MSAs in the country**[c] and situated strategically in a corridor experiencing **rapid commercial and industrial investment** (over $50bn capital projects currently being executed)[c]
  - Austin and San Antonio expected to continue **growing at multiples of U.S. growth rates**[c] as the region converges to a single mega MSA
- **Located at the intersection of I-10 and I-35**, SH 130 serves as an essential link in the prominent **Texas Triangle freight network**
- **United States-Mexico-Canada Agreement trade route corridor** via the Laredo border crossing (#1 U.S. inland port by trade value)[m]
- Attractive toll escalation regime providing an **embedded inflation hedge and direct GDP-linkage**, with no requirement to lower tolls

SH 130 Segments 5 & 6: Key Facts

Asset	■ 41 miles; 2x2 lanes; 2 mainline gantries (each direction) and 12 ramp gantries; fully electronic tolling system ■ 85 mph posted speed limit
Concession	■ 50-year concession with 39 years remaining (2062 expiry)
Toll Regime	■ Annual escalation based on Nominal Gross State Product per Capita for Texas, with no requirement to lower tolls ■ Current Full Length Toll Rate (Class A / D): $9.49 / $37.87[n]
Revenue	■ 2023 revenue ~93% above 2019 revenue (pre-COVID) ■ ~38% light vehicles; ~62% heavy vehicles[o]

Critical Artery in Highly Congested Corridor



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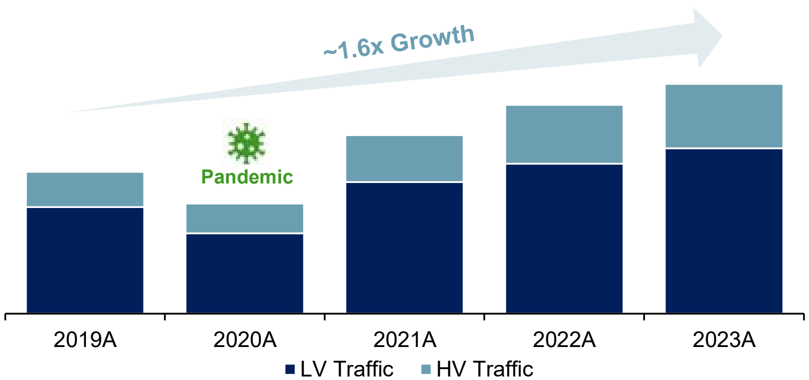
Compelling Traffic Growth and Financial Trends

Attractive historical double-digit volume and EBITDA[s] growth

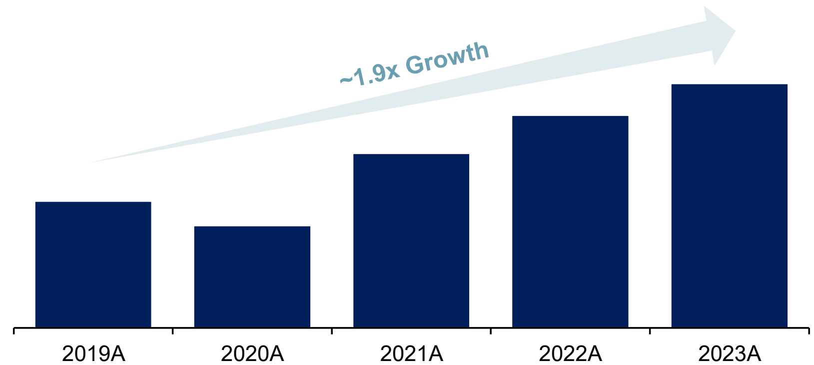
Robust Historical Traffic Growth[1]

~13% CAGR since 2019[g]



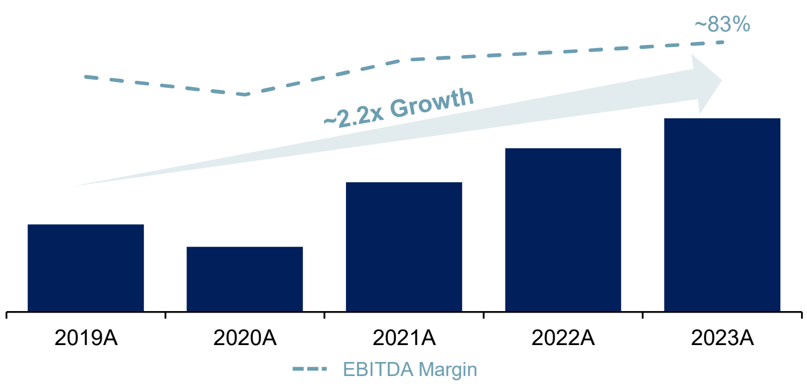
Significant Revenue Growth driven by Volume and Price[2]

~18% CAGR since 2019[g]



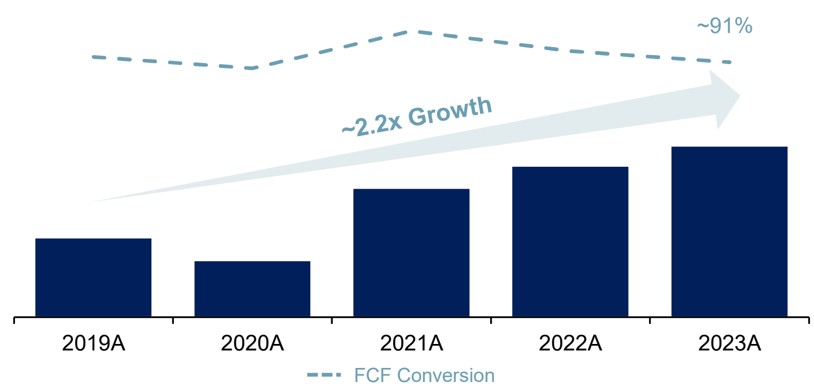
High and Growing EBITDA[s] Margins

~22% CAGR since 2019[g]



Strong FCF Profile Driven by Low Maintenance Capex[3]

~89%+ average FCF conversion since 2019[g]



Note: Past financial performance is not indicative of future results. There can be no assurance that any expected trends or developments presented herein will continue

1. Growth rates based on number of transactions
2. Reflects toll revenue after revenue adjustments and TxDOT revenue share
3. Reflects EBITDA less recurring capex; Please refer to Endnote S on page 15 for further detail on EBITDA

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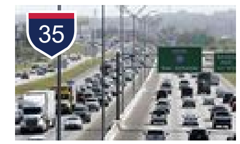
SH 130 Key Investment Highlights

Well Located in Booming Economic and Demographic Corridor

- Link between two of the **fastest growing MSAs in the U.S.: Austin and San Antonio**[c]
- Essential route for US-Mexico freight movement, with **10% of all domestic truck freight**[c] passing through the corridor
- **Significant corporate investment** adjacent to SH 130 (e.g., Tesla, Amazon, Samsung, Lockhart industrial park)[h]

Positioned for Continued Market Share Growth by Offering Significant Value Proposition

- SH 130 offers **time savings and greater reliability,** which we believe is poised to increase from potentially **worsening I-35 congestion**[k]
- SH 130 has **taken share from I-35**[1] over time, with **headroom to continue** capturing rapid growth due to available capacity
- I-35 is expected to **remain congested despite planned expansion**[2]

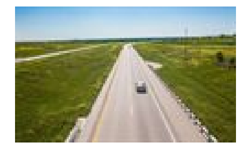


Long-Dated Concession Agreement with Favorable Toll Regime

- **~39-years remaining concession life** subject to annual toll escalation with **embedded inflation hedge**
- Significant **outperformance of toll regime** relative to competing toll roads[i]
- **Favorable concession agreement terms**

Well-Maintained Asset with Efficient Operating Model

- Substantial **remediation of prior roadway issues** with **minimal near-term capex expected**[j]
- **Independent operator** with focus on optimizing for efficiency and value maximization
- Efficient operations with **fully electronic, open road tolling** with **no collection risk exposure**[p]



Compelling Traffic Growth and Financial Trends

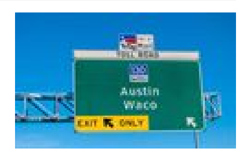
- **Strong historical growth** in revenue and EBITDA[s] (~18% and ~22% CAGR between 2019-2023, respectively)
- Economic shock **resiliency**, with 2023 revenue ~93% above pre-COVID (2019) levels[g]
- **Double-digit revenue and EBITDA** projections[b] underpinned by economic trends and development underway

High Quality Management Team Driving Substantial Upside That the Company Can Actively Influence

- Management team comprised of **highly experienced industry veterans**
- Significant **operational and financial management achievements already accomplished**
- Additional developments underway create **substantial near-term benefit potential** (e.g., Lockhart interchange, TruckPort, and VMS)
- Government partnership efforts create **portfolio of potential 'step-change' upsides** (e.g. Connector/concession extension, I-35 Corridor partnership, Caldwell site partnership)

Exceptional Community Partner and Established ESG Practices

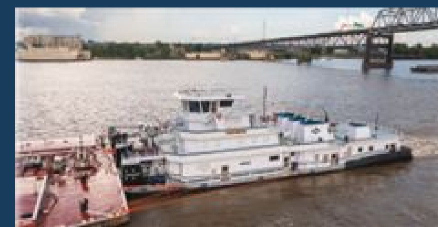
- **Demonstrated positive relationships** with key community stakeholders and government bodies
- Ongoing work with local and state governments to **advance priorities**
- **Strong ESG programs complement positive community engagement**, with both accomplishments to date and programs underway

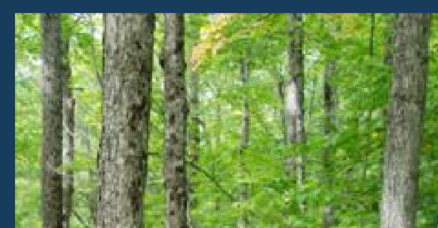


1. Based on management analysis of SH 130 market share vs. I-35 using Streetlight data for trips between I-10 to SH 130 Segments 1-6 to I-35 in Jarrell vs. either of (a) I-35 all the way from NE of San Antonio to Jarrell, or (b) I-35 NE of San Antonio to SH 45SE to SH 130 Segment 1-4 to I-35 in Jarrell
2. Based on management analysis of current public plans, which continue to predict that I-35 will remain at capacity despite $5bn+ in upgrades

Other Real Return Strategies Reviewed / In Consideration

- Transportation leasing: Currently in diligence
- Energy credit / energy secondaries: Initial calls
- Mining credit: Early-stage evaluation
- Timberland: Early-stage evaluation
- Infrastructure: Early-stage evaluation
- Global maritime: Passed
- Permanent cropland: Passed





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