



State of Rhode Island
Office of the General Treasurer

KKR Diversified Core Infrastructure Fund L.P. - Staff Recommendation

May-2021

RECOMMENDATION: Approve a commitment of up to \$100 million to KKR Diversified Core Infrastructure Fund

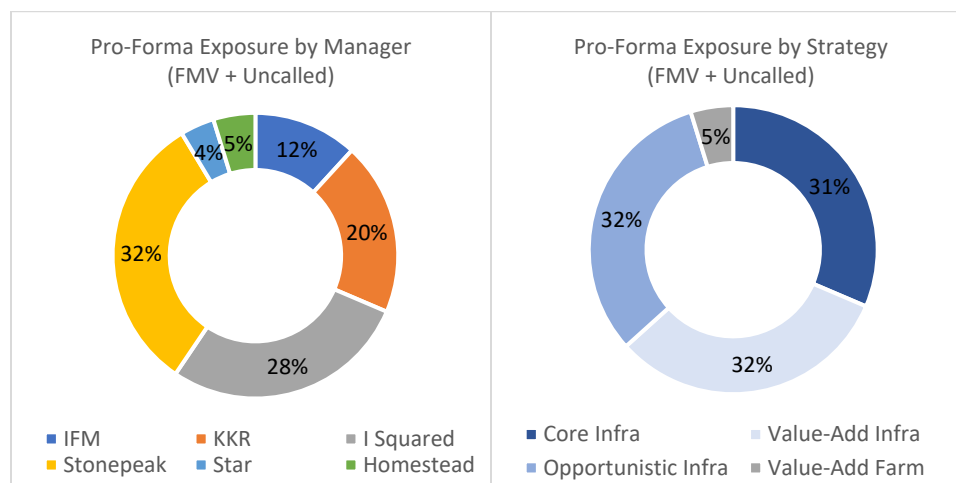
ASSET CLASS: Private Real Assets (ex-Real Estate)

SUB-STRATEGY: Core Private Infrastructure

ALLOCATION: The target allocation for private real assets will be 4% effective July 1, 2021 (increasing from 2.4% previously) and the actual allocation as of March 31 is 2.3%. The pacing plan for private real assets is \$80 million per year committed to 1 -3 primary funds per year at \$20 -\$100 million per primary fund.

PORTFOLIO FIT: The private real assets portfolio currently consists of five managers. The allocation was established in 2013 as a private infrastructure portfolio and subsequently was expanded to include other real assets, ex-real estate. The allocation includes both core and non-core strategies. To date, ERSRI's only exposure to core infrastructure has been through IFM's Global Infrastructure Fund, which represents approximately 15% of the allocation's 12/31 NAV + unfunded commitments. Adding KKR's Diversified Core Infrastructure Fund would increase the allocation's core exposure to 31%.

Manager	Asset Class	Strategy	Structure	Sectors	Market	Geography
IFM	Infrastructure	Core	Evergreen	Diversified	Large	Global
KKR	Infrastructure	Core	Evergreen	Diversified	Large	Global
I Squared	Infrastructure	Value-add	Close-ended	Diversified	Mid	Global
Star	Infrastructure	Value-add	Close-ended	Diversified ex-energy	Mid	U.S.
Stonepeak	Infrastructure	Opportunistic	Close-ended	Diversified	Mid-large	North America
Homestead	Farmland	Value-add	Close-ended	Prem and row crop	Mid	U.S.



* I Squared and Stonepeak consist of multiple fund commitments given the close-ended structure

MERITS: KKR's Diversified Core Infrastructure Fund (DCIF) focuses on investments in established brownfield assets diversified by sector and geography with high EBITDA margins and contracted or regulated cash flows. Sectors will include utilities focused on the water, wastewater, electricity and natural gas distribution, digital infrastructure, renewable power, contracted transportation, and energy transition. DCIF will utilize KKR's large corporate network, from which the firm has sourced most of its infrastructure investments in bi-lateral transactions or limited auctions. The DCIF team will also employ the firm's broader resources, including KKR Capstone, a team of over 80 operating professionals (including 4 dedicated to Infrastructure) who help diligence new deals and work with portfolio company management to drive KKR's strategic initiatives after closing. As an evergreen fund, DCIF will not be subject to the time horizon mismatch between lock-up fund terms and the longer-term investment horizons of core infrastructure assets, allowing the firm to extract value from these assets without short-term selling pressure.

KKR is offering reduced fee terms for founding investors who commit between \$50 and \$200 million of capital prior to 6/30/2021. The reduced fees are 0.6% management fee on NAV and no performance fee for six year.

CONCERNS: DCIF is KKR's first core infrastructure fund, and as such is subject to standard risks of first-time funds. However, DCIF will benefit from KKR's established core plus infrastructure platform, which has invested over \$18B to date. The team has already been sourcing core assets, which have not been invested in as they do not meet the return targets of the Flagship Fund. These assets therefore also have less downside risk and value-add execution risk, mitigating some concern on the new strategy. However, pricing in the core space has been elevated. KKR's ability to leverage its larger team and network to source assets from corporations in processes outside of broad auctions and its long-term hold in the evergreen structure mitigates some of the pricing concern.

While this is a first time fund, the current DCIF team is well-seasoned. There will be shared team resources across the infrastructure strategies with dedicated deal leads in each target geography for the core strategy. KKR expects to hire additional team members as the portfolio ramps up and assets come under management. DCIF has already completed two transactions representing approximately \$650M of fund assets and has several deals in its pipeline.

ESG: KKR is categorized as a **Leader** on ESG. The firm became a signatory to the UN Principles for Responsible Investing in 2009 and has followed the framework since. KKR's dedicated Global Public Affairs team, led by Ken Mehlman, is involved in due diligence and often works with portfolio companies to implement ESG and sustainability programs. Investment memos evaluated by DCIF's investment committee include key ESG risks and opportunities, incorporating Sustainability Accounting Standard Board (SASB) industry-specific standards. Many of the DCIF's investments are expected to be in the renewables or energy transition sub-sectors, including one of the fund's two seed investments.

KKR has a strong culture of promoting diversity and inclusion at the firm, having established an Inclusion & Diversity Council in 2014. Portfolio companies Chief Human Resources Officers use KKR's Diversity & Inclusion Handbook to develop and execute best-practice D&I strategies.

FEES: Fee terms are favorable. LPs who commit between \$50 and \$200 million will be subject to a 0.8% management fee on invested capital, with a 100% offset for standard expenses. Carry is 5% of gross cash yields over a 4% hurdle. However, founding investors who commit between \$50 and \$200 million of capital prior to 6/30/2021 will benefit from a reduced management fee of 0.6% on NAV and no performance fee for six years. ERSRI will be considered a founding investor and receive the preferential fee terms.