Croydon Council

REPORT TO:	**PENSION COMMITTEE** **11 June 2019**
SUBJECT:	**Progress Report for Quarter Ended 31 March 2019**
LEAD OFFICER:	**Nigel Cook** **Head of Pensions and Treasury**
CABINET MEMBER	**Councillor Simon Hall** **Cabinet Member for Finance and Resources**
WARDS:	**All**

CORPORATE PRIORITY/POLICY CONTEXT:

Sound Financial Management: Reviewing and ensuring that the performance of the Council's Pension Fund investments are in line with their benchmark and in line with the assumptions made by the Actuary.

FINANCIAL SUMMARY:

This report shows that the market value of the Pension Fund (the Fund) investments as at 31 March 2019 was £1,242 m compared to £1,181 m at 31 December 2018, an increase of £61 m and a return of 5.08% over the quarter. The performance figures, Independent information and analysis on the fund managers and markets have been provided by the Fund's independent investment advisor Mercer.

FORWARD PLAN KEY DECISION REFERENCE NO.: N/A

1 RECOMMENDATIONS

1.1 The Committee is asked to note the performance of the fund for the quarter.

2 EXECUTIVE SUMMARY

2.1 This report provides an update on the London Borough of Croydon Pension Fund's (the Fund's) performance for the quarter to 31 March, 2019. The report falls into four parts. Section 1 addresses performance against strategic goals. The second section considers the asset allocation strategy and how that is being applied, specifically current and planned investments. The third section deals with risk management and the fourth and final section summarises the recent investment manager site visit. Detailed numeric data and commentary from the Fund's advisors is included as appendices to this report.

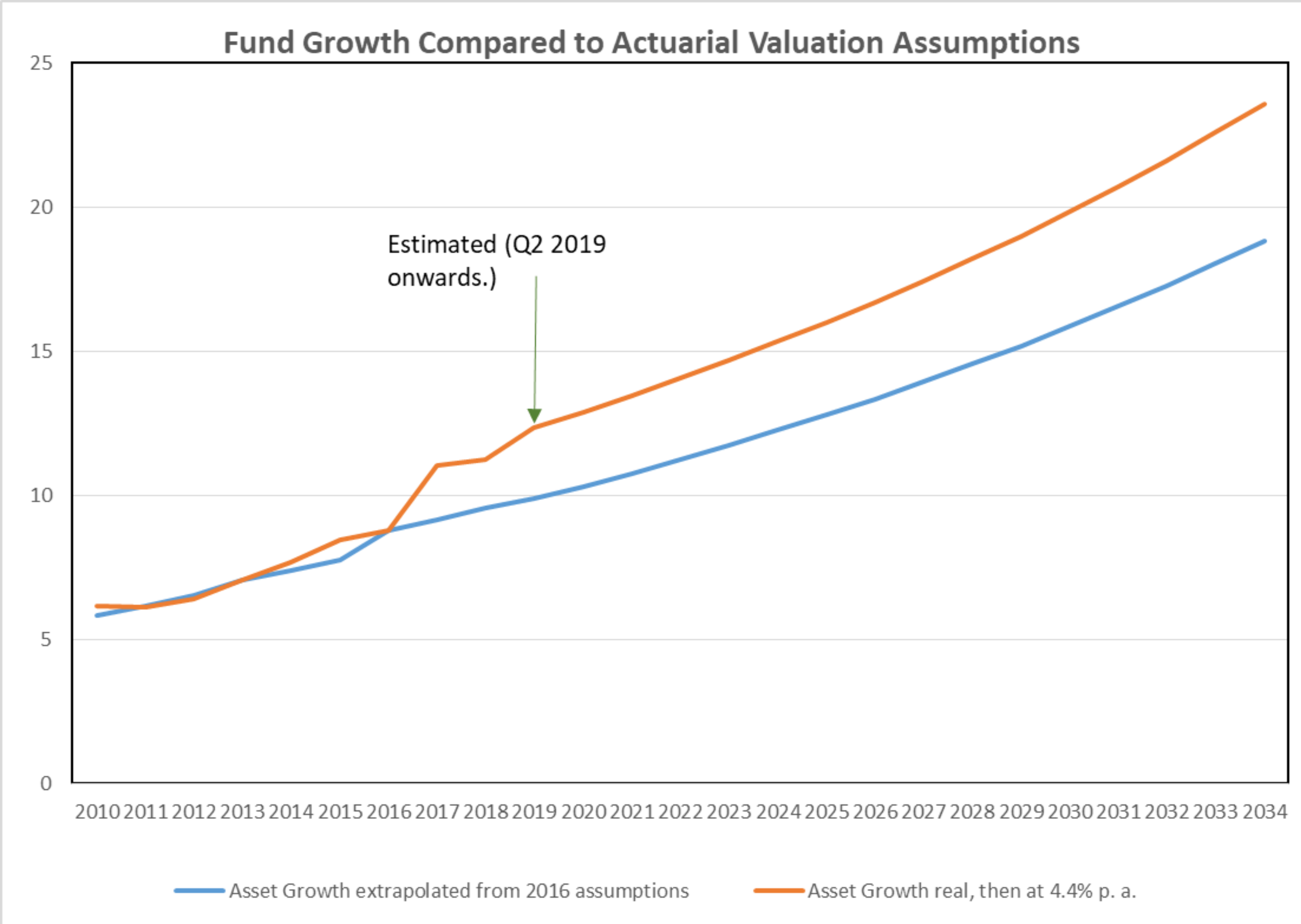
3 DETAIL

Section 1: Performance

3.1 The 2016 Triennial Actuarial Valuation used an asset outperformance assumption of 2.2% over gilt yields, meaning an asset return assumption, otherwise described as the discount rate, of 4.4%. The valuation also assumes that the funding gap will be closed over a 22 year period. However, as a risk based model has been adopted, the recovery period is less critical. In setting the Pension Fund's investment strategy, performance is measured against a benchmark return of CPI + 4% for the whole fund. Achieving this benchmark return will ensure the investments achieve a higher return than as calculated in the valuation and on the basis that other assumptions remain constant, the funding gap will reduce.

3.2 Graph 1 has been compiled from this information. The blue line shows the expected track of the value of assets growing in line with the 2016 valuation assumptions. This will be adjusted after subsequent valuations. The orange line shows the actual value of the Fund to date and plots the course of growth over subsequent years using the same assumptions. This measure does not take account of other variables, such as changes in demographic factors, wage inflation forecasts and other assumptions and it does not reflect changes in cash contributions nor movements in the gilt yield curve. It is valuable as a tool to help track whether the direction of travel is in the right direction.

Graph 1: Fund Growth Compared to Actuarial Valuation Assumptions



3.3 Details of the performance of individual components of the portfolio are detailed in the report produced by the Fund's investment advisors in Appendix A.

Section 2: Asset Allocation Strategy

3.4 A current asset allocation strategy was approved at the Committee meeting held on 8 September 2015 (Minute A29/15 refers). The portfolio now reflects the proportions described in that strategy, allowing for the vagaries of the market.

3.5 The target portfolio can be broken down as follows:

Asset Class		***Target Allocation***	***Allowable Tolerance***
Equities including allocation to emerging markets.		42%	+/- 5%
Fixed interest		23%	+/- 5%
Alternates		34%	+/- 5%
Comprised of:			
Private Equity	8%		
Infrastructure	10%		
Traditional (Commercial) Property	10%		
Private Rental Sector (Residential) Property	6%		
Cash		1%	
	Total	**100%**	

3.6 **Progress towards revised asset allocation**

3.6.1 **Global Equity –** The quarter was positive for the equity markets despite the significant storms battering the global economy – the risk of trade wars between the USA and China; Brexit; unresolved issues in the Eurozone; and so forth. With each asset class at target allocation there is currently no need to disinvest further from the LGIM fund, which represents 41.6% of the portfolio compared to the target of 42%. The L&G FTSE World (Ex Tobacco) fund returned a positive 9.7% during the quarter compared with a large downswing last quarter and illustrating the real volatility currently experienced as well as the difficulty in clawing back losses.

3.6.2 There have been initial difficulties with the emerging London CIV Emerging Market equity fund. A key manager, together with his team, have left Janus Henderson, the investment firm that has hosted the fund and team. The CIV are working on a solution in response to this development.

3.6.3 **Fixed Interest** – Again, the four funds, managed by three managers, represent the target allocation to this asset class. Currently these funds are valued at 22.7% of the portfolio whereas the target allocation is 23%.

3.6.4 **Infrastructure** – Performance information relating to Infrastructure investments and indeed Private Equity, discussed in more detail below, is lagged by a quarter. This is due to the process involving collating information from a number of sub-funds and various compliance checks. The table below shows that the Fund is marginally over-exposed (11.5% compared with a target allocation of 10%, equivalent to £17 m). However the nature of these funds is that it is necessary to over-commit to ensure adequate coverage largely because of the impact of net cash flows. For the same reason it is necessary to commit to each new vintage, all other factors being equal and there being no contrary indicators.

3.6.5 **Private Equity** – .The Fund continued to see distributions during the quarter that served to help with cash flow. This part of the portfolio is slightly overweight for the reasons discussed above.

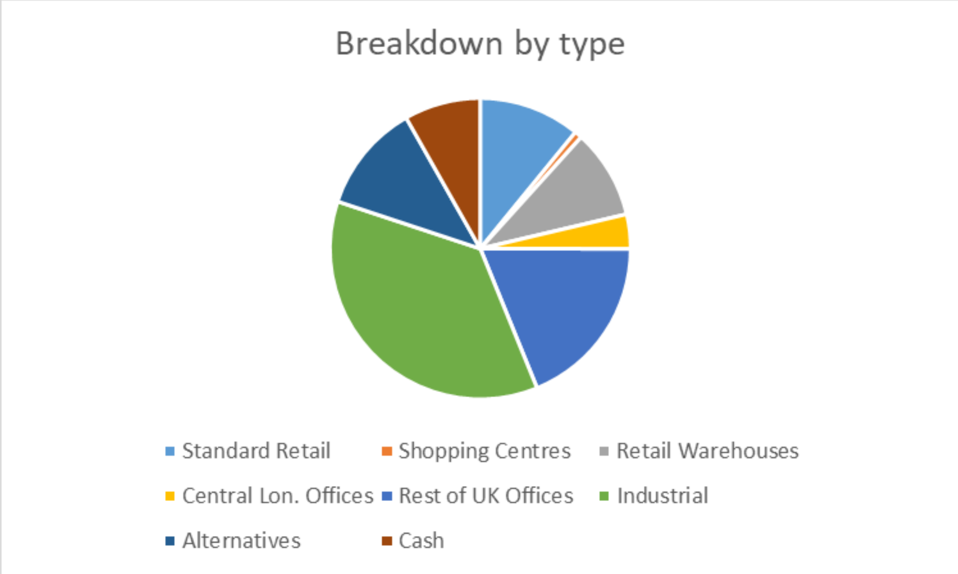
3.6.6 **Traditional Property** – The Schroders portfolio is on target compared to the asset allocation target. The Committee, at its last meeting, requested more detail about this part of the portfolio. The headline figure are set out here, as percentages:

	3 months %	12 months %	3 years %	5 years %	Since inception %
Portfolio return (net of fees)	**0.5**	**5.6**	**6.6**	**9.7**	**8.9**
Compared to MSCI / AREF UK Property Fund Index	**+0.2**	**+0.8**	**+0.5**	**+0.6**	**+1.1**

3.6.7 Returns remain strong and are above benchmark over all time periods. Performance exceeds the benchmark over three months (+0.2%), twelve months (+0.8%), three years (+0.5% per annum), five years (+0.6% per annum) and since inception (+1.1% per annum). The industrial sector, and alternatives were the strongest positive drivers of quarterly performance. Performance exceeded benchmark over the quarter (+0.2%). Value add funds (+0.3%) contributed positively. Core funds, real estate debt and cash holdings made a negligible contribution to relative returns. The Industrial Property Investment Fund (IPIF) was the strongest contributor to performance over the quarter, followed by Multi-Let Industrial Property Unit Trust (Multi-Let). UK Retail Warehouse Fund was the weakest contributor reflecting a further decline in valuations. Cash holdings (-0.2%) detracted from returns, whilst real estate debt made a negligible contribution to relative returns. The sector focussed industrial funds were amongst the strongest positive contributors over one year, alongside Metro Property Unit Trust (Metro), another fund with a significant exposure to industrials. The positive contribution of the three funds mirrored the situation in Q4 2018. UK Retail Warehouse Fund and Legal & General were the main detractors over twelve months.

3.6.8 Returns were above the benchmark over three years (+0.5% per annum), unchanged from the previous quarter. Value add funds (+0.7% per annum) and core funds (+0.3% per annum) both made a positive relative contribution to returns, whilst cash has detracted from returns (-0.2% per annum). The IPIF, Metro and Multi-Let funds have again been the strongest contributing funds over three years. The UK Retail Warehouse Fund, West End of London Property Unit Trust (fully disinvested) and Standard Life were the weakest contributing holdings to performance over three years. Returns exceeded the benchmark by +0.6% per annum over a five-year period. Value add (+0.9% per annum) and core funds (+0.3% per annum) have made a positive contribution to relative performance. Cash (-0.3% per annum) has diluted returns. IPIF, Metro and Hermes Property Unit Trust were the three strongest contributing holdings over five years. UK Retail Warehouse Fund is the weakest contributing holding over the same period. Portfolio returns have outperformed the benchmark by +1.1% per annum since inception.

3.6.9 This pie chart shows the composition of the fund.



Standard Retail 10.9%
Shopping Centres 0.8%
Retail Warehouses 9.6%
Central Lon. Offices 3.7%
Rest of UK Offices 18.8%
Industrial 36.2%
Alternatives 11.7%
Cash 8.2%

3.6.10 **Private Rental Sector –** £10.8m was drawn by M&G during the previous reported quarter. This means the Fund's total commitment of £60 m is now fully invested in the PRS mandate. The allocation is at 4.9% which is below the original target of 6%, but this is due to the good performance experienced by the rest of the portfolio. The Fund does not consider it appropriate to top up this part of the portfolio further.

3.6.11 The table below illustrates the movement in the Fund's valuation during the quarter and the current asset allocation against the target.

London Borough of Croydon Pension Fund
Fund valuation and asset allocation for the quarter ending 31 March 2019

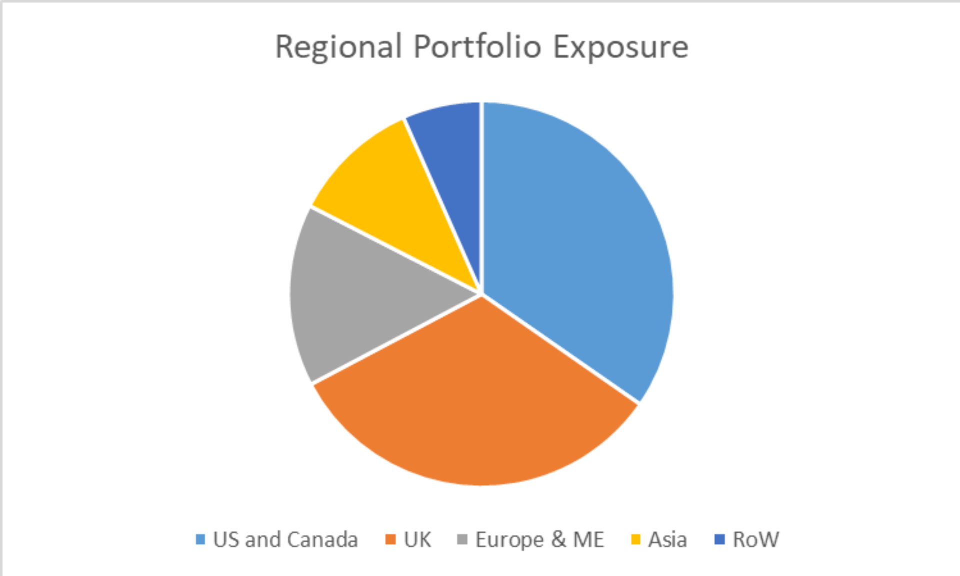
	Valuation at 31/12/2018 £'000	Net Cashflow £'000	Gain/loss £'000	Valuation at 31/03/2019 £'000	Asset Allocation Fund Percentage	Asset Allocation Target Percentage
Equities					**41.6%**	**42%**
Legal & General FTSE4Good	241	-	-2	239		
Lega & General FTSE World (Ex Tobacco)	417,508	-	40,484	457,993		
LCIV Emerging Markets	55,506	-	2,538	58,044		
Fixed Interest					**22.7%**	**23%**
Standard Life	127,200	-	4,028	131,228		
Wellington	64,735	-	2,391	67,126		
LCIV Global Bond	80,254	-	3,813	84,066		
Infrastructure					**11.5%**	**10%**
Access	13,574	-326	169	13,417		
Temporis	31,257	-	3,273	34,530		
Equitix	64,473	-2,849	2,420	64,045		
Green Investment bank	25,149	-994	-	24,155		
I Squared	4,754	-300	2,353	6,807		
Private Equity					**8.9%**	**8%**
Knightsbridge	28,971	88	160	29,219		
Pantheon	68,113	-1,950	-1,612	64,552		
Access	12,597	1,412	-858	13,151		
North Sea	2,452	800	-209	3,044		
Property					**10.0%**	**10%**
Schroders	123,553	-	851	124,403		
Property PRS					**4.9%**	**6%**
M&G	60,085	-	160	60,245		
Cash					**0.4%**	**1%**
Cash	645	4,845	46	5,536		
Fund Total	**1,181,068**	**726**	**60,005**	**1,241,799**	**100%**	**100%**

Valuations are based on the bid price as reported by the Fund Managers. The valuations of the Infrastructure and Private Equity funds are lagged by 3 months due to the timing of the reporting of these funds.

3.7 Regional Exposure

3.7.1 The Committee asked for an indication of the geographical dispersion of the underlying assets comprising the portfolio. This is set out graphically in the chart below. This information is for illustrative purposes only. It should be noted that there are differences in the period represented as some data is updated far more frequently than others.

Graph 2: Geographic dispersion of funds.



3.7.2 The descriptor Asia includes Japan, Korea and Australia. The rest of the world (RoW) includes the continent of Africa and Latin America.

Section 3: Risk Management

3.8 The principle risk addressed by the Funding Strategy is that returns on investment will fall below the target asset outperformance assumption to ensure that the Pension Fund matches the value of liabilities in the future. Dependent upon that are of course a number of issues.

3.9 The global economy will always represent a specific risk and opportunity for the Fund and will effectively be impossible to quantify or evaluate. As each asset class, investment strategy and characteristic will be impacted differently by any number of macroeconomic scenarios it is critical to ensure that the portfolio is sufficiently diversified. This will ensure that opportunities can be exploited and downside volatility reduced as far as possible.

3.10 Mercer, the Fund's investment advisor, have drafted a Fund Monitoring Report, for the 3 months to 31 March 2019. These reports are included in Part B of this Committee agenda.

Section 4: Investment Manager Visits

3.11 Members of the Pensions Committee continued with their programme of visits:

- Temporis, January 2019 and
- I Squared in February.

These visits help develop the relationship between investor and fund manager and count against training day requirements.

4 CONSULTATION

4.1 Officers have fully consulted with the Pension Fund's advisers in preparing this report.

5 FINANCIAL CONSIDERATIONS

5.1 This report deals exclusively with the investment of the Council's Pension Fund and compares the return on investment of the Fund against the benchmark return.

6. LEGAL CONSIDERATIONS

6.1 The Head of Litigation and Corporate Law comments on behalf of the Director of Law and Governance that there are no direct legal implications arising from the recommendations within this report.

Approved by: Sandra Herbert, Head of Litigation and Corporate Law on behalf of the Director of Law and Governance and Deputy Monitoring Officer.

7. FREEDOM OF INFORMATION/DATA PROTECTION CONSIDERATIONS

7.1 This report contains only information that can be publicly disclosed. The confidential information is reported in the closed part of the agenda.

CONTACT OFFICER:

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BACKGROUND DOCUMENTS:

Included in Part B of the agenda.
Quarterly reports from each fund manager (circulated under separate cove to the Committee Members.)

Appendices:

There are no part A appendices.

Part B appendices:

Pursuant to Schedule 12A paragraph 3: Information relating to the financial or business affairs of any particular person (including the authority holding that information), the following appendices are considered to be precluded from publication:

Appendix A: London Borough of Croydon Returns to 31 March 2019, Mercer

Appendix B: Market Background and Market View Q1 2019, Mercer