REPORT TO:	**PENSION COMMITTEE 7 January 2020**
SUBJECT:	**Progress Report for Quarter Ended 30 September 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 30 September 2019 was £1,332m compared to £1,295.3m at 30 June 2019, an increase of £36.7m and a return of 3.17% 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

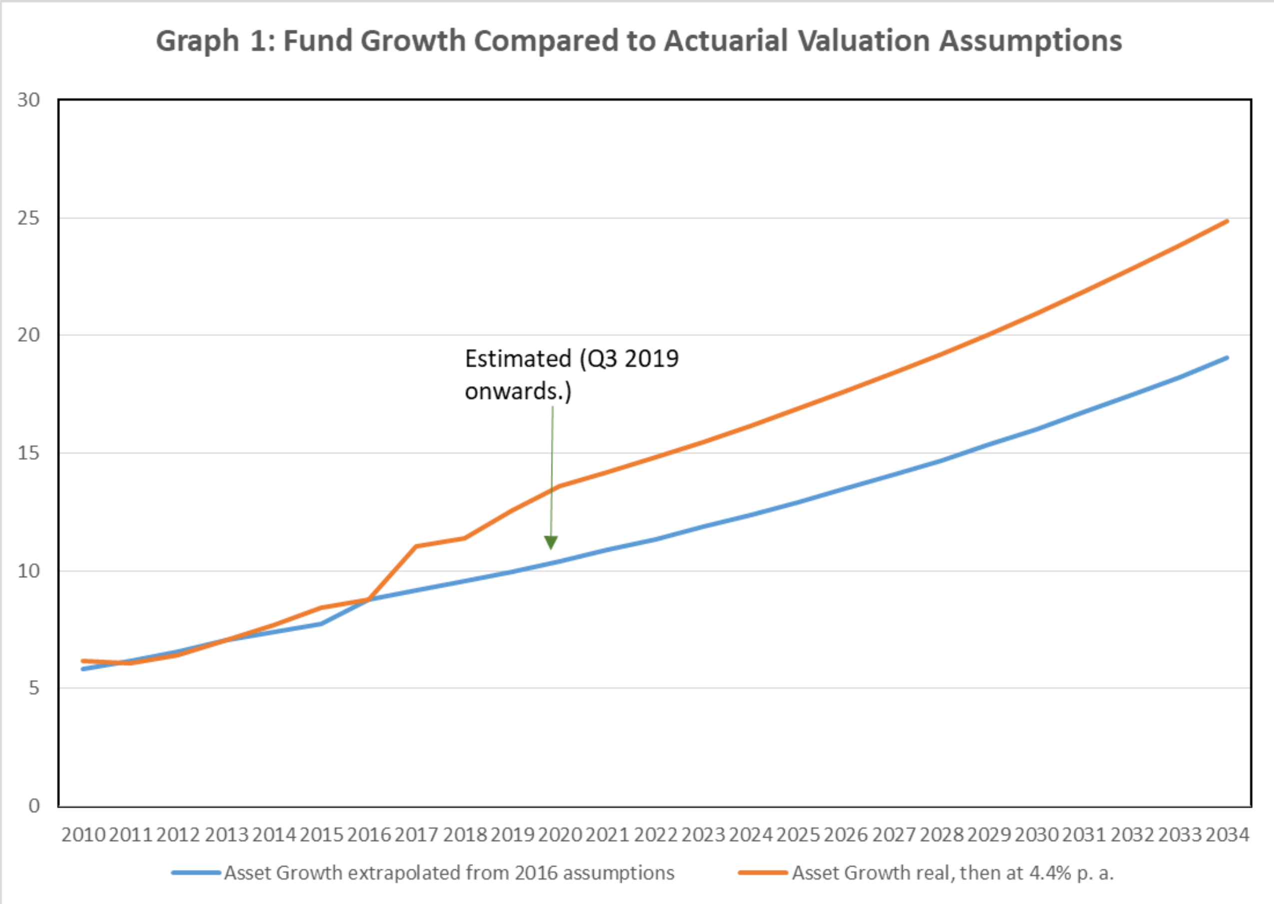
2.1 This report provides an update on the London Borough of Croydon Pension Fund's (the Fund's) performance for the quarter to 30 September 2019. The report falls into four parts. Section 1 addresses performance against strategic goals. The second section considers the asset allocation strategy and how 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. Over the three year valuation cycle since 2016 the investment return has been 41.1% against the expected return of 13.9%. This has had a positive impact on the funding level.



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 The 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. Members should note that the Council is seeking independent valuation for the property transfer project, discussed and agreed by the Committee 21 November, 2018. This will need to be reflected in future iterations of the Investment Strategy.

3.5 The target portfolio can be broken down as follows:

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

3.6 **Monitoring of asset allocation**

3.6.1 **Global Equity –** Our Global Equity portfolio had another strong quarter, returning 4.3% it was the major contributor to the good return of the Fund over the quarter. On 1 August 2019 a 50% currency hedge was applied to the LGIM Developed World (ex-Tobacco) Equity fund. As at 30 September 2019 the hedge was working in favour of the Fund, resulting in a gain of approximately £2m extra when compared to the unhedged element.

3.6.2 Equity returns have remained strong, although we are expecting these to soften over the medium term as the global economy starts to show signs of weakening. The allocation to Global equities was 41.9%, so considered at the target allocation for the Fund.

3.6.3 The Fund has experienced continued difficulties with the emerging London CIV Emerging Market equity fund. The fund underperformed the benchmark returning 7% (negative) against a benchmark of -1.1% (negative). Following the departure of the portfolio manager and immanent departure of his team from the current provider, Janus Henderson, the London CIV has been through a selection process and appointed JP Morgan to run the London CIV Emerging Market mandate. The transition to the JP Morgan mandate was set to take place post quarter end. During the transition it came to light that the new JP Morgan fund may not fulfill the ESG requirements of this Committee. Therefore a decision was taken to liquidate the fund in its entirety.

3.6.4 **Fixed Interest** – All four funds, managed by three managers, made positive contributions to returns and the target allocation to this asset class was maintained. Currently these funds are valued at 22.4% and are considered at the target allocation of the Fund.

3.6.5 **Infrastructure** – Due to the nature of the assets performance of Infrastructure investments and indeed Private Equity, discussed in more detail below, is better measured over a period of time, rather than on a quarter by quarter basis. All the Fund's Infrastructure investments are performing as expected and above the benchmark of CPI +5% on a since inception basis. The table below shows that the Fund is marginally over-exposed (11.8% compared with a target allocation of

10%). We are expecting this to continue in the short term as the Fund has had to over commit in order to get to the target allocation. Our allocations to Equitix, the Green Investment Bank, Temporis and Access are all yielding cash which will fund new investments and also ensure the allocation comes back into line over the medium term.

3.6.6 The Committee had asked in a previous meeting about how the Fund's Infrastructure investments are linked to inflation. Officers have analysed the portfolio and established that there is a strong linkage between inflation and the value of the infrastructure portfolio although the correlation is not perfect in that a 1% increase in inflation would not lead to a 1% increase in the value of the portfolio other things being equal. As there are many different assets within the portfolio, there are many different drivers to value some of these being directly linked to inflation and some indirectly. It should be noted that we have chosen a benchmark of CPI +5% and are confident that our investments will at least meet this target in any foreseeable scenario.

3.6.7 **Private Equity** – .The Fund's Private Equity managers performed particularly well over the quarter. The Fund received distributions of approximately £8m during the quarter that served to help with cash flow. This part of the portfolio is at 8.8% of the Fund which is slightly overweight. This is mainly due to the good performance of the asset class.

3.6.8 **Traditional Property** – The Schroders portfolio is on target compared to the asset allocation target. The portfolio continues to perform relatively well, especially considering the ongoing uncertainty caused mainly by BREXIT.

3.6.9 **Private Rental Sector –** The Fund's total commitment of £60m is now fully invested in the PRS mandate. The allocation is at 4.6% which is below the original target of 6%.This is mainly due to the good performance experienced by the rest of the portfolio and also to the stagnation of UK house prices. The mandate continues to perform well compared to the peer group. Although the Fund is below its target allocation, we do not consider it appropriate to top up this part of the portfolio further at this time.

3.6.10 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 30 September 2019

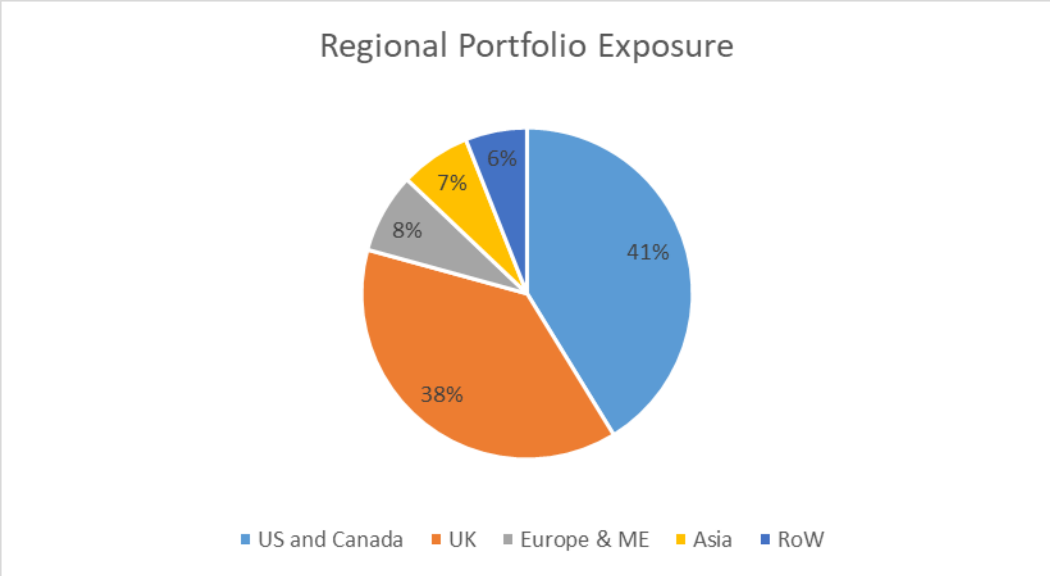
	Valuation at 30/06/2019 £'000	Net Cashflow £'000	Gain/loss £'000	Valuation at 30/09/2019 £'000	Asset Allocation Fund Percentage	Asset Allocation Target Percentage
Equities					**41.9%**	**42%**
Legal & General FTSE4Good	178	-	0	178		
Lega & General FTSE World (Ex Tobacco)	488,636	-10,000	21,030	499,666		
LCIV Emerging Markets	61,298	-	-2,875	58,422		
Fixed Interest					**22.4%**	**23%**
Standard Life	133,155	-	2,808	135,963		
Wellington	68,220	-	4,257	72,477		
LCIV Global Bond	87,245	-	2,120	89,364		
Infrastructure					**11.8%**	**10%**
Access	14,025	1,513	645	16,182		
Temporis	31,612	-241	977	32,348		
Equitix	65,694	7,807	1,243	74,744		
Green Investment bank	24,579	-240	-30	24,308		
I Squared	7,302	2,343	432	10,078		
Private Equity					**8.8%**	**8%**
Knightsbridge	31,423	226	2,632	34,281		
Pantheon	65,249	-2,331	4,184	67,102		
Access	15,458	-5,614	2,144	11,988		
North Sea	3,319	-	137	3,456		
Property					**9.5%**	**10%**
Schroders	125,410	-	759	126,169		
Property PRS					**4.6%**	**6%**
M&G	60,879	-	525	61,404		
Cash					**1.0%**	**1%**
Cash	11,618	2,235	10	13,863		
Fund Total	**1,295,300**	**-4,303**	**40,998**	**1,331,995**	**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 the latest available and can be lagged by 3 months.

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.

3.7.3 It should be noted that of the 38% invested in the UK 14% is allocated to Property and 10% to Infrastructure. The majority of the Private Equity and Global Equity investments are in the US and Canada.

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 30 September 2019. These reports are included in Part B of this Committee agenda.

Section 4: Investment Manager Visits

3.11 No visits were arranged during the quarter, however Members of the Pensions Committee met the following managers post quarter end:

- Schroders October 2019 and
- Pantheon November 2019

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 DATA PROTECTION IMPLICATIONS

6.1 Will the subject of the report involve the processing of ‘personal data’?

No.

Has a data protection impact assessment (DPIA) been completed?

No. This report relates to matters relating to the Pension Fund.

Approved by: Lisa Taylor, Director of Finance, Investment and Risk, S151 Officer

7. LEGAL CONSIDERATIONS

7.1 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.

8. FREEDOM OF INFORMATION/DATA PROTECTION CONSIDERATIONS

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

CONTACT OFFICER:

Nigel Cook – Head of Pensions and Treasury
Resources Department, ext. 62552.

BACKGROUND DOCUMENTS:

Included in Part B of the agenda.
Quarterly reports from each fund manager (circulated under separate cover 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 30 September 2019, Mercer

Appendix B: Market Background and Market View Q3 2019, Mercer