Croydon Council

REPORT TO:	**PENSION COMMITTEE** **17 March 2020**
SUBJECT:	**Progress Report for Quarter Ended 31 December 2019**
LEAD OFFICER:	**Nigel Cook** **Head of Pensions and Treasury**
CABINET MEMBER	**Councillor Simon Hall** **Cabinet Member for Finance and Resources**

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 December 2019 was £1,347.2m compared to £1,332m at 30 September 2019, an increase of £15.2m and a return of 1.07% 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.

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 December 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 are included as appendices to this report.

3 DETAIL

Section 1: Performance

3.1 The 2019 Triennial Actuarial Valuation has now been completed showing a whole of fund funding position of 88% using a future investment return assumption (otherwise described as the discount rate) of 4.0% p.a. The Fund would be 100% funded if an assumed investment return of 4.8% p.a. is used. 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 close.

3.2 Since the valuation date the Fund has returned 7.4%. This will have 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 to the Part B report.

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 day-today volatility of the markets.

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 **Monitoring of asset allocation**

3.6.1 **Global Equity –** The Global Equity portfolio had another strong quarter, returning 4.2%; it was the major contributor to the 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 31 December 2019 the hedge was working in favour of the Fund, resulting in a gain of approximately £17.2m extra when compared to the unhedged element.

Since the quarter end global equity markets have been negative due to the uncertainty caused by the possible effect of the coronavirus to global growth despite the attempts at intervention by the US Federal Reserve and announcements by the Bank of England.

3.6.2 The Fund divested from the London CIV Emerging Market mandate in November 2019 and is currently holding the proceeds in cash. This means the Fund is currently at the lower end of the target asset allocation, although we are comfortable with this position at the current time.

3.6.3 **Fixed Interest** – During the quarter fixed interest returns were flat and the target allocation to this asset class was maintained. Currently these funds are valued at 22.0% and are considered at the target allocation of the Fund.

3.6.3 **Infrastructure** – Due to the nature of the assets performance of Infrastructure investments and indeed Private Equity, discussed in more detail below, the performance of these investments 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 (paragraph 3.6.7) shows that the Fund is marginally over-exposed for this asset class (11.7% compared with a target allocation of 10%). Officers 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 of cash invested. 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.

3.6.4 **Private Equity** – .Private Equity showed a negative return over the quarter, this being a reflection of the strengthening pound following the General Election in December 2019, rather than being due to performance of the managers. The private equity programme is ongoing which means the effects of currency movements will be muted over the long term as calls and distributions are matched at a fairly even rate. This part of the portfolio is at 8.4% of the Fund which is slightly overweight. This is mainly due to the good performance of the asset class.

3.6.5 **Traditional Property** – The Schroders portfolio is on target compared to the asset allocation target. The portfolio continues to perform relatively well.

3.6.6 **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.

3.6.7 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 December 2019

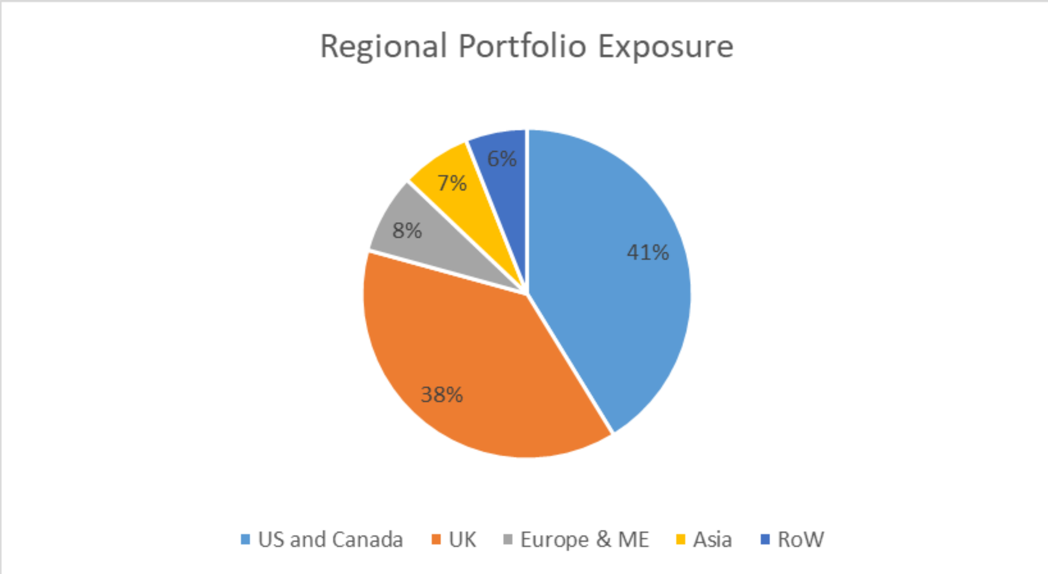
	Valuation at 30/09/2019 £'000	Net Cashflow £'000	Gain/loss £'000	Valuation at 31/12/2019 £'000	Asset Allocation Fund Percentage	Asset Allocation Target Percentage
Equities					38.7%	42%
Legal & General FTSE4Good	178	-	48	227		
Legal & General FTSE World (Ex Tobacco)	499,666	-	21,015	520,681		
LCIV Emerging Markets	58,422	-57,060	-1,362	-		
Fixed Interest					22.0%	23%
Standard Life	135,963	-	247	136,210		
Wellington	72,477	-	-2,871	69,607		
LCIV Global Bond	89,364	-	606	89,971		
Infrastructure					11.7%	10%
Access	16,182	1,394	-706	16,871		
Temporis	32,348	-4,133	-	28,215		
Equitix	74,744	731	1,203	76,679		
Green Investment bank	24,308	-592	363	24,079		
I Squared	10,078	1,938	-320	11,696		
Private Equity					8.4%	8%
Knightsbridge	34,281	239	-1,277	33,243		
Pantheon	67,102	-1,904	-3,530	61,667		
Access	11,988	2,068	-507	13,549		
North Sea	3,456	693	5	4,155		
Property					9.4%	10%
Schroders	126,169	-	1,005	127,175		
Property PRS					4.6%	6%
M&G	61,404	-16	284	61,672		
Cash					5.3%	1%
Cash	13,863	57,511	120	71,494		
Fund Total	**1,331,995**	**869**	**14,325**	**1,347,190**	**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. ME is the abbreviation for the Middle East.

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

3.7 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 a number of issues.

3.8 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.

3.9 Mercer, the Fund's investment advisor, have drafted a Fund Monitoring Report, for the 3 months to 31 December 2019 and an analysis of the state of the markets. These reports are included in Part B of this Committee agenda.

Section 4: Investment Manager Visits

3.10 During the quarter, Members of the Pensions Committee met the following managers:

- Schroders, October 2019
- Pantheon, November 2019
- Equitix, December 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. 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**

7.1 This report contains only information that can be publicly disclosed.

8 **DATA PROTECTION IMPLICATIONS**

8.1 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 administration of the LGPS and the Croydon Pension Fund.

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

9. HUMAN RESOURCES CONSIDERATIONS

9.1 There are no direct workforce implications arising from the recommendations within this report.

Approved by: Sue Moorman , Director of Human Resources

CONTACT OFFICER:

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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 31 December 2019, Mercer

Appendix B: Market Background and Market View Q4 2019, Mercer