

Croydon Council

REPORT TO:	PENSION COMMITTEE 15 September 2020
SUBJECT:	Progress Report for Quarter Ended 30 June 2020
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 June 2020 was £1,354.4m compared to £1,347.2m at 31 December 2019, an increase of £7.2m and a return of 1.0% over the half year. 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 half year to 30 June 2020.

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 half year to 30 June 2020. 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 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 For the 18 month period since the valuation date the Fund has returned 8.3% against an assumed return of 6.1% from the valuation. This has had a positive impact on the funding level and to date shows the resilience of the Fund despite the negativity brought about by the COVID-19 pandemic. No one can be certain what the future will bring, but we remain confident that the diverse nature of the Fund puts it in as good a position as any to deal with what lies ahead.
- 3.3 Details of the performance of individual components of the portfolio are detailed in the report produced by the Fund's investment advisors which is in Appendix A of the Part B report.

Section 2: Asset Allocation Strategy

- 3.4 The current asset allocation strategy was approved at the Committee meeting held on 17 March 2020 (Minute 24/20 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.		40%	+/- 5%
Fixed interest		20%	+/- 5%
Alternates		40%	+/- 5%
<i>Comprised of:</i>			
Private Equity	10%		
Infrastructure	14%		
Property (Commercial & Residential)	16%		
Cash			
	Total	100%	

3.6 Monitoring of asset allocation

3.6.1 **Global Equity** – During the quarter to 31 March 2020, our Global Equity portfolio returned -18.2% (negative) as the COVID-19 impact hit the Global markets. On 16 April 2020 the Fund invested £55m in the LCIV Sustainable Equity Exclusion Fund as directed by the Pensions Committee on 17 March 2020. The mandate which is managed by RBC Global Asset Management (UK) Limited (RBC) has strong ESG credentials and has outperformed the benchmark index over multiple time horizons dating back to its inception in 2006. The RBC mandate has gained 15.5% against a benchmark of 13.3% since the date the Fund made the investment to 30 June 2020. For the quarter to 30 June 2020 Global equities returned 19.8% which mean the performance of the Global equity portfolio for the half year to 30 June 2020 was slightly down by -0.9%.

We continue to monitor the effectiveness of currency hedging strategy which was implemented in August 2019.

As at 30 June 2020 the Fund's allocation to Global Equities stood at 42.2% which is within the target range.

3.6.2 **Fixed Interest** – During the quarter to 31 March 2020 fixed interest returns among our three managers were mixed and overall recorded a negative return of -2.4%,(negative), however like Global Equities, the return for Fixed Interest investments bounced back in the quarter to 30 June 2020 recording a return of 5.5%; meaning the return for the half year was 3.0%. The allocation to this asset class at 30 June 2020 was 22.5%, which is within the target range.

3.6.3 **Infrastructure** – To date Covid-19 has had little operational impact on the performance of the Fund's Infrastructure assets. However, the majority of the Fund's Infrastructure assets are valued using a discounted cash flow methodology and Officers continue to monitor the Investment managers' assumptions used when valuing these assets. Covid-19 may have an impact on longer term assumptions such those used for power prices, interest rates and inflation rates. Changes to the assumptions could have a material impact on the valuations of these assets. During the half year to 30 June 2020 Infrastructure assets returned 2%. The Fund now has a 12.5% allocation to Infrastructure assets compared to the revised target allocation of 14%. Officers continue to look for opportunities with both our existing managers and potential new managers including the London CIV.

- 3.6.4 **Private Equity** – Private Equity showed a return of 6% over the half year to 30 June 2020. All the Fund's private equity investments are valued in either Euros or US Dollars and it should be noted that the positive returns have solely been as a result of currency movement, rather than the performance of the underlying assets. The private equity holdings are well diversified, but tend to be invested in small to medium sized businesses which tend to have been the most affected by the Covid-19 pandemic. The Fund's private equity portfolio has held up relatively well to date, but we remain cautious about the outlook. On the positive side this could present increased opportunity for further investment.
- 3.6.5 **Traditional Property** –Our Property portfolio has seen the biggest negative impact from Covid-19 so far and has the greatest uncertainty about the future outlook. The national lockdown has had a huge effect on the ability of businesses to trade and therefore rent collections and valuations. This has led to a -3.2% (negative) return for the half year to 30 June 2020. Our property managers have been working hard to minimize the impact of Covid-19 introducing rent reductions and deferrals to protect the long term viability of tenants struggling with cash flow. We expect there to be further volatility in the property sector over the next year as the impact of Covid-19 and the effects this may have on future behavior becomes better understood. The portfolio is slightly below the target asset allocation and we expect this to continue. Committee are reminded that property is a long term investment and Officers are continuing to monitor the situation for signs of more clarity on the future outlook.
- 3.6.6 **Private Rental Sector** – The Fund's total commitment of £60m is fully invested in the PRS mandate and the allocation is at 4.6% which is below the original target of 6%. PRS is another sector which is facing very challenging conditions caused by the Covid-19 pandemic. Rent collections have remained strong to date, however occupancy rates have come under pressure. 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 Members will be aware of the scheme to transfer property from the Council to the Pension Fund in lieu of contributions. Discussions are in train to establish the appropriate treatment for this transaction. This will be reflected in future progress reporting.

3.6.8 The tables below illustrates the movement in the Fund's valuation during the quarter to 31 March 2020 which is the accounting year end and the quarter to 30 June 2020 the quarter following the year end. It also shows the current asset allocation against the target.

London Borough of Croydon Pension Fund
Fund valuation and asset allocation for the quarter ending 31 March 2020

	Valuation at 31/12/2019 £'000	Net Cashflow £'000	Gain/loss £'000	Valuation at 31/03/2020 £'000	Asset Allocation Fund Percentage	Asset Allocation Target Percentage
Equities					33.9%	42%
Legal & General FTSE4Good	227	-	80	307		
Legal & General FTSE World (Ex Tobacco)	520,681	-	94,722	425,959		
Fixed Interest					23.0%	23%
Standard Life	136,210	-	3,882	132,328		
Wellington	69,607	-	2,777	72,383		
LCIV Global Bond	89,971	-	5,867	84,104		
Infrastructure					13.3%	10%
Access	16,871	1,507	1,138	19,516		
Temporis	28,215	2,291	1,879	28,627		
Equitix	76,679	-	479	78,071		
Green Investment bank	24,079	-	707	22,302		
I Squared	11,696	5,742	1,180	18,619		
Private Equity					9.1%	8%
Knightsbridge	33,243	-	593	2,930		
Pantheon	61,667	-	3,129	2,361		
Access	13,549	639	1,031	13,157		
North Sea	4,155	674	0	4,829		
Property					9.9%	10%
Schroders	127,175	-	2,527	124,648		
Property PRS					4.9%	6%
M&G	61,672	-	267	61,939		
Cash					5.9%	1%
Cash	71,494	1,946.35	130	73,570		
Fund Total	1,347,190	7,891	- 98,241	1,256,840	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 at 31 March 2020.

London Borough of Croydon Pension Fund

Fund valuation and asset allocation for the quarter ending 30 June 2020

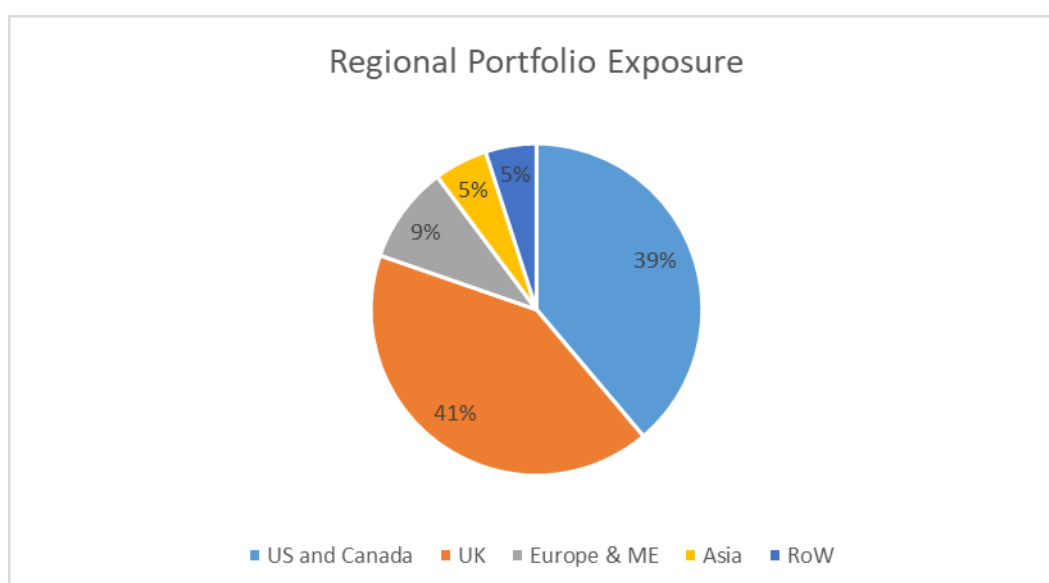
	Valuation at 01/04/2020 £'000	Net Cashflow £'000	Gain/Loss £'000	Valuation at 30/06/2020 £'000	Asset Allocation Fund Percentage	Asset Allocation Target Percentage
Equities					42.2%	40%
Legal & General FTSE4Good	307	-	11	318		
Legal & General FTSE World (Ex Tobacco)	425,959	-	81,681	507,640		
LCIV RBC	-	55,000	8,191	63,191		
Fixed Interest					22.5%	20%
Standard Life	132,328	-	7,265	139,593		
Wellington	72,383	-	2,331	74,714		
LCIV Global Bond	84,104	-	6,303	90,407		
Infrastructure					12.5%	14%
Access	19,516	448	610	19,677		
Temporis	28,627	-	140	28,766		
Equitix	78,071	622	1,336	80,028		
Green Investment bank	22,302	520	192	21,589		
ISquared	18,619	-	214	18,833		
Private Equity					8.6%	10%
Knightsbridge	35,581	410	142	35,312		
Pantheon	60,899	936	476	60,439		
Access	13,157	-	1,673	14,831		
North Sea	4,829	727	132	5,688		
Property					9.1%	10%
Schroders	124,648	-	1,556	123,092		
Property PRS					4.6%	6%
M&G	61,939	-	47	61,987		
Cash					0.6%	0%
Cash	73,570	65,277.63	8	8,300		
Fund Total	1,256,839	11,244	108,810	1,354,406	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 geographical dispersion of the underlying assets comprising the portfolio 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 41% invested in the UK 13.7% 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. As an example, the portfolio has benefited from the impact of the Covid 19 pandemic, contrary to intuitive expectations.
- 3.10 It is probably too early to assess the long-term impact of the pandemic, setting aside the personal impact on a great number of people. Much ink has been spilled as to whether the markets will experience a 'V-shaped' or 'U-shaped' recovery and over what period. Many of these arguments were rehearsed during the 2008 Global Financial Crisis. The current portfolio was designed with diversity in mind to ensure that such events could be mitigated and to date we have not experienced the phenomenon whereby asset classes tended to all correlate. Stock markets have rallied vigorously and indeed both equities and fixed interest are over-weight in the portfolio. Infrastructure and Private Equity have been impacted because of the global reach of the economic impact of the crisis; property has been impacted the most. However, by and large the portfolio has performed as expected and returns have held up. No reactive measures are required.
- 3.11 Mercer, the Fund's investment advisor, have drafted two reports covering the recent period, one analysing performance and the other the state of the markets. These reports are included in Part B of this Committee agenda.

Section 4: Investment Manager Visits

- 3.12 With the impact of the lockdown most meetings were virtual affairs, conducted by Teams, Zoom or the like. During 2020 officers have met with:

Access Capital Partners, April 2020, (Infrastructure, Buy Out);
The London CIV, April 2020;
Equitix, April 2020, (Energy Efficiency Fund AGM);
Access C P, April 2020 (Buy Out I Advisory Committee);
The London CIV, May 2020, (Renewables Seed Investor Group);
Equitix, May 2020;
Access C P, May 2020 (Infrastructure II and Buy Out Co-investment);
M&G Residential, May 2020;
London CIV, May 2020, (Business Update);
Wellington, June 2020;
Knightsbridge, June 2020, (Funds VII, VII and IX);
London CIV, June 2020, (Cost Transparency Workshop);

Equitix, June 2020, (Funds I, II, IV and V);
London CIV, June 2020, (Business Update);
Pantheon, June 2020, (Advisory Committee);
London CIV, June 2020, (Sustainable Exclusion Investment Fund);
Schroders, June 2020;
London CIV, July 2020, (Business Update);
London CIV, August 2020, (Funding Model Workshop).

In addition, the Chair and Vice-Chair met:

Knightsbridge, January 2020 (Funds VII, VIII and IX).

These meetings are critical in ensuring close management of the portfolio and in building strong business relationships.

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 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 June 2020, Mercer

Appendix B: Market Background and Market View Q1 & Q2 2020, Mercer