REPORT TO:	**Pension Committee 3 December 2021**
SUBJECT:	**Progress Report for Quarter Ended 30 September 2021**
LEAD OFFICER:	**Nigel Cook - Head of Pensions and Treasury**

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 provides Members with performance information regarding investment of the pension Fund. Appendix A and Appendix B contain commercially sensitive reports prepared by the Council's advisers to inform the Committee and are exempt from publication

This report shows that the market value of the Pension Fund (the Fund) investments as at 30 September 2021 was £1,652.1m compared to £1,619.3m at 30 June 2021, an increase of £32.8m and a return of 2.22% 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

This report provides Members with performance information in relation to the Pension Fund over the most recent quarter ended 30 September 2021.Performance analysis and market commentary provided by Mercer are included at Appendix A and Appendix B respectively but are withheld from publication in view of the commercially sensitive nature of the information contained.

1.1 The Committee is asked to note the performance of the Fund for the quarter ended 30 September 2021.

1.2 The Committee is asked to note the investment advice set out in paragraph 3.6.9, to divest £33m from the LGIM developed world (ex-tobacco) equity fund with the proceeds being invested in the Pimco Global Bond Mandate which is offered through the London CIV.

1.3 Agree to the high level portfolio structure set out in paragraph 3.6.12 with an immediate action to increase the allocation to LCIV Sustainable Equity Exclusion Fund (RBC) by £52m (20% of the strategic equity allocation)

1.4 Undertake a high level strategy review focussing on the approach to currency hedging and allocation to alternatives

1.5 Investigate LCIV PEPPA and LCIV RIF in more detail (including liquidity profile)

1.6	Look at the other LCIV equity managers to fill the final slot (if neither are deemed appropriate we will re-visit the underlying allocations)

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 2021. 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 meetings. Detailed numeric data and commentary from the Fund's advisors is included as appendices to this report. This report makes recommendations to the Committee as to how to amend the current asset allocation to incorporate the results of recent discussions by Members.

3. DETAIL

Section 1: Performance

3.1 At the 2019 Triennial Actuarial Valuation the whole of fund funding position was 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. was 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 made a cumulative return of 32.75% against a return of 10.3% assumed by the valuation. 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 Pension Committee discussed changes to the current asset allocation strategy at the Committee meeting held on 17 March 2020 (Minute A27/20 refers). However, reviewing the current allocation it is apparent that the target allocation cannot yet be applied as it has not been formally adopted because, as per the Minute – “Officers pointed out that they were not able to give investment advice and the Pension Fund’s investment adviser had not been given the opportunity to offer appropriate advice to inform the decision.” The prudent option is therefore to measure allocation against the prior allocation. This option is supported by the Pension Fund’s investment advisers. Any proposal to amend this asset allocation will require a period of consultation with other Scheme Employers.

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%		
Property	16%		
	Cash	**1%**	
	Total	**100%**	

3.6 **Monitoring of asset allocation**

3.6.1 **Global Equity –** During the quarter the LGIM Developed World (ex-Tobacco) Equity fund returned 1.28%. The currency hedge curbed the returns slightly as Sterling weakened against most other major currencies, although the hedge has still led to over £22m of excess gains since its implementation.

The LCIV RBC fund continues to perform well and returned 3.64% over the quarter.

Officers and Advisers are currently looking at new products offered by the London CIV with the view to decarbonise the equity portfolio further. Officers are conscious of the need to do this, but need to ensure that this does not bring excess risk to the Fund and does not impede on returns.

Global equities are now at 45.9% compared to the target allocation of 42% with a 5% tolerance. This has largely been due to equity returns significantly outpacing most of the other areas of the portfolio over the last few years.

3.6.3 **Fixed Interest** – During the quarter fixed interest returns were pretty flat returning negative 0.1%. The allocation is 18.5% which is within the target allocation of 23% allowing for a 5% tolerance.

3.6.2 **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 in line with their targets.

The Fund has increased commitments with some of its existing managers and is also assessing opportunities with the London CIV. The allocation currently stands at 10.7% compared to a target of 10%.

3.6.4 **Private Equity** – Our Private Equity managers continue to perform extremely well and have been the main contributor to positive returns over the last few years. The performance of private equity investments tends to follow the same direction as global equities. The allocation is at 10.1% which is above the target allocation of 8%.

3.6.5 **Property** – The Property allocations have increased from 12.1% to 12.3% over the quarter. This is well short of the target of 16% and is largely as a result of the excess returns from global equities. Commercial property investments suffered as a result of COVID-19, however the Property portfolio has now returned 6% in the first half of the year.

3.6.6 The Fund's investment advisers, Mercers, were asked to provide advice in respect of the asset allocation. The rest of this section sets out that advice.

3.6.7 Due to the continued strong performance of equities, the Fund's equity allocation (46% of total assets) has moved overweight versus the benchmark position (42% of assets as per the most recently published Investment Strategy Statement). This overweight position has been beneficial to 30 September and beyond as equities have continued to deliver while bond yields have (on the whole) risen.

3.6.8 The Fund's equity position is starting to approach the upper end of the operational range set at 47%. As such, the Pensions Committee ("the Committee") may want to consider rebalancing the position to control risk. To balance a disciplined approach to risk versus regret risk of equities continuing to outperform, in the first instance we would recommend rebalancing the equity portfolio half-way back to the benchmark position. This means reducing the equity portfolio by 2% of total assets or £33m.

3.6.9 If the Committee want to make this rebalancing move we would suggest divesting £33m from the LGIM developed world (ex-tobacco) equity fund with the proceeds being invested in the Pimco Global Bond Mandate with LCIV. This reflects:

- The consideration of increasing the allocation to the RBC mandate;
- Underweight position to fixed income and the liquidity of the portfolio ; and
- The fixed income review currently in the work plan and the fact the Pimco mandate was the most recently selected component of the fixed income portfolio, is the only fixed income allocation that is pooled and has been the strongest performing fixed income fund. As such of all the fixed income funds, the Pimco mandate is the one most likely to remain in the long-term. We also understand from LCIV that the mandate excludes tobacco credits.

3.6.10 The following paragraphs provide a high level view of the Fund's equity allocation and answer specific questions posed by the Committee Chair on behalf of the Pensions Committee. They refer to funds managed by the London Collective Investment Vehicle or LCIV.

LCIV PEPPA Fund

3.6.11 The PEPPA fund is still relatively new. Having done initial investigations on it, Mercer would be supportive of an allocation to PEPPA as a Responsible Investment (RI) aware passive approach. Mercer notes that there is not a currency hedged version of the PEPPA fund for the Fund to replicate the current approach to currency management. LCIV would need to be asked to set-up an FX version of the PEPPA fund or a different approach to currency hedging would need to be adopted. More details of the LCIV PEPPA fund are included in Part B of this agenda.

Portfolio Structure

3.6.12 Ideally the equity portfolio should demonstrate a diversification across styles, approach, sectors and risks. Having looked at the options currently available on LCIV and bearing in mind the governance of the Pensions Committee this report recommends the Committee investigate a high level portfolio structure with a RI aware passive core with active managers satellite managers appropriately sized. This table sets out this recommendation.

Approach	**Current Allocation**	**Suggested Allocation**	**Current Manager**	**Suggested Approach**
Passive/RI Passive	88%	60%	LGIM Dev World (ex-tobacco) 50% fx hedged	Undertake full due-diligence on LCIV PEPPA fund including approach to currency hedging.
Active manager 1	12%	20%	LCIV Sustainable Equity Exclusion Fund (RBC)	Increase allocation to fund by c.£52m (to fill strategic allocation)
Active manager 2 (optional)	0%	20%	None	Continue to hold allocation passive. Investigate other active manager options on LCIV.*

3.6.13 The following funds on LCIV are suitable for investigation for the active manager 2 slot given the Fund's ESG policy:

1. LCIV Global Equity Core (to be renamed Resilient Quality Global Equity), managed by MSIM (exclusion to be formalised in Q1 2022).
2. LCIV Global Alpha Growth Paris Aligned Fund managed by Baillie Gifford (exclusion due to adherence to Paris-aligned benchmark exclusions).

These options would need further investigation as to their suitability.

LCIV Renewable Infrastructure Fund

3.6.14 The attached note (Appendix C: London CIV: Renewable Infrastructure Fund) sets out the information on the LCIV Renewable Infrastructure Fund ('RIF'). Mercer would be supportive of an allocation to RIF, however given the lock-up period and fund nature, it would more naturally sit in the alternatives portfolio. This would necessitate an increased strategic allocation to alternatives, formally agreed and reflected in the Investment Strategy Statement. That can be investigated as part of the strategic asset allocation review in early 2022. That said given the liquidity of the RIF fund, the Committee may wish to investigate RIF in tandem with that review.

Next steps

3.6.15 The following next steps are recommended:

1. To agree to the high level portfolio structure set out in paragraph 3.6.12 with an immediate action to increase the allocation to LCIV Sustainable Equity Exclusion Fund (RBC) by £52m (20% of the strategic equity allocation);
2. Divest £33m from the LGIM developed world (ex-tobacco) equity fund with the proceeds being invested in the Pimco Global Bond Mandate with LCIV;
3. To undertake a high level strategy review focusing on the approach to currency hedging and allocation to alternatives;
4. To investigate LCIV PEPPA and LCIV RIF in more detail (including liquidity profile); and
5. To look at the other LCIV equity managers to fill the final slot (if neither are deemed appropriate to re-visit the underlying allocations).

3.6.16 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 2021

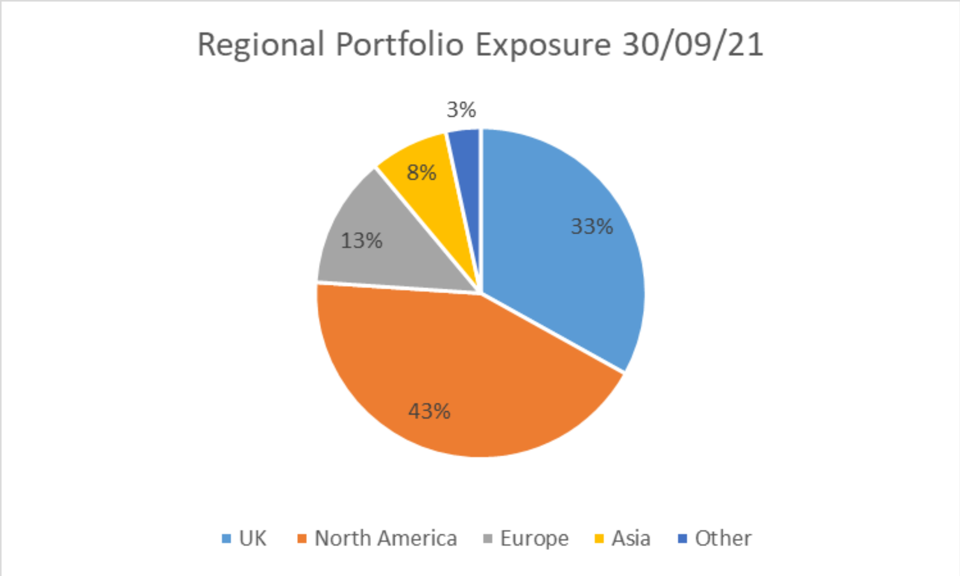
	Valuation at 30/06/2021 £'000	Net cashflow £'000	Gain/Loss £'000	Valuation at 30/09/2021 £'000	Asset allocation Fund percentage	Asset allocation target percentage
Equities					45.9%	42%
Legal & General FTSE World (Ex Tobacco)	663,292	-	8,621	671,912		
LCIV RBC	83,773	-	3,168	86,941		
LCIV	150			150		
Fixed Interest					18.5%	23%
Standard Life	141,825	-	-1,707	140,118		
Wellington	71,527	-	-1,179	70,348		
LCIV Global Bond	94,642	-	98	94,740		
Infrastructure					10.7%	10%
Access	28,619	53	31	28,703		
Temporis	29,754	-	2	29,756		
Equitix	75,989	-1,152	419	75,256		
Macquarie GIG Renewable Energy	21,000	-410	-	20,590		
I Squared	20,995	1,092	543	22,631		
Private Equity					10.1%	8%
Knightsbridge	51,216	-1,399	9,290	59,106		
Pantheon	70,527	-4,353	8,773	74,948		
Access	21,122	-785	22	20,359		
North Sea	10,554	782	1,407	12,743		
Property					12.3%	16%
Schroders	133,869	-	5,782	139,651		
M&G	62,365	-234	605	62,736		
Cash					2.5%	1%
Legal & General FTSE4Good Cash	727	-	11	738		
Cash	37,380	3,298	-	40,678		
Fund Total	1,619,324	-3,106	35,886	1,652,104	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 33% invested in the UK 12.3% is allocated to Property and 7.5% 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 of course 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 adviser, have drafted a Fund Monitoring Report, for the 3 months to 30 September 2021. These reports are included in Part B of this Committee agenda.

Section 4: Investment Manager Visits

3.10 During the quarter, Officers met the following managers:

- Temporis July 2021;
- The London CIV about their Passive Equity Progressive Paris Aligned Fund (PEPPA), July 2021;
- M&G, August 2021; ; and
- The London CIV's Medium Term Financial Strategy September 2021.

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.

Approved by: Richard Ennis, Interim Corporate Director of Resources (Section 151) and Deputy Chief Executive

6. LEGAL CONSIDERATIONS

6.1 The Head of Litigation and Corporate Law comments on behalf of the interim Director of Law and Governance that there are no direct legal implications arising from the recommendations within this report. The Committee must, however, be mindful of their fiduciary duty to obtain the best possible financial return on the investment of the Fund it administers within the investment strategy framework.

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

7. HUMAN RESOURCES IMPACT

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

Approved by: Dean Shoesmith, Interim Chief People Officer

8. EQUALITIES IMPACT

8.1 There are no equalities impacts arising from this report.

9. ENVIRONMENTAL IMPACT

9.1 There are no environmental impacts arising from this report.

10. CRIME AND DISORDER REDUCTION IMPACT

10.1 There are no crime and disorder impacts arising from this report.

11. FREEDOM OF INFORMATION/DATA PROTECTION CONSIDERATIONS

11.1 This report and Appendices contain confidential information which could be of a sensitive nature, disclosure of which could prejudice the commercial interest of the companies involved and those of the Council's Pension Fund and will be reported in the closed part of the agenda. On application of the public interest test it is considered that the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

Approved by: Nigel Cook, Head of Pensions and Treasury

CONTACT OFFICER:

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

APPENDICES:

Part A

There are no Part A appendices.

Part B

Exempt 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 2021, Mercer
Appendix A: London Borough of Croydon Investment performance report – quarter to 30 September 2021, Mercer exempt from public disclosure under paragraph 3 of schedule 12A of the Local Government Act 1972, as amended and the public interest in withholding this information outweighs the public interest in disclosure.

Appendix B: Market Background and Market View Q3 2021, Mercer
Appendix B: Market background and outlook – 30 September 2021, Mercer exempt from public disclosure under paragraph 3 of Schedule 12A of the Local Government Act 1972, as amended and the public interest in withholding this information outweighs the public interest in disclosure.

Appendix C: London CIV: Renewable Infrastructure Fund, Initial Information, Mercer, November 2021

Appendix D: London CIV: PEPPA Fund, Initial Information, Mercer, November 2021

BACKGROUND DOCUMENTS:

Included in Part B of the agenda.
Quarterly reports from each fund manager (circulated under separate cover to the Committee Members.) Exempt pursuant to Schedule 12A paragraph 3 of the Local Government Act 1972 as amended.