Croydon Council

REPORT TO:	**PENSION COMMITTEE** **20 June 2023**
SUBJECT:	**Part A -Progress Report for Quarter Ended 31 March 2023**
LEAD OFFICER:	**Matthew Hallett** **Head of Pensions and Treasury**
CORPORATE PRIORITY/POLICY CONTEXT: **Sound Financial Management**: Reviewing and ensuring that the performance of the Council's Pension Fund (the 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 Fund investments as at 31 March 2023 was £1,674.2m compared to £1,620.9m at 31 December 2022, an increase of £53.3m and a return of 3.54% 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 and are included in the part B report.	
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 ended 31 March 2023.

2 EXECUTIVE SUMMARY

2.1 This report provides an update on the Fund's performance for the quarter to 31 March 2023. 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.

3 DETAIL

Section 1: Performance

3.1 At the 2022 Triennial Actuarial Valuation funding position for the Fund was 97% 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 4.2% p.a. was used and the likelihood of achieving this investment return was deemed to be 73%. 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 At the 2019 valuation date the Fund was 88% funded with assets totalling £1,258m. From the 2019 valuation to the 2022 valuation the funding position improved to 97%. The main reason for this improvement was due to investment returns being 23.9% (or £299m) higher than expected. The assets at the valuation date of 31 March 2022 were £1,731m.

3.3 Since the valuation date the assets have returned -2.44% compared to the investment return assumption of 4.0%. In isolation the investment returns have had a negative impact on the funding level, however it should be noted that this would be outweighed by a positive impact due to a decrease in liabilities under current market conditions.

Section 2: Asset Allocation Strategy

3.4 Following the results of the triennial valuation at 31 March 2022, the Fund’s investment advisers are in the process of conducting an asset allocation review in consultation with the Pension Committee. The current target allocations will be amended when this review has been completed.

3.5 The current 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 –** Global equities rallied in the first part of the quarter as investors decided that inflation concerns were easing enough to allow central banks to moderate the pace of tightening. This was short lived as the failures of Silicon Valley Bank and Signature Bank bought the risk of contagion, although this was muted by the action of central banks. This all led to a positive return of 6.12% for the LGIM

Developed World (ex-Tobacco) Equity fund which follows that of the major indices. The LCIV RBC fund again suffered due to its stock selection and returned -0.34% for the quarter. The LCIV RBC fund has performed slightly below its benchmark (12.75% compared to 14.62%) since its inception on 16/04/2020.
Global equities are now at 44.7% compared to the target allocation of 42%.

3.6.2 **Fixed Interest** – During the quarter fixed interest investments continued to recover with a positive return of 1.83%, with Aberdeen Standard 0.85%, Wellington 2.21% and the LCIV Global Bond 3.06%. Positive returns for the quarter were down to expectations of easing inflation and stabilization interest rates at the start of the quarter and also due to being underweight in long term duration.
The overall allocation was 15.7% of the portfolio, remaining outside the target allocation of 23% allowing for a 5% tolerance. This is largely due to the poor performance of bonds when compared to the other asset classes. Given the continued uncertainty Officers have continued in not rebalancing the Fund with the view to waiting for the outcome of the strategic asset allocation review which is being conducted over the coming months.

3.6.3 Infrastructure – Due to the nature of these assets, performance of Infrastructure investments and indeed Private Equity, discussed in more detail below, is better measured over a period of time, rather than quarter by quarter. All the Fund's Infrastructure investments continue to perform well largely due to their link to inflation. The renewable investments have performed particularly well recently due to increased inflation expectations and increases in power prices, both of which have a positive impact on the returns. There was an uplift of £20.5m to the Temporis investments which was due to the valuations being conducted as part of their accounts at 31 December 2022. The allocation currently stands at 14.8% compared to a target of 10%.

3.5.4 **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. During the last quarter the valuations have come down as they tend to follow the direction of global equities, however the performance of the underlying companies remains strong and so there is currently no cause for concern. The majority of the Fund's private equity investments are priced in foreign currency so as Sterling strengthened over the quarter relative to the US dollar and Euro this compounded the negative returns. Over the quarter the allocation moved from 11.0% to 10.0%. This is above the target allocation of 8%.

3.5.5 **Property** – During the quarter the Schroders property portfolio returned 0.48% and the M&G UK Residential Property Fund returned -0.73%. UK commercial real estate has seen a sharp correction in prices over the last nine months as a result of high inflation and increasing interest rates. Negative capital returns have principally been driven by an outward yield shift as low yields in the sector have become expensive relative to 10year gilts. The quarter saw the first signs of stabilization. Although negative, on a relative basis, the performance of the Fund's property portfolios has been good. The MSCI/AREF UK Quarterly Property Fund Index returned -0.2% for the quarter. The property allocation now makes up 12.0% of the Fund. The outlook for 2023 is that the property sector will remain challenging. The Fund's property portfolio is positioned defensively being underweight to retail and office sectors.

3.5.6 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 2023

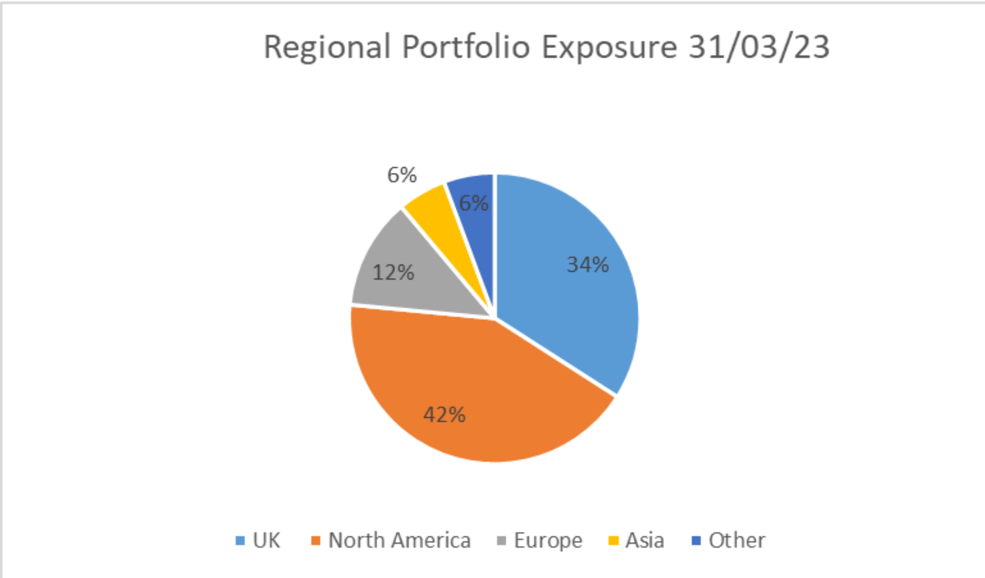
	Valuation at 31/12/2022 £'000	Net cashflow £'000	Gain/Loss £'000	Valuation at 31/03/2023 £'000	Asset allocation Fund percentage	Asset allocation target percentage
Equities					44.7%	42%
Legal & General FTSE World (Ex Tobacco)	632,159	-	38,704	670,863		
LCIV RBC	78,230	-	- 267	77,964		
LCIV	150			150		
Fixed Interest					15.7%	23%
Standard Life	122,030	-	1,036	123,066		
Wellington	56,097	-	1,239	57,336		
LCIV Global Bond	79,372	-	2,432	81,804		
Infrastructure					14.8%	10%
Access	35,635	948	- 17	36,566		
Temporis	58,114		20,508	78,622		
Equitix	79,026	- 1,674	1,278	78,630		
Macquarie GIG Renewable Energy	24,212	- 944	-	23,268		
I Squared	29,251	-	1,061	30,312		
Private Equity					10.0%	8%
Knightsbridge	67,704	- 541	- 6,488	60,676		
Pantheon	73,867	- 927	- 2,173	70,767		
Access	15,730	- 1,075	209	14,864		
North Sea	21,110	-	- 644	20,465		
Property					12.0%	16%
Schroders	137,192	-	653	137,845		
M&G	64,365	- 318	- 471	63,576		
Cash					2.8%	1%
Legal & General FTSE4Good Cash	736	-	219	955		
Cash	45,882	542	-	46,424		
Fund Total	1,620,864	- 3,988	57,278	1,674,154	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.



3.6.2 The descriptor Asia includes Japan, Korea and Australia. The descriptor Other includes the continent of Africa and Latin America.

3.6.3 It should be noted that of the 34% invested in the UK 12.0% is allocated to Property and 10.4% to Infrastructure. The majority of the Private Equity and Global Equity investments are in the US and Canada.

3.7 Section 3: Risk Management

3.7.1 The main 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.

3.7.2 The global economy will always represent a specific risk and opportunity for the Fund and will effectively be impossible to quantify or evaluate. The Fund takes a long-term view and manages risk by investing in a portfolio of assets which is sufficiently diversified. Having a sufficiently diversified portfolio should ensure the Fund continues to meet its performance objectives over the long term while reducing the impact of short term volatility in caused by uncertainty in global markets.

3.7.3 Mercer, the Fund's investment adviser, have drafted a Fund Monitoring Report, for the 3 months to 31 March 2023. These reports are included in Part B of this Committee agenda.

3.8 Section 4: Investment Manager Visits

3.8.1 Officers attended an update meeting with Access Capital Partners. The performance of the underlying companies within the portfolios managed by this manager remain strong and there were no concerns raised. This was encouraging and we are expecting the performance of this manager to remain strong. Officers attended the AGM for one of the Temporis portfolios. After an initial slow start due to COVID, the portfolio is now doing extremely well along with the other Temporis investments. This is reflected in the uplift to the valuations on completion of the accounts at 31 December 2022. Officer also met Dean Bowden who is the new Chief Executive Officer for the London CIV.

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 provides an update on the investment of the Council's Pension Fund, including the value of investments to fund future liabilities and the allocations between different asset classes to diversify risk, maximise return and ensure necessary liquidity. The report notes that at the 2022 Triennial Actuarial Valuation, the funding position for the Pension Fund was 97% using a future investment return assumption (otherwise described as the discount rate) of 4.0% p.a.

Approved by: Allister Bannin on behalf of Jane West, Corporate Director of Resources (Section 151 Officer)

6. LEGAL CONSIDERATIONS

6.1 Burges Salmon LLP (a legal advisor appointed to the Pension Fund) comments that there are no direct legal implications arising from the recommendations within this report.

6.2 The Committee must, however, be mindful of their fiduciary duty to make investment decisions including in the best long-term interests of Fund beneficiaries and taxpayers within the investment strategy framework.

7. HUMAN RESOURCES IMPACT

7.1 There are no direct workforce implications arising from the recommendations within this report. If any should arise these will be managed under the Council's policies and procedures.

Approved by: Gillian Bevan**,** Head of HR, Resources and Assistant Chief Executives on behalf of the Chief People Officer

8. EQUALITIES IMPACT

8.1 The Council has a statutory duty to comply with the provisions set out in the Sec 149 Equality Act 2010. The Council must therefore have due regard to:

(a) eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under this Act.

(b) advance equality of opportunity between persons who share a relevant protected characteristic and persons who do not share it

(c) foster good relations between persons who share a relevant protected characteristic and persons who do not share it.

8.2 Any risks to the investment fund are likely to impact on the age characteristic in relation to older workers. The council is 67.73% female and 32.27% male so therefore women are more likely to be impacted by any investment risks.

Approved by: Denise McCausland Equality Programme Manager

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.

CONTACT OFFICER:

Matthew Hallett, Acting Head of Pensions and Treasury,

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.

Appendices:

There are no part A appendices.

Part B appendices:

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 31 March 2023, Mercer

Appendix B: Market Background and Market View Q1 2023, Mercer