

Croydon Council

REPORT TO:	PENSION COMMITTEE 4 December 2018
SUBJECT:	Update on Asset Allocation Implementation
LEAD OFFICER:	Richard Simpson, Executive Director of Resources
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 is in line with their benchmark and within the assumptions made by the Actuary.	
FINANCIAL SUMMARY: This report discusses the allocation of assets comprising the Pension Fund to different asset classes.	

1 RECOMMENDATIONS

- 1.1 The Committee are asked to consider and note the contents of this report.

1 EXECUTIVE SUMMARY

- 1.1 This report summarises the current balance of allocations compared to the target asset allocation for the Pension Fund. In particular it describes the implications of the underweight position on the Private Rental Sector fund; the treatment of the gift of affordable housing properties; and the imbalance between equities and fixed interest and the actions being taken to address this.

2 Background

- 2.1 The September meeting of this Committee considered a paper drafted by Mercer, the Fund's investment advisors, which considered the structure of the Fund's current fixed income portfolio and the suitability of options currently available with the London CIV ("London CIV") and in the pipeline to be added to the LCIV in future. Although there are no directly comparable sub-funds in the London CIV, Mercer consider the PIMCO global credit fund to be the closest comparable option.

- 2.2 On this basis the Committee agreed to invest, over a period of time, the proportion of the portfolio allocated to fixed interest, less the current allocation to the Aberdeen Standard Life Absolute Return, to the London CIV PIMCO sub-fund.

Detail

- 2.3 Underpinning this process of optimising investment decisions, the asset allocation strategy determines the proportion of assets that the Fund has invested in. The mix of asset classes has been chosen because it should offer the greatest opportunity of achieving, over the long run, the target return of CPI + 2.2%, within a risk budget acceptable to the Committee. The strategy intends that assets are diversified, by asset classes, by investment philosophy and by region and currency. It is anticipated that different classes will perform differently in different macro-economic environments, noting that in the beginning of the Great Financial Crisis all assets behaved in a similar fashion.
- 2.4 The current strategy comprises five asset classes: equities; fixed interest; and alternatives – infrastructure, private equity, and property (commercial and residential). Cash is held for business reasons, not as an investment. Although each asset class, and indeed sub-category, is held because they demonstrate different characteristics, broad, high level features are relevant. Equity, under the present global conditions, is generating returns above expectations. It is also held because it is a very liquid asset, which is an attractive characteristic in the current climate where cash may be needed for rebalancing and is required to make up contribution shortfalls. In the medium to long-term there will be greater emphasis on this latter characteristic. Fixed interest funds are useful to match some of the liabilities of the Fund although there are other assets that could perform this function as they have an inflation index embedded. Certain infrastructure could be said to display this but with a higher level of risk, (and hence return).
- 2.5 Alternate assets are held to generate higher returns, access markets and investment opportunities not readily accessible through the listed markets, and ad hoc business opportunities. Most of the allocated risk budget for the overall portfolio is spent on these assets. This Croydon Fund, proportionately, has a greater exposure to alternate assets than the majority of UK LGPS Funds.
- 2.6 A long-term plan has been agreed by the Committee to allocate Pension Fund cash to these assets. Identifying asset managers, evaluating them, performing due diligence and making the investments can be a lengthy process. This has been further complicated by the development of the London CIV and the pooling agenda.
- 2.7 The current allocation to asset classes is in line with the long-term strategy. However there are two positions that need to be resolved. Due to lack of opportunities and a lengthy queue of investors, the allocation to residential property, through the M&G Private Rental Sector fund remains underweight (4% invested against a target of 6%). As the Croydon Fund will be evaluated as part of the Triennial Actuarial valuation, this might be an opportunity to revisit this allocation decision. The review of the asset allocation strategy will inform the Funding Strategy Statement.
- 2.8 The Private Rental Sector is developing and can be considered an innovative asset class. However a degree of expertise from the fund management team is necessary to ensure the best chance of achieving target returns. In turn this means that there

is a competition to acquire underlying assets and funds limit access to avoid diluting their offerings. As a consequence for this Fund, the strategic allocation has been only partially filled. The Committee should consider whether the current target allocation is appropriate, weighing up the opportunity cost of waiting for investment opportunities in a dynamic environment. This consideration should sit within the wider context of reviewing the asset allocation strategic as part of the triennial Actuarial Valuation.

2.9 At a special meeting of the Pensions Committee (21 November) it was decided to take forward a proposal to gift housing stock acquired for Croydon Affordable Housing LLP to the Fund at a future date in 40 years. The Committee should note that this asset category is distinct from the Private Rental Sector class discussed above. These houses have been acquired to meet a social need for decent, affordable housing. Private Rental Sector properties are acquired to generate a profit through rental income. They are directed at an entirely different housing needs. They will demonstrate different and distinct characteristics over the spread of economic environments the Fund could be expected to encounter. Furthermore, the current asset allocation strategy will not feature an allocation to social housing because this gifting process will not take place in the short-term, so that the strategy would be under-weight to social housing, should that be included, for the long-term, distorting the underpinnings of the Fund. The Funding Strategy will nevertheless include narrative to include this proposal as it will impact on the long-term development of the Fund.

2.10 The Committee has discussed the extent to which the imbalance between equities and Fixed Interest should be addressed and how. The decision has been taken to transfer a sum equivalent to the overweight position to the Global Fixed Interest sub-fund offered by the London CIV. This is considered the closest match available through the CIV. The existing investments with Aberdeen Standard Life and Wellington will also be transitioned to the CIV.

2.11 Based on current valuations this adjustment will look like this:

Disinvest from LGIM Equity fund	£ 80 m
from Aberdeen Standard Life	£ 62 m
from Wellington	£ 63 m
Which sums to	£ 205 m

Transfer to London CIV global bonds £ 205 m.

These figures assume that the bond market will continue to benefit from market uncertainty. The Aberdeen Standard Life Absolute Return fund will not be included in this process.

2.12 The London CIV Global Bonds sub fund is managed by PIMCO. The Croydon Fund is a seed funder of this investment together with Bexley. The seed funding is £100m. Due to the timetabling of dealing dates the initial Croydon investment is of £14 million. This will be followed by another £ 66 million from the LGIM, then the other two funds in turn.

3 CONSULTATION

3.1 Officers have fully consulted with the Pension Fund's advisers in preparing this report.

4 FINANCIAL CONSIDERATIONS

4.1 This report deals exclusively with the structure of the Council's Pension Fund.

5 COMMENTS OF THE COUNCIL SOLICITOR AND MONITORING OFFICER

5.1 There are no additional legal implications arising from the recommendations within this report.

Approved by: Sandra Herbert, Head of Litigation and Corporate Law, for and on behalf of Jacqueline Harris-Baker, Director of Law and Governance and Monitoring Officer.

6 OTHER CONSIDERATIONS

6.1 There are no Human Resource, Customer Focus, Equalities, Environment and Design, Crime and Disorder or Human Rights considerations arising from this report.

7 FREEDOM OF INFORMATION/DATA PROTECTION CONSIDERATIONS

7.1 This report contains 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.

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BACKGROUND DOCUMENTS:

None