Croydon Council

REPORT TO:	**PENSION COMMITTEE** **12 March 2019**
SUBJECT:	**Progress Report for Quarter Ended 31 December 2018**
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 December 2018 was £1,181m compared to £1,243.4m at 30 September 2018, a decrease of £62.3m and a return of -4.68% 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.

1.2 The Committee is asked to delegate fund investment decisions to the Chief Finance Officer in consultation with the Chair of the Pension Committee and the Cabinet Member for Finance and Resources.

2 EXECUTIVE SUMMARY

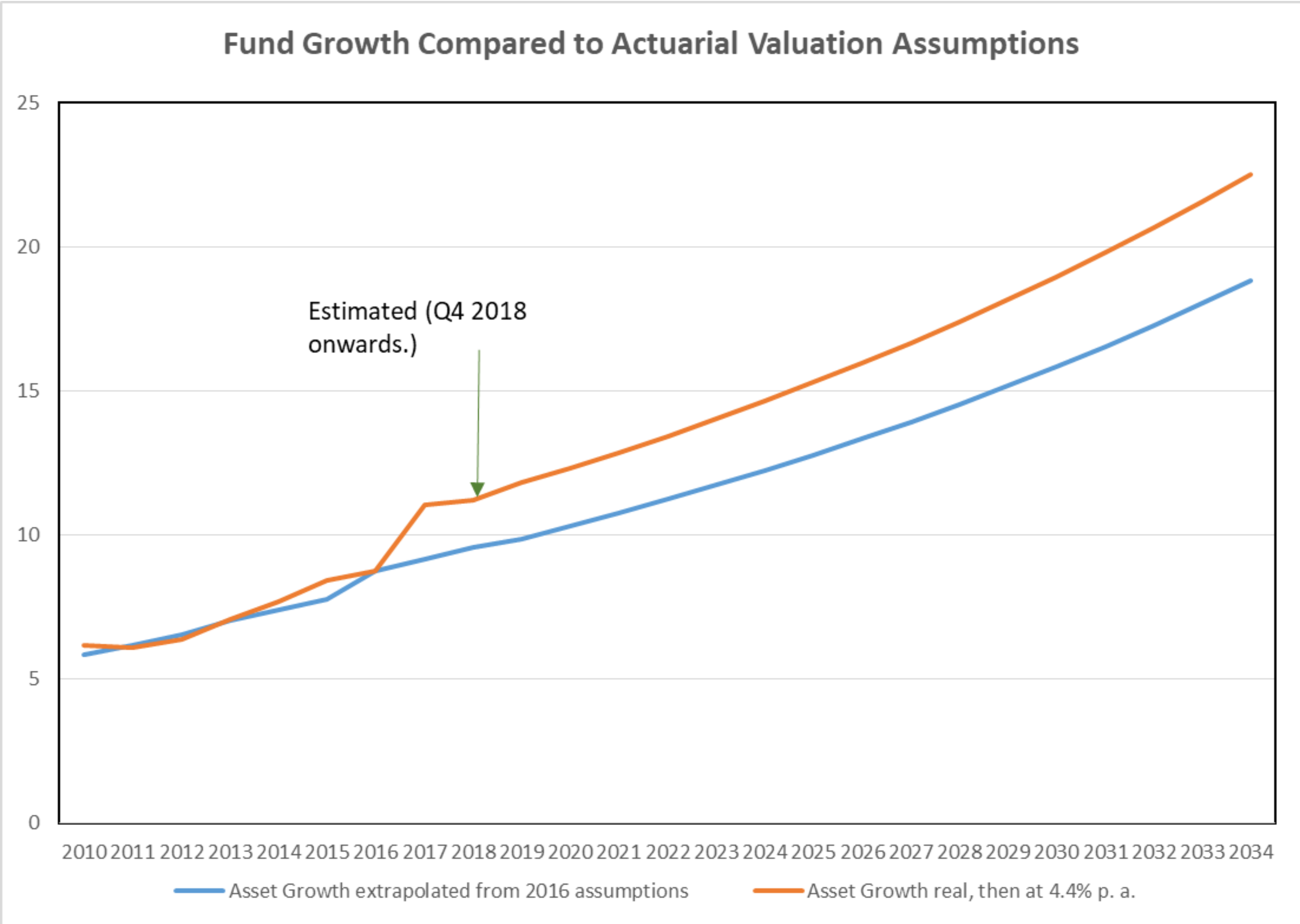
2.1 This report provides an update on the London Borough of Croydon Pension Fund's (the Fund's) performance for the quarter to 31 December 2018. The report falls into four parts. Section 1 addresses performance against strategic goals. The second section considers the asset allocation strategy and how 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 2016 Triennial Actuarial Valuation used an asset outperformance assumption of 2.2% over gilt yields, meaning an asset return assumption, otherwise described as the discount rate, of 4.4%. The valuation also assumes that the funding gap will be closed over a 22 year period. However, as a risk based model has been adopted, the recovery period is less critical. 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 assuming other assumptions remain constant, the funding gap will reduce.

3.2 The following graph has been compiled from this information. The blue line shows the expected track of the value of assets growing in line with the 2016 valuation assumptions. This will be adjusted after subsequent valuations. The orange line shows the actual value of the Fund to date and plots the course of growth over subsequent years using the same assumptions. This measure does not take account of other variables, such as changes in demographic factors, wage inflation forecasts and other assumptions and that does not reflect changes in cash contributions nor movements in the gilt yield curve. It is valuable as a tool to help track whether the direction of travel is in the right direction.



3.3 Details of the performance of individual components of the portfolio are detailed in the report produced by our investment advisors in Appendix A

Section 2: Asset Allocation Strategy

3.4 A new asset allocation strategy was approved at the Committee meeting held on 8 September 2015 (Minute .A29/15 refers). Recognising that there are a number of factors dictating the delivery timeframe for the asset allocation, namely: the selection process and time taken to undertake due diligence; the revision of the LGPS investment regulations; and the role of the London CIV; delivering the revised asset allocation remains a work in progress.

3.5 This asset allocation will give rise to a portfolio which can be broken down as follows:

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%
	100%

3.6 **Progress towards revised asset allocation**

3.6.1 **Global Equity –** During the quarter £155.6m was divested from the L&G FTSE World (Ex Tobacco) fund. The amount divested was used to fund the following:

- **£55m** - Invested in the London CIV Emerging Markets fund managed by Janus Henderson in order to gain exposure to emerging markets as stated in the Fund's target asset allocation.

- **£80m** - Invested in the London CIV Global Bond mandate managed by PIMCO. This was in order rebalance the Fund to bring the Fixed Interest allocation back into the target range.

- **£10.8m** - To pay the final part of the Fund's commitment to the Private Rental Sector mandate managed by M&G.

- **£9.8m** - To fund various private equity and infrastructure fund calls and other working capital during the period.

The L&G FTSE World (Ex Tobacco) fund returned a negative 11.13% during the quarter. The Fund was shielded from the full impact of this loss due to the timing of the transactions above.

Allocation: The allocation dropped to 40.1% of the overall Fund due to the poor performance of global equities during the quarter. The allocation is still within the target range and since the quarter end global equities have made a slight recovery.

3.6.2 **Fixed Interest** – During the quarter £80m was invested in the London CIV Global Bond mandate managed by PIMCO. This was a rebalancing of the Fund in order to bring the Fixed Interest allocation back to target. The Fixed Interest allocation produced positive returns of £2.1m for the quarter. The bond mandate managed by Aberdeen Standard Life is due to be transferred to the London CIV Global Bond mandate in due course. The Absolute return mandate manage by Aberdeen Standard Life and the Bond mandate managed by Wellington are to be retained, but kept under review.

Allocation: On target.

3.6.3 **Infrastructure –** During the quarter further net investments of £7.4m were made to the Funds Infrastructure mandates. During the quarter the first distributions were received from Temporis and Access Capital Partners. The Fund's infrastructure mandates have now distributed £4.1m for the year to date. Distributions from infrastructure investments will be used to finance further investments and benefit payments the Fund moves to a cash flow negative position when considering contributions against benefit payments. The Fund's infrastructure investments are performing well.

Allocation: Infrastructure has moved above target due to the poor performance of equities in the quarter. The allocation is still in an acceptable range.

3.6.4 **Private Equity –** .The Fund received net distributions of £0.8m during the quarter and gains of £5.9m were experienced, although it should be noted that the valuations of these funds are lagged and usually mirror global equity valuations.

Allocation: The allocation by 31 December 2018 was 9.5%. This is 1.5% above the target allocation, but within the acceptable range.

3.6.5 **Traditional Property –** There was a modest gain of £1.1m during the quarter.

Allocation: The allocation at 10.5% is considered on target.

3.6.6 **Private Rental Sector –** £10.8m was drawn by M&G during the quarter. This means the Fund's total commitment of £60m is now fully invested in the PRS mandate.

Allocation: The allocation is at 5.1% which is below the original target of 6%, but this is due to the good performance experienced by the rest of the portfolio.

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 2018

	Valuation at 30/09/2018 £'000	Net Cashflow £'000	Gain/loss £'000	Valuation at 31/12/2018 £'000	Asset Allocation Fund Percentage	Asset Allocation Target Percentage	
Equities					**40.1%**	**42%**	
Legal & General FTSE4Good	203	-	38	241			
Lega & General FTSE World (Ex Tobacco)	633,599	-155,637	-60,453	417,508			
LCIV Emerging Markets	-	55,000	506	55,506			
Fixed Interest					**23.0%**	**23%**	
Standard Life	127,565	-	-365	127,200			
Wellington	63,234	-	1,501	64,735			
LCIV Global Bond	-	80,000	254	80,254			
Infrastructure					**11.8%**	**10%**	
Access	10,656	2,844	74	13,574			3 month lagged
Temporis	30,209	1,048	-	31,257			3 month lagged
Equitix	62,005	1,382	1,085	64,473			
Green Investment bank	25,618	-728	259	25,149			
I Squared	1,562	3,092	101	4,754			3 month lagged
Private Equity					**9.5%**	**8%**	
Knightsbridge	25,902	847	2,223	28,971			3 month lagged
Pantheon	66,111	-1,377	3,379	68,113			
Access	12,769	-328	156	12,597			3 month lagged
North Sea	2,327	-	125	2,452			3 month lagged
Property					**10.5%**	**10%**	
Schroders	122,437	-	1,116	123,553			
Property PRS					**5.1%**	**6%**	
M&G	49,008	10,871	207	60,085			
Cash					**0.1%**	**1%**	
Cash	10,158	-1,195	-8,318	645			
Fund Total	**1,243,363**	**-4,181**	**-58,114**	**1,181,068**	**100%**	**100%**	

Valuations are based on the bid price as reported by the Fund Managers. The valuations of some of the Infrastructure and Private Equity funds are lagged by 3 months due to the timing of the reporting of these funds.

Section 3: Risk Management

3.9 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.

3.10 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.

3.11 Mercer, the Fund's investment advisor, have drafted a Fund Monitoring Report, for the 3 months to 31 December 2018. These reports are included in the closed part of this Committee agenda.

Section 4: Investment Manager Visits

3.12 Members of the Pensions Committee visited Access Capital Partners in October 2018. Access Capital manage a Co-Investment Fund focused on investing in the smaller buy-out market in Europe and an Infrastructure Fund focused on investing into European brownfield infrastructure assets. The Committee noted that both funds are delivering in line with our expectations.

3.13 Following an internal restructure the Committee is asked to reflect the change in senior management thus:

To delegate fund investment decisions to the Chief Finance Officer in consultation with the Chair of the Pension Committee.

This is consistent with established practice and reflects the changes in job title and usage in the Council's Constitution.

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 that no additional legal considerations arise from this report.

(Approved by Sandra Herbert, Head of Litigation and Corporate Law on behalf of the Director of Law and Governance & 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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Resources Department, ext. 62552.

BACKGROUND DOCUMENTS:

Quarterly reports from each fund manager (circulated under separate cover)

Appendices:

Appendix A: London Borough of Croydon Returns to 30 December 2018, Mercer

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 B: Market Background and Market View Q3 2018, Mercer