Report for:	Pensions Committee and Board 13 September 2018
Item number:	
Title:	Investments Review
Report authorised by:	Jon Warlow, Chief Finance Officer, (CFO and S151 Officer)
Lead Officer:	Thomas Skeen, Head of Pensions thomas.skeen@haringey.gov.uk 020 8489 1341
Ward(s) affected:	N/A
Report for Key/ Non Key Decision:	Non Key decision

1. Describe the issue under consideration

1.1. This paper presents an overview of some of the fund's private market investments: property and private equity, and highlights where the fund is unable to achieve the targets set out in the fund's Investment Strategy Statement through existing committed funds. The paper goes on to consider potential options to remedy this.

2. Cabinet Member Introduction

2.1. Not applicable.

3. Recommendations

3.1. That the Committee and Board consider and note the contents of this report, including any verbal information or advice given by the fund's investment consultant Mercer, in the meeting.

In relation to Property:

3.2. That the Committee and Board agrees to invite representatives of the London Collective Investment Vehicle (CIV) to the November Pensions Committee and Board meeting, in order to discuss in further detail the potential for the CIV to include a residential property investment option.

3.3. That the Committee and Board notes and agrees to adopt two broad principles outlined throughout this report in relation to residential property investment, namely:

- In the first instance, any new investment should be done via the London CIV

- Any new investment should be done in a diversified manner: preferably using a pooled investment vehicle approach, with an experienced specialist fund manager, and with exposure to the UK property market as a whole.

In relation to Private Equity:

3.4. That the Committee and Board note that the existing allocation is underweight and that the S151 Officer will take action to correct this as detailed within this report.

4. Reason for Decision

4.1. The fund's current investment strategy is summarised below:

	Asset Class	Manager	Strategic Allocation
Equity	Passive equity (including low carbon)	Legal and General	**45.0%**
Absolute Return	Multi Asset Absolute Return	London CIV - Ruffer	**7.5%**
Growth Fixed Income	Multi Asset Credit	London CIV - CQS	**7.0%**
Liability Matching	Passive Index Linked Gilts	Legal and General	**15.0%**
Private Markets	Property (Conventional)	CBRE	7.5%
	Property (Long Lease)	Aviva	5.0%
	Private Equity	Pantheon	5.0%
	Renewable Energy Infrastructure	Blackrock	2.5%
	Renewable Energy Infrastructure	CIP	2.5%
	Infrastructure Debt	Allianz	3.0%
		Subtotal:	**25.5%**
		Grand Total:	**100.0%**

4.2. When the fund commits to certain investments it does so based on the size of the fund at that point in time. For example, the 5% allocation to long lease property was made in 2016, and given the fund was approximately £1.0bn in value, 5% of total assets equated to £50m. £50m was therefore agreed to be invested in the long lease property fund with the chosen fund manager: Aviva. 'Private market' investments, such as property are often highly illiquid, and it often takes several years to fully invest committed funds.

4.3. Since the Aviva Commitment was made in early 2016, the fund has grown significantly since then, and based on the current size of the fund, this £50m will equate to roughly 3.5% of total assets. This type of divergence has occurred in a number of the fund's private market asset classes, as is displayed below:

Haringey LONDON

Asset Class	Manager	Strategic Allocation	Actually Invested or Committed*	Variance
Property (Conventional)	CBRE	7.5%	6.5%	-1.0%
Property (Long Lease)	Aviva	5.0%	3.5%	-1.5%
Private Equity	Pantheon	5.0%	4.0%	-1.0%
Renewable Energy Infrastructure	Blackrock	2.5%	2.5%	0.0%
Renewable Energy Infrastructure	CIP	2.5%	2.5%	0.0%
Infrastructure Debt	Allianz	3.0%	3.0%	0.0%
	Subtotal	**25.5%**	**22.0%**	**-3.5%**

**to nearest 0.5% for ease*

4.4. The fund could choose to commit to invest further funds with existing fund managers to bring these amounts in line with the strategic allocation, or it could explore the possibility of further diversifying its private markets portfolio by including a new mandate within the portfolio.

Property

4.5. Property is a very helpful asset class for the fund, as property investments yield income (such as rent), and often this income has a natural inflation linkage (to Consumer Price Index, CPI). All pensions benefits that the fund administers are uplifted by CPI each year, so it is helpful to invest in asset classes which share, or approximate to some extent this inflation linkage. Income is important, as the fund now pays out more in pension benefits than it receives from employer and employee contributions (i.e. what is known as cash flow negative). A constant and predictable cash yield from an investment (such as a rental income) helps to offset the shortfall the fund has from paying out more pensions than it collects in contributions, and helps the fund avoid having to sell other investments to make good this shortfall, (which could happen at an inopportune time e.g. being forced to sell equities after a market correction).

4.6. Currently, the fund has a 12.5% allocation to property, with two fund managers, CBRE (conventional property 7.5%), and Aviva (long lease property 5.0%). The fund currently has 6.5% of total assets invested with CBRE, and has committed to investing an amount equal to 3.5% of total assets to Aviva (expected to be invested later in 2018).

4.7. These allocations are currently all to commercial property, comprising of assets such as office space, retail outlets, warehouses and distribution centres, with there being no exposure to the residential property market. The table above highlights that the two current investments which the fund has committed to will be underweight compared to the fund's strategic allocation by around 2.5% combined. This 2.5% could potentially be deployed to a residential property investment to diversify the property portfolio further.

4.8. Members of the Pensions Committee and Board have previously expressed an interest in exploring the possibility of investing in residential property, in particular in property that would display high ESG credentials, and cover a broad spectrum of affordability levels.

4.9. The Fund's Investment Consultant, Mercer, have advised that residential property often displays a very strong inflation linkage, and that this could sit well within the fund's overall property allocation, provided an investment option can be sourced that will give the fund sufficiently high returns (net of fees) that help meet the fund's overall objectives, is well diversified and managed in a professional manner. They have noted that there are currently few investment options in this are available to institutional investors. Finally, they would also be comfortable with a slightly higher allocation than 2.5%, if this was funded from selling down a portion of the current property portfolio.

4.10. It is suggested, that the best way to approach an initial scoping exercise around residential property, would be to formally approach the London CIV, to initiate discussions. Representatives from the London CIV could be invited to the next Pensions Committee and Board meeting in November 2018 as a first step.

<u>Private Equity</u>

4.11. Private Equity is a growth asset class that allows the fund to gain exposure to companies that are not available to invest in via public stock exchanges. Private equity is an expensive (i.e. high fee) asset class to invest in, however it also typically has the highest levels of returns of all of the fund's investments. The fund has a total 5.0% allocation to private equity. This allocation within the fund's investment strategy is an important driver of returns for the fund, helping the fund with its goal to become 100% funded.

4.12. Private equity is an asset class in which investments are typically made for a set time period (often 10-15 years plus), via a limited partnership agreement in conjunction with other investors. In the early years of the investment, a fund manager will draw down on the funds to be invested, and in the latter years of the investment, funds will be returned to the investor. As such, an allocation to private equity requires periodic 'top ups' as funds mature and are returned to the fund, in order to maintain a given strategic allocation. The fund has done this several times since the private equity portfolio with Pantheon was introduced in 2007, and the last time this was done was in 2014.

4.13. The fund's investment with Pantheon currently equates to around 4.0% of assets. This is forecast to fall, as the existing investments mature and return funds to Haringey. Having less invested in private equity gives rise to the risks that expected returns on the fund's assets will fall below those anticipated modelled within the fund's investment and funding strategies, and the fund not investing in line with the agreed Investment Strategy Statement.

4.14. It is therefore necessary to 'top up' this allocation, to keep the fund's allocation at the appropriate level. It is not currently anticipated that the CIV will have a private equity option available within the next 12 months, so this 'top up' will be done via investing additional funds with Pantheon, the fund's existing fund manager (subject to further consideration of the available options). The S151 Officer, and his officers will effect this, but this will likely take over 12 months to complete given the illiquidity of the asset class.

4.15. In the future, the fund will have to consider making new private equity allocations via the London CIV once it opens private equity sub funds.

4.16. Mercer, the fund's investment consultant, have confirmed to officers that they remain supportive of the fund's allocation to private equity as an asset class, and that Pantheon, the fund's current manager, is one which they rate highly.

5. Other options considered

5.1. The fund currently has a total of 10 mandates, with 9 fund managers, (two of whom are via the London CIV). Whilst increasing the number of asset classes the fund invests in should be seen as a broadly positive move, as it allows for further diversification, increasing the number of fund managers also increases the administration and governance burden on the fund. Private market asset classes such as property and private equity are a disproportionately large drain on resources as they are far more complex investments, with added administration and governance requirements around valuations, audit, financial and performance reporting.

5.2. For a fund of Haringey's size, it is thought that the current number of fund managers is about average; however officers are minded not to seek to increase this further, unless absolutely necessary. New investments through the London CIV, or with existing fund managers should not cause a significant additional drain on resource for the fund.

5.3. Collaboration is an important consideration, investors who pool funds are able to achieve increased diversification, and often able to enjoy other efficiencies (e.g. via reduced fees) by having an increased value of funds available for investment. The majority of Haringey's fund is already invested via pooled investment vehicles for this very reason. Like most LGPS funds, Haringey does not do direct investment, in any asset class.

5.4. Collaboration is clearly something which goes hand in hand with the pooling agenda; it is therefore suggested that the London CIV would be an optimal way to investigate investment in residential property. Alternatively, the fund could examine whether there is any scope to alter the mandates of existing property fund managers. Any new investment would be subject to gaining professional advice from the fund's investment consultant, Mercer Ltd.

6. Background information

6.1. The fund has previously examined the potential of investment in residential property in January 2018, this paper was focussed on what scope there was (if any) to invest in residential property, including the potential to invest locally, and what initiatives have been completed by other Local Authorities. This report highlighted that limited investment had taken place to date in the LGPS sphere, and that diversification (including geographic diversification), is a key factor when considering investment in residential property.

6.2. Any new investment completed by Haringey fund will only be done based on sound investment advice received from the fund's investment consultant, who would assess how a new investment class would impact on the fund's overall risk, return and liability profile.

7. Comments of the Independent Advisor

7.1. I am supportive of the principle that the Fund seek to invest in Residential Property as an Asset Class and would concur with the comments made at Section 4.9 of this report. Residential Property can potentially provide both a good investment return (particularly focussed on income) and also potentially a social benefit.

7.2. Members of the Pensions Committee and Board have previously expressed an interest in exploring the possibility of investing in residential property, in particular in property that would display high ESG credentials, and cover a broad spectrum of affordability levels. The proposal that the London CIV be approached to see if it can facilitate such an approach is, in my view, sensible. The involvement of the London CIV could potentially facilitate interest from other Boroughs which should increase the likelihood of Asset Managers developing a product which meets the Regulatory requirement that investments should be made primarily on financial grounds, but which also includes a positive social impact which is allowed by the relevant Statutory Guidance of July 2017 as follows:

7.3. ***"Although schemes should make the pursuit of a financial return their predominant concern, they may also take purely non-financial considerations into account provided that doing so would not involve significant risk of financial detriment to the scheme and where they have good reason to think that scheme members would support their decision.***

7.4. ***Investments that deliver social impact as well as a financial return are often described as "social investments". In some cases, the social impact is simply in addition to the financial return; for these investments the positive social impact will always be compatible with the prudent approach. In other cases, some part of the financial return may be forgone in order to generate the social impact. These investments will also be compatible with the prudent approach providing administering authorities have good reason to think scheme members share the concern for social impact, and there is no risk of significant financial detriment to the fund."***

7.5. I am also supportive of Private Equity as an Asset Class and concur with the comments made at Section 4.11 of this report. The Fund should, however, seek the views of its appointed Investment Consultant (which it has done) with regard to the selection of any particular Asset Manager to provide access to Private Equity investments.

8. Contribution to Strategic Outcomes

8.1. None.

9. Statutory Officers comments (Chief Finance Officer (including procurement), Assistant Director of Corporate Governance, Equalities)

Finance and Procurement

9.1. The Fund has enjoyed strong returns in recent years primarily from rising equity valuations. The Pension Committee and Board's responsibility is to look to the long term when setting an investment strategy, ensuring an appropriate degree of diversification.

9.2. This report highlights how the fund's investment commitments have drifted over time from the fund's strategic asset allocation, due to the growing size of the fund. The report highlights the fact that the fund is falling below its allocations to private equity and property, action must therefore be taken in order to comply with the fund's Investment Strategy Statement.

9.3. Before any new fund managers or asset classes are introduced to the pension fund, proper due diligence will be undertaken, and sound professional advice will be sought. Officers will ensure that the Pensions Committee and Board receive adequate and appropriate training on any new investment techniques or asset classes prior to these being undertaken by the pension fund.

Legal

9.4 The Council as administering authority for the Haringey Pension Fund has the power to invest fund monies as set out in Local Government Pension Scheme (Management & Investment Funds) Regulations 2016.

9.5 The authority must review and if necessary revise its investment strategy from time to time and at least every 3 years, and publish a statement of any revisions. Any allocations recommended in this report must comply with the Pension Fund Investment Strategy Statement.

Equalities

9.6 There are no equalities issues arising from this report

10. Use of Appendices

10.1. Not applicable

11. Local Government (Access to Information) Act 1985

11.1. Not applicable.