Report for:	Pensions Committee and Board 7 July 2020
Title:	Investment Strategy Review
Report authorised by:	Jon Warlow, Director of Finance (S151 Officer)
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Ward(s) affected:	N/A
Report for Key/ Non Key Decision:	Non Key decision

1. Describe the issue under consideration

1.1. In March 2020, The Pensions Committee and Board (PCB) considered a report on the Fund's investment strategy review. A number of decisions were made in the March 2020 meeting (some in principle), and this report follows on from the last paper with options and a recommendation as to changes to be made to the fund's investment strategy.

2. Cabinet Member Introduction

2.1. Not applicable.

3. Recommendations

3.1. That the PCB note the Investment Strategy Review Paper, appended as Confidential Appendix 1.

3.2. That the Committee approves a change to the fund's target investment strategy to implement the 'strawman portfolio 1' as shown in Confidential Appendix 1, namely to:

- Increase the allocation to equity by 2.5%
- Increase the allocation to multi-asset credit by 3.0%
- Reduce the allocation to infrastructure debt by 0.5%
- Reduce the allocation to gilts by 5.0%

Alternatively, the Committee and Board could choose to implement 'strawman portfolio 2' as detailed in the Mercer paper in Confidential Appendix 1.

3.3. The PCB delegate authority to the Assistant Director of Finance to implement the above changes (if approved), on the advice of Mercer, and in conjunction with the Chair of the PCB and Independent Advisor.

3.4. The PCB delegate authority to the Assistant Director of Finance to update and republish the fund's Investment Strategy Statement consistent with decisions made above.

4. Reason for Decision

4.1. The Council is required by law to undertake an actuarial valuation of the Fund's liabilities, currently every three years. It is usual practice to review the Fund's investment strategy following the completion of the valuation, and this report forms part of the ongoing investment strategy review following on from the 31/3/2019 Valuation of the Fund.

5. Other options considered

5.1. None

6. Background information

6.1. In preparation for the review of the Fund's investment strategy, officers of the fund arranged for the Investment Consultant to meet with the Fund Actuary to thoroughly discuss all the assumptions used in the 2019 Valuation.

6.2. Following on from this, the Head of Pensions, Independent Advisor, Chair of the Pensions Committee and Board met with the Investment Consultant in December 2019 to discuss initial ideas, themes and points to review before work on the strategy review began in earnest.

<u>Gilts Allocation</u>

6.3. A paper was then presented to the PCB in January discussing the Fund's allocation to index linked gilts; it was decided in this meeting to switch the Fund's index linked gilts allocation for fixed interest gilts on a temporary basis until the uncertainty surrounding the RPI consultation concluded. The Fund's current allocation of 15% is understood to be relatively high for an LGPS fund. Some members of the PCB expressed the view that they would like to consider this mandate more fundamentally, i.e. whether to hold a gilts allocation at all, or indeed whether to reduce this from 15%. This has been taken into account in the investment strategy review appended at Confidential Appendix 1 – with both portfolios proposed reducing this allocation.

6.4. Officers have reviewed this switch to fixed gilts in early 2020, as it is noted that fixed gilts have performed better during the volatile market conditions in recent months. Officers have calculated that this decision has benefited the fund by approximately £10.7m: i.e. had the fund continued to hold index linked gilts, it would have been £10.7m lower in value as at 30/5/20.

<u>Residential Property</u>

6.5. The PCB has discussed residential property on a number of occasions, it being an asset class that has the potential to have strong positive responsible investment credentials. A training session on the asset class was arranged in February 2020 for members of the PCB. This was discussed in the March 2020 PCB meeting: there was not a clear consensus that this should ultimately be included in the fund's investment strategy, however it was clear that the PCB would prefer this to be implemented via the London CIV if at all. The London CIV is working on a 'London Fund' currently which will primarily be aimed at investing in residential property. The CIV has set up a 'Seed Investors Group' which officers are involved with.

Decisions made in the March 2020 PCB Meeting

6.6. The PCB made two firm decisions in the March 2020 meeting:

- To draw income from the London CIV Multi-Asset Credit portfolio (managed by CQS) to improve the fund's cashflows by c. £5m per annum;
- To commit a further £25m to the Aviva Long Lease Property fund, to bring this in line with the 5% target allocation in the fund's investment strategy;

Both of these have been actioned, although the Aviva £25m is not anticipated to be invested until Q4 2020 at the earliest, given the 'queue' for the Aviva Fund, and the fact that transaction activity is relatively slow due to Covid-19.

Recommendations in this paper

6.7. The paper in Confidential appendix 1 proposes two possible changes to the fund's investment strategy. Both of these options increase the fund's allocation to liquid growth assets, and decrease the allocation to gilts by a greater or lesser extent.

6.8. The Fund's allocation to infrastructure debt has been fully invested for several years now, and capital is gradually being returned to the fund. This means the allocation will naturally shrink in comparison to the size of the whole fund, so it is proposed to reduce this allocation from 3.0% of assets to 2.5% of assets and allocate the 0.5% elsewhere in the investment strategy. This is a minor change and something that will have to be revisited as time goes on and this allocation shrinks further. It is not proposed to reallocate funds to this asset class to 'top up' the allocation.

6.9. The more substantial change in strategy is the proposed reduction in the allocation to gilts of either 5% or 10% in strawmen portfolios 1 and 2 respectively. This would be reallocated to the fund's equity, multi-asset credit portfolios, and for strawman portfolio 2, the multi asset absolute return portfolio as well. All of these portfolios are liquid growth asset classes, and all are invested in London CIV Funds, or are under the CIV's oversight. The switch into more growth assets increases the expected return of the fund, however this does marginally increase risk, as would be expected.

6.10. Both of these options are proposed on the basis that 5% of the residual allocation to gilts is earmarked for a future decision on whether to allocate to residential property. As such, if residential property is included in the investment strategy in the future, the target allocation to gilts would be either 5% (strawman portfolio 1) or 0% (strawman portfolio 2).

Further work and future decision making

6.11. Later in 2020 the Fund will have to review its commitments to Renewable Energy and Private equity and decide whether to 'top up' these commitments, so that they achieve and maintain an allocation of 5% of total fund assets. The London CIV have also set up a 'Seed Investors Group' for a Renewable Fund, which officers are a part of. A report on this will be targeted for the September PCB meeting.

6.12. The Fund will also have to review the allocation to fixed gilts and make a decision regarding switching these back into index linked gilts later in 2020 when the government consultation is finalised and results are announced. This is likely to be presented to the PCB in the November meeting, bearing in mind the consultation is now due to close in August, and it will take some time for the results to be announced.

6.13. The PCB agreed in principle in the March 2020 meeting to utilise a low carbon variant of the RAFI multifactor strategy, subject to implementation considerations, once this is launched. It is anticipated that a report regarding this for final decision making will be presented in the September or November PCB meeting.

6.14. A final decision regarding residential property will be somewhat dependent on the CIV's progress in setting up the London Fund. At this point, it is not anticipated that this will have progressed sufficiently for the September PCB meeting, however it may be possible to present a report at the November meeting.

7. Contribution to Strategic Outcomes

7.1. Not applicable

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

Finance and Procurement

8.1. The Fund's 2019 Valuation showed overall improvement to the Fund's funding level. However the cost of ongoing accrual of pension benefits within the LGPS continues to rise, and the McCloud ruling is likely to increase ongoing costs further. Ultimately pension benefits in the LGPS are funded by 3 things: employee contributions, employer contributions and investment returns. Employee contributions are set centrally, however investment strategy and employer contributions are set locally. All else being equal, over the long term, if investment returns are higher, this will allow employer contributions to be lower. Higher investment returns are usually achieved by setting an investment strategy with higher allocations to asset classes that display more volatility or take higher levels of risk.

8.2. As highlighted in previous meetings, given the increasing ongoing costs of servicing LGPS pensions, de-risking the Fund's investment strategy at this time would not be appropriate, nor is this suggested. The report of Mercer highlights options which will increase expected returns, however it should be noted that this does marginally increase overall risk.

Legal Services Comments

8.3. Under Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 the administering authority must, after taking proper advice, formulate an Investment Strategy (in accordance with guidance issued from time to time by the Secretary of State). It must also keep this under review (at least every three years) and if necessary revise it.

8.4. The Investment Strategy must include:
(a) a requirement to invest fund money in a wide variety of investments;
(b) the authority's assessment of the suitability of particular investments and types of investments;
(c) the authority's approach to risk, including the ways in which risks are to be assessed and managed;
(d) the authority's approach to pooling investments, including the use of collective investment vehicles and shared services;
(e) the authority's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and
(f) the authority's policy on the exercise of the rights (including voting rights) attaching to investments.

8.5. The Investment Strategy must set out the maximum percentage of the total value of all investments of fund money that will be invest in particular investments or classes of investment. Therefore, any decision made by the PCB must not exceed the maximum percentage for that particular or class of investment.

Equalities

8.6. None applicable.

9. Use of Appendices

9.1. Confidential Appendix 1: Investment Strategy Review

10. Local Government (Access to Information) Act 1985

10.1. Not applicable.