Report for: Pensions Committee 20th September 2016

Item number: **10**

Title: Pension Fund Quarterly Update

Report authorised by: Tracie Evans, Chief Operating Officer (COO)

Lead Officer: Oladapo Shonola, Head of Finance - Treasury & Pensions
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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. To report the following in respect of the three months to 30th June 2016:

- Investment asset allocation
- Investment performance
- Responsible investment activity
- Budget management
- Late payment of contributions
- Communications
- Funding level update

2. Cabinet Member Introduction

2.1 Not applicable.

3. Recommendations

3.1 That the information provided in respect of the activity in the three months to 30th June 2016 is noted.

4. Reason for Decision

4.1. N/A

5. Other options considered

5.1. None

6. Background information

6.1. This update report is produced on a quarterly basis. The Local Government Pension Scheme Regulations require the Committee to review investment performance on a quarterly basis and sections 13 and 14 provide the information for this. Appendix 1 shows the targets which have been agreed with the fund managers. The report covers various issues on which the Committee or its predecessor body have requested they receive regular updates.

7. Contribution to Strategic Outcomes

7.1. Not applicable

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

Finance and Procurement

8.1. The investment performance figures in section 12 show the impact of the introduction of passive fund managers in that generally the variance from target has reduced.

8.2. London CIV and LGIM have agreed new fee commission rate for all members of the CIV that are much lower than what is currently being paid. The impact of these new rates are not as significant for the Fund as it was for some other Funds in the CIV because Haringey had previously managed to agree rates that were significantly below market average prior to the establishment of the London CIV.

8.3. A £127k saving on current fees indicates extraordinary low fees proposal by LGIM and could be deemed an aggressive play for a larger share of the passive equity market in the LGPS.

Legal Services Comments

8.4. The Council as administering authority for the Haringey Pension Fund (“Fund”) has an obligation to keep the performance of its investment managers under review. In this respect the Council must, at least every three months review the investments made by investment managers for the Fund and any other actions taken by them in relation to it;

8.5. Periodically the Council must consider whether or not to retain the investment managers. In particular members should note the continuing negative performances compared with the target benchmarks and the reason stated in this report as to why this is the case;

8.6. In carrying out its review proper advice must be obtained about the variety of investments that have been made and the suitability and types of investment;

8.7. All monies must be invested in accordance with the Funding Strategy Statement and the Council's investment policy and members of the Committee should keep this duty in mind when considering this report and have regard to advice given to them.

Comments of the Independent Advisor

8.6. The total value of the Fund at 30th June 2016 was £1,112m. At 31st March 201 the total value of the Fund was £1,046m compared to £1,014m at 31st December 2015. The value of the Fund has seen gradual and continuous increase over the last several quarters.

8.7. The overall performance of the Fund over the last Quarter, Year and Three Years is close to benchmark (see section 12.1). A major contributor to this is the recent steady performance of stock markets globally. As a significant proportion of the Fund is invested in passive funds, the Fund assets have experienced similar growth to that of the markets.

8.8. The inclusion of European investments within the property portfolio which have performed extremely poorly (currently having nil value compared to a purchase cost of £9.7m) continue to present a challenge and adversely impact longer term performance.

Equalities

8.10 The Local Government Pension Scheme is a defined benefit open scheme enabling all employees of the Council to participate. There are no impacts in terms of equality from the recommendations contained within this report.

9. Use of Appendices

9.1. Appendix 1: Investment Managers' mandates, benchmarks and targets.

10. Local Government (Access to Information) Act 1985

10.1. Not applicable.

11. Portfolio Allocation Against Benchmark

11.1. The value of the fund increased by £66m million between April and June 2016. All parts of the portfolio performed well in this quarter other than infrastructure which underperformed benchmark. In particular, equities had a strong quarter with North America contributing the most to gains. However, the strongest performance of the quarter was delivered by index linked gilts with returns in excess of 11% for the quarter.

11.2. The equity allocation exceeds target by 4%. This is mostly due to the unfunded Allianz mandate. It is anticipated that the Infrastructure debt mandate will be close to being fully funded in 2016.

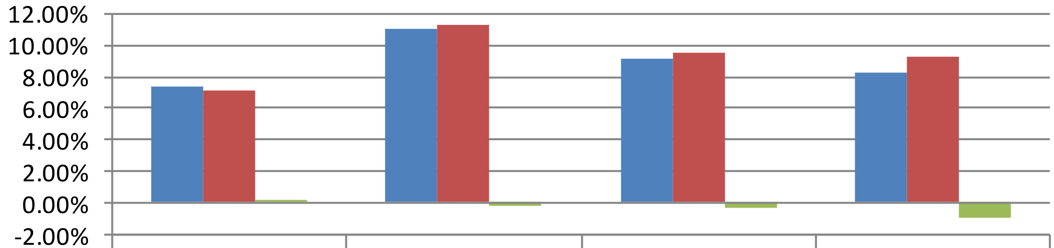
Total Portfolio Allocation by Manager and Asset Class

	Value	Value	Value	Allocation	Strategic
	30.12.2015	31.03.2106	31.06.2106	31.06.2016	Allocation
	£'000	£'000	£'000	%	%
Equities					
UK	162,900	159,980	148,912	13.39%	13.30%
North America	250,342	240,625	239,705	21.55%	19.30%
Europe	78,954	79,122	73,496	6.61%	6.57%
Japan	39,398	38,568	37,138	3.34%	3.10%
Asia Pacific	36,961	39,174	36,665	3.30%	3.03%
Emerging Markets	89,343	102,482	112,686	10.13%	8.00%
Global Low Carbon Tgt	0	0	65,538	5.89%	6.67%
Total Equities	**657,898**	**659,951**	**714,140**	**64%**	**60%**
Bonds					
Index Linked	**146,547**	**150,667**	**167,547**	**15.06%**	**15.00%**
Property					
CBRE	**104,378**	**111,024**	**101,352**	**9.11%**	**10.00%**
Private equity					
Pantheon	**40,476**	**44,110**	**45,649**	**4.10%**	**5.00%**
Multi-Sector Credit					
CQS	**46,425**	**46,529**	**47,451**	**4.27%**	**5.00%**
Infrastructure Debt					
Allianz	**22,648**	**21,621**	**22,457**	**2.02%**	**5.00%**
Cash & NCA					
Cash	**3,152**	**11,665**	**13,645**	**1.23%**	**0.00%**
Total Assets	**1,021,524**	**1,045,567**	**1,112,241**	**100%**	**100%**

12. Investment Performance Update: to 30th September 2015

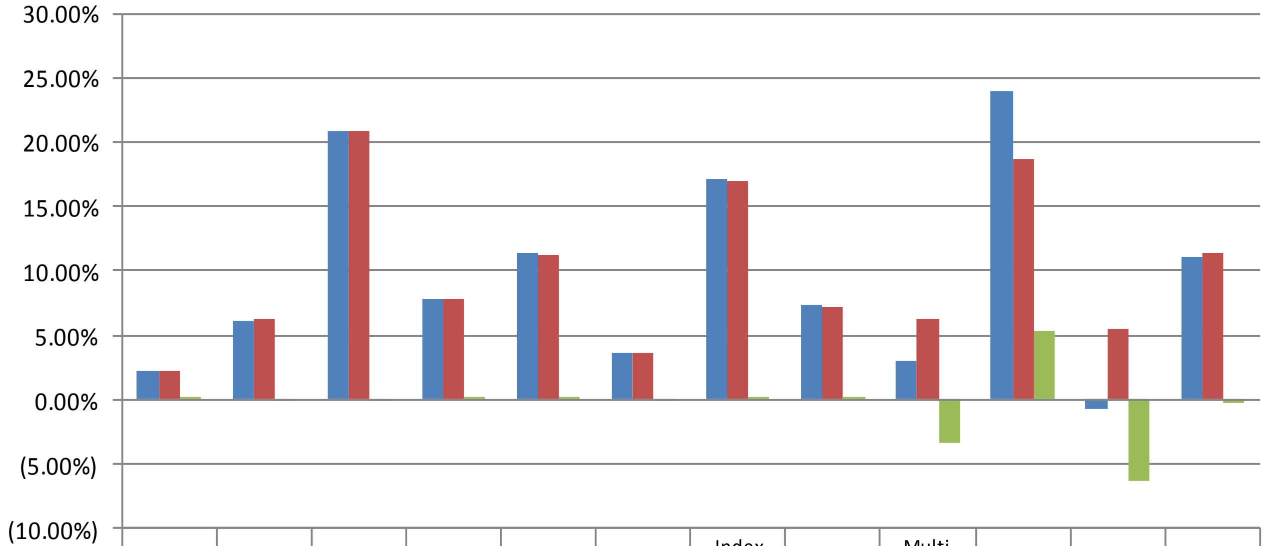
12.1. Appendix 1 provides details of the benchmarks and targets the fund managers have been set. The tables below show the performance in the quarter April to June 2016 and for one, three and 5 years.

Whole Fund

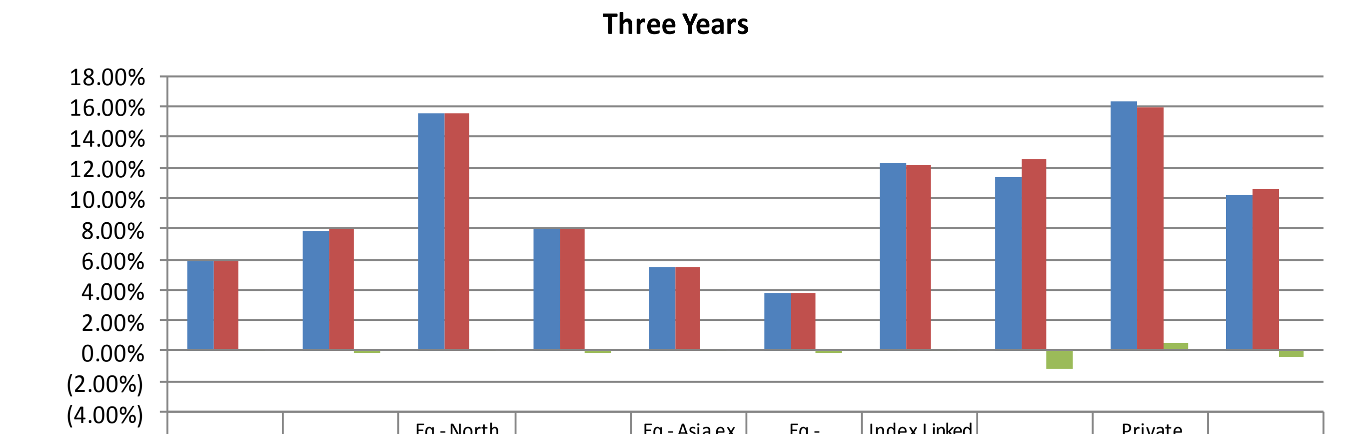


	Apr 2016 - Jun 2016	One Year	Five Years	Since Inception
Return	7.33%	11.09%	9.10%	8.31%
Benchmark	7.13%	11.33%	9.49%	9.28%
(Under)/Out	0.20%	(0.24%)	(0.39%)	(0.97%)

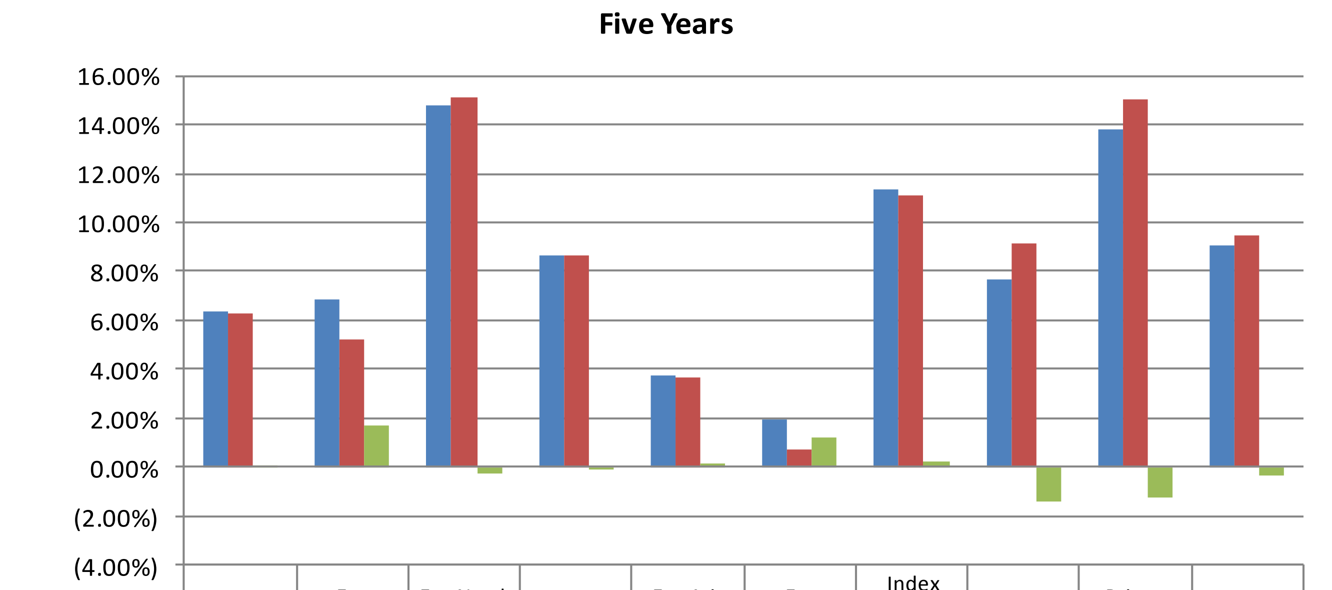
One Year



	Eq - UK	Eq - Europe	Eq - North America	Eq - Japan	Eq - Asia ex Japan	Eq - Emerging	Index Linked Bonds	Property	Multi-sector Credit	Private Equity	Infrastructure	Total Fund
Fund Return	2.27%	6.10%	20.83%	7.79%	11.31%	3.54%	17.11%	7.37%	2.91%	24.03%	(0.81%)	11.09%
Benchmark	2.21%	6.21%	20.84%	7.74%	11.25%	3.68%	17.01%	7.16%	6.23%	18.72%	5.50%	11.33%
(Under)/out	0.06%	(0.11%)	(0.01%)	0.05%	0.06%	(0.14%)	0.10%	0.21%	(3.32%)	5.31%	(6.31%)	(0.24%)



	Eq - UK	Eq - Europe	Eq - North America	Eq - Japan	Eq - Asia ex Japan	Eq - Emerging	Index Linked Bonds	Property	Private Equity	Total Fund
Return	5.91%	7.89%	15.60%	7.92%	5.54%	3.80%	12.30%	11.35%	16.40%	10.21%
Benchmark	5.86%	7.98%	15.57%	8.03%	5.49%	3.84%	12.22%	12.51%	15.94%	10.60%
(Under)/out	0.05%	(0.09%)	0.03%	(0.11%)	0.05%	(0.04%)	0.08%	(1.16%)	0.46%	(0.39%)



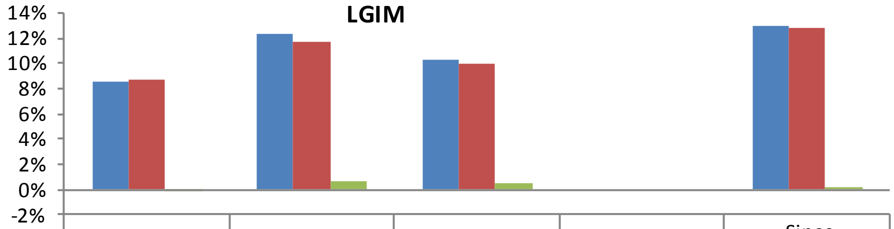
	Eq - UK	Eq - Europe	Eq - North America	Eq - Japan	Eq - Asia ex Japan	Eq - Emerging	Index Linked Bonds	Property	Private Equity	Total Fund
Return	6.35%	6.88%	14.80%	8.64%	3.76%	1.93%	11.39%	7.70%	13.79%	9.10%
Benchmark	6.27%	5.22%	15.10%	8.69%	3.62%	0.73%	11.15%	9.15%	15.02%	9.49%
(Under)/out	0.08%	1.66%	(0.30%)	(0.05%)	0.14%	1.20%	0.24%	(1.45%)	(1.23%)	(0.39%)

12.2. The Fund returned 7.33% over the quarter and has over-performed benchmark of 7.13% by 0.20%. In terms of stock selection; equity and index linked income had a particularly strong quarter making significant contributions to gains. North America and Emerging Markets region also made significant contributions to over-performance in this quarter. However, most asset classes, sectors and regions contributed to a good quarter's performance.

Haringey LONDON

12.3. Over the last 12 months the Fund returned 11.09%, but trail benchmark by 0.25%; three and five year performance show underperformance of 0.39% and 0.93% respectively.

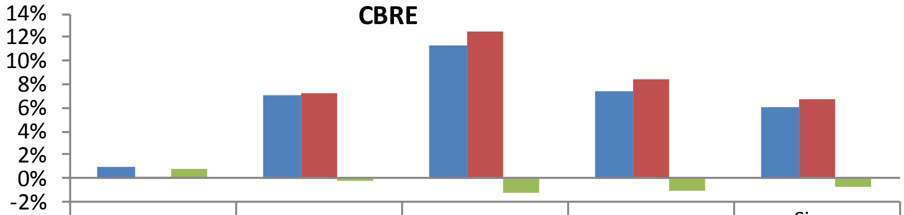
Legal & General Investment Management



	Apr16 - Jun 16	One Year	Three Years	Five Years	Since Inception (May 12)
Return	8.60%	12.33%	10.32%		13.03%
Benchmark	8.65%	11.70%	9.91%		12.80%
(Under)/Out)	(0.05%)	0.63%	0.41%		0.23%

12.4. Legal and General returned 8.6% this quarter and has underperformed composite benchmark by 0.05% - most of the underperformance is mainly driven by asset allocation. The overweight position in North America and Emerging Markets were major contributors to over-performance in the quarter. Index linked income performed in line with benchmark in the quarter. Performance of the manager over the long term is also ahead of benchmark.

CBRE



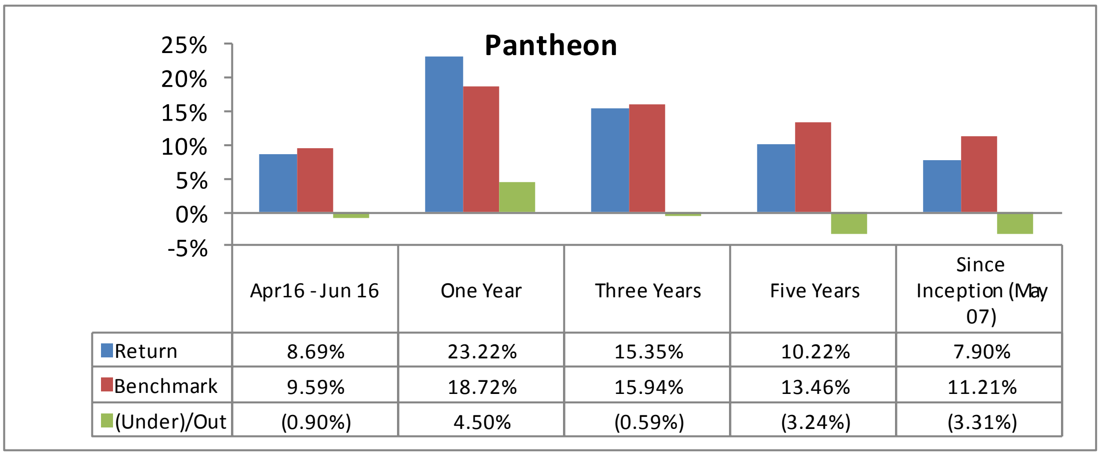
	Apr16 - Jun 16	One Year	Three Years	Five Years	Since Inception (Mar 03)
Return	0.89%	7.15%	11.27%	7.37%	6.07%
Benchmark	0.10%	7.16%	12.52%	8.45%	6.76%
(Under)/Out	0.79%	(0.01%)	(1.25%)	(1.08%)	(0.69%)

12.5. The manager saw a positive total return of 0.89% in the quarter and over-over-performed benchmark by 0.79%. Since inception the manager has underperformed benchmark by 0.69%. The relative performance of the property portfolio over the longer term has been driven by two European holdings that have suffered significant capital loss.

12.6. The two European funds have been unsuccessful. With an aggregate cost of £9.7 million, they are now valued at £0.2 million, a virtual total loss. Both funds are invested in highly leverage non prime property (German residential and Italian office / retain). The underlying holdings have suffered during the Euro crisis and the impact has been magnified on unit holders by the high levels of debt in each fund. Both funds are being rationalised which may offer an exit opportunity, but with little recovered value.

12.7. Adjusting for the European investment would put the manager significantly ahead of benchmark in terms of performance. However, the portfolio is expected to lag the benchmark for many years until the impact of the two European funds passes through.

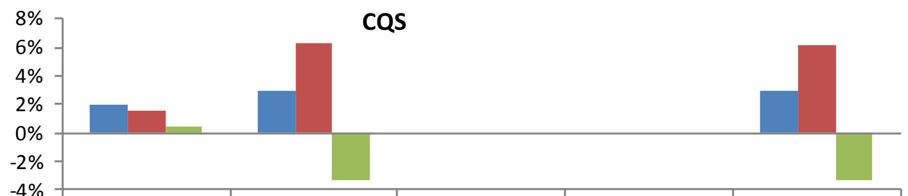
Pantheon Private Equity



	Apr16 - Jun 16	One Year	Three Years	Five Years	Since Inception (May 07)
Return	8.69%	23.22%	15.35%	10.22%	7.90%
Benchmark	9.59%	18.72%	15.94%	13.46%	11.21%
(Under)/Out	(0.90%)	4.50%	(0.59%)	(3.24%)	(3.31%)

Pantheon Private Equity has underperformed benchmark by 0.90% in the quarter - although the manager's performance in the last 12 months is significantly ahead of benchmark (4.5%). Longer term performance continues to lag benchmark.

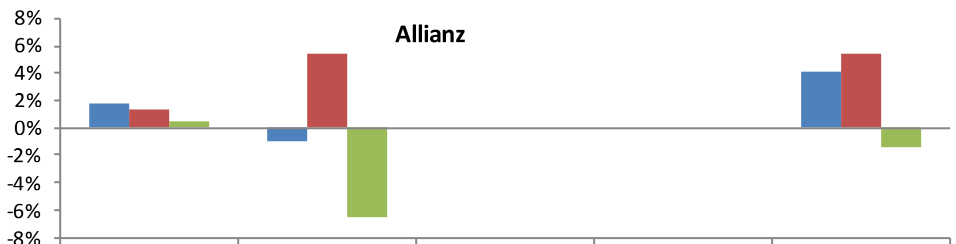
CQS Multi Sector Credit



	Apr16 - Jun 16	One Year	Three Years	Five Years	Since Inception (Aug 14)
Return	1.98%	2.91%		0	2.93%
Benchmark	1.53%	6.23%		0	6.21%
(Under)/Out	0.45%	(3.32%)		0.00%	(3.28%)

12.8. The manager has over-performed in the quarter by 0.45%, returning 1.98% against the benchmark return of 1.53%. Over the longer term, performance lags benchmark by 3.28%. This is due to general underlying problems with the sector although CQS remains on average a good performer among managers in the sector.

<u>Allianz Infrastructure Debt</u>



	Apr16 - Jun 16	One Year	Three Years	Five Years	Since Inception (Dec 14)
Return	1.84%	-1.04%		0	4.08%
Benchmark	1.35%	5.50%		0	5.50%
(Under)/Out	0.49%	(6.54%)		0.00%	(1.42%)

12.9. Allianz has returned 1.84% against benchmark of 1.35% giving an over-performance of 0.49% in the quarter. Since inception, the manager has underperformed benchmark by 1.42%.

13. Budget Management – Quarter Ending 30th June 2016

	Prior Year 2015-16 £'000	Reporting Period 2016-17 £'000	Change in expenditure £'000
Contributions & Benefit related expenditure			
Income			
Employee Contributions	2,301	2,156	-145
Employer Contributions	8,405	8,546	141
Transfer Values in	310	76	-234
Total Income	11,016	10,778	-238
Expenditure			
Pensions & Benefits	-10,962	-10,213	749
Transfer Values Paid	-525	-1,043	-518
Administrative Expenses	-132	-174	-42
Total Expenditure	-11,619	-11,430	189
Net of Contributions & Benefits	-603	-652	-49
Returns on investment			
Net Investment Income	1,118	1,126	8
Investment Management Expenses	-78	-525	-447
Net Return on Investment	1,040	601	-439
Total	**437**	**-51**	**-488**

13.1. The Fund is entering a period of maturity, where benefits payable is more than contributions received – this is reflected in the latest actual spend to date in 2016/17. Consequently, as the Fund further matures, it will be necessary to increase liquid asset holdings to ensure that the Fund is always able to meets its obligations to retired members.

13.2. The Funding Strategy would need to be revised to include investment in cash yielding assets, such as is being targeted for the renewable energy mandate, to provide greater liquidity in the Fund in order to prevent liquidation of assets to pay benefits.

13.3. The income shown in the above table is property income from the Property mandate as income from other asset classes are re-invested and shown within the overall fund asset value.

13.4. In all the net increase in expenditure in Qtr 1 2016 compared to the same period in the last financial year. However, this is mainly due to the increased spend of £477k on investment management expenses in 2016 compared to last year.

Investment Related Update

14. Pooling (London CIV)

14.1. The Fund was one of the early investors in the London CIV (LCIV).

14.2. An officer meeting of members of the LCIV was held on 8th August 2016 where LGIM presented their revised offer to London CIV members.

14.3. Following instruction from the Government that Funds currently invested in live funds should be able to retain to those funds where it makes financial sense to do so. This meant that LCIV and LGIM had to renegotiate terms on behalf of the 14 members of the LCIV that are invested in LGIM live funds.

14.4. LCIV and LGIM presented details of the new offer to LGIM investors at a meeting on 8th August 2016. The new agreements have been received and are now being reviewed by officers. The agreement will need to be signed by 24th August 2016, but the agreement (lower fees) will be backdated to 1st July 2016.

14.5. Provisional estimates indicate Haringey Pension Fund will make investment fee savings of £127k and also be to retain all of its investments with LGIM in their current form. The Committee had previously agreed to transfer all equity holdings (less emerging markets) to LCIV – this is no longer necessary.

14.6. These investments will be deemed by the Government to be part of the LCIV pool regardless of the fact that they will continue to be held outside of the LCIV Authorised Contractual Scheme (ACS) Fund structure.

15. Aviva Long Lease Property Mandate

15.1. The Committee at its meeting on 11 April 2016 approved to invest £50m in the Aviva Long Lease Property Fund. The instruments of the Lime Trust Fund and information memorandum for the Lime Property Fund have been received from the manager.

15.2. Subscription agreements have now been signed and returned to Aviva who are now in the process of completing their due diligence/Know Your Customer checks.

15.3. The next steps are as follows:

- The Jersey Manager will hold a board meeting to approve the subscription agreement once the original hard copy is received and KYC checks are complete. Once approved the Fund will formally join the queue.

15.4. It is anticipated that the Fund will join the queue of investors by the end of this year.

16. Low Carbon Index Update

16.1. The Committee agreed at its meeting of 14 January 2016 to shift one third of its equities portfolio or approximately 20% of total fund assets to low carbon target. Committee also agreed that the switch should be implemented in tranches to mitigate the risk of unfavourable market timing on oil prices.

16.2. The first tranche of asset switching worth approximately £60m was completed on 3 May 2016 at a cost of £51k (0.086%). The cost of transferring has been kept low by some internal switching of assets within the overall fund and coordinating with the sale of some assets by the Environment Protection Agency who were exiting the Index.

16.3. The transfer of the second tranche of assets was executed on 1st August 2016 at a cost £25k (0.042%). The cost of transferring and rebalancing of investment portfolio for the second tranche was halved when compared with the cost of executing the first tranche. This is mainly due to the increased level of matching that the manager was able to undertake within its overall portfolio of assets.

16.4. The third tranche is provisionally scheduled for 1 November 2016. A further update will be provided to the Committee once the third and final transfer has been completed.

17. CBRE Update

17.1. The Committee asked for an update on the impact of Brexit on the Pension Fund's property portfolio at its meeting of 11th July. Following feedback from our two property managers appointed by the Fund, it appears that Brexit impact on the property market has mostly affected retail funds – Haringey is not invested in retail funds. The manager has provided detailed commentary below:

Market Commentary

17.2. We anticipate downward shifts in valuations over the coming months. We are monitoring underlying funds and the direct market for feedback on an ongoing basis. At present the market signals are mixed with deals for prime / good quality properties let on secure, long term leases transacting at or close to pre-Brexit vote levels, whereas more secondary assets - or those with vacancy or shorter unexpired lease periods - are seeing a wider pricing discount. In terms of sectors, indications from July valuations are that values are down, generally by 0-5%, with central London offices seeing the largest value write-downs, especially in the City. Industrial values are holding up relatively well, as are values in the alternative sectors (such as student accommodation) and those for assets with long leases subject to RPI or fixed uplifts.

17.3. Given market uncertainties in the UK property market, valuers are including valuation caveats for the funds held within the Haringey portfolio until sufficient evidence from comparable investment & leasing transactions emerges. Accordingly the impact of Brexit was not revealed in your June 2016 valuation and performance results but we anticipate this to occur in Q3 and the following months.

17.4. You will have noted negative press coverage concerning retail funds (funds which retail investors can access). There have been NAV reductions within the open ended retail funds of around 5% and in some cases some funds introduced hefty exit fees, in certain cases to a 15-17% discount to NAV, to protect against redemption pressures. Please be assured that your portfolio is not invested in any such funds. Furthermore, there is still liquidity in the UK property market for some of the assets these retail funds are looking to sell. More recently we have seen the hefty exit fees imposed by some of the retail funds reduce to 7-10%. Some retail funds have also reported that a portion of the redemptions they received having been withdrawn, and in some cases they are seeing inflows of capital.

17.5. Although the impact of Brexit will be negative to the outlook for UK property, Brexit-related disruption has occurred when UK fundamentals were relatively favourable with lower long term government bond yields, cheaper sterling and monetary policy able to provide some support to the economy and property pricing. What happens within occupational markets is very important – so far the initial response from occupiers has been encouraging with many leases agreed before the referendum being executed post Brexit on the same terms. However we caution it is still early days and the leasing deals that have been executed post-Brexit were well advanced pre-Brexit. We will continue to watch business sentiment surveys closely to gauge the sustainability of tenant demand.

17.6. It is a combination of factors that will drive returns and pricing going forwards. This will include but is not limited to: investor sentiment and return requirements, the supply and demand for investment product (many investors are adopting a wait and see approach, particularly from overseas, or looking to extract price adjustments on purchases), how property fares relative to other assets classes (UK property still provides a strong yield spread over bonds/ gilts) and what happens in the occupier market (which will impact rental levels).

Haringey Portfolio

17.7. As noted in your Q2 2016 report, we do not expect to make a fundamental shift to your portfolio. As a general overall commentary the Haringey portfolio is exposed to good quality institutional property that should prove be relatively more resilient to any decrease in capital values (as noted above). For example we have built an overweight position (relative to our portfolio models – and the benchmark) in funds in the 'other commercial' (which includes student accommodation and leisure property) and continued to maintain a high exposure to the industrial sector.

17.8. We also made investments into funds like Cordatus Property Trust, which provides an above average income yield, and Palmer Capital Income Unit Trust, which has a portfolio with a longer than average lease length. Furthermore we have remained 'underweight' to both central London offices and 'rest of UK' offices which should also prove positive given the expected Brexit 'traffic light' impacts noted above. You will note that we have decreased your holding in West End of London Property Unit Trust in 2016 and plan to reduce this further in 2016-17. We are also underweight to the retail warehouse sector, which we believe is appropriate, although the funds in this sector have experienced either leverage or over-valuation issues.

17.9. We continue to monitor the markets and are generally prepared to secure opportunities where re-pricing is attractive. We believe that a flight to quality and further monetary stimulus could mean that pricing for prime, long leases assets holds firm, or could improve.

17.10. As you are aware we are in the process of reducing the Haringey portfolio by some 25%. You will note that the portfolio had just over 10% in cash at the end of June as part of this process. Clearly market pricing has been and will continue to be affected by the Brexit vote. In particular this has impacted the secondary market pricing of funds in which you are invested. This will increase the cost and/ or timeframe of completing the sell down exercise although we will continue to optimise disposals as opportunities and market conditions dictate.

18. Renewable Energy Manager Search

18.1. The Committee agreed to appoint bfinance as search manager to assist with the appointment of an investment manager to actively manage the Funds proposed investment into the renewable energy sector.

18.2. The high level universe screening of potential managers commenced in July following agreement of request for proposal and mandate specification questionnaire. This culminated in the submission of 18 applications by the deadline of 19 August 2016.

18.3. The initial number and mix of managers that have responded should provide a broad range from which the Fund can narrow down to a preferred manager. A long list of 9 managers was initially submitted by bfinance, but this has been further refined down to 7 managers at a joint meeting between bfinance and the Council and its representatives. These 7 managers will now go on to the next stage of the selection process. The successful managers that are through to the next stage are set out in the below table.

Name	Fund
Aquila Capital	Aquila Capital European Hydropower Fund S.A
BlackRock	Global Renewable Power Fund II
Carlyle Group	Carlyle Global Infrasture Opportunity Fund L.P. (Renewable Infrasture Side-Car)
Copenhagen Infrastructure Partners	Copenhagen Infrastructure III K/S
Foresight Group - FEIP	Foresight Energy Infrastructure Partners
Impax Asset Management	New Energy Investors III L.P.
KGAL Investment Management	ESPF 4

18.4. The next phase of the search is to issue a second stage questionnaire which will be issued on 13th September and due to be submitted late September. A selection interview panel will be convened soon after the questionnaires have been received back to review submissions and interview prospective managers on the short list.

18.5. A final onsite meeting will be arranged with the preferred manager(s) prior to making a recommendation to the Committee. It expected that the Committee will have the opportunity appoint a new manager at its meeting scheduled for 22nd November 2016.

Appendix 1

Manager	% of Total Portfolio	Mandate	Benchmark	Performance Target
Legal & General Investment Management	75.00%	Global Equities & Bonds	See overleaf	Index (passively managed)
CQS	5%	Multi Sector Credit	3 month libor + 5.5% p.a	Benchmark
Allianz	5%	Infrastructure Debt	5.5% p.a.	Benchmark
CBRE Global Investors	10%	Property	IPD UK Pooled Property Funds All Balanced Index	+1% gross of fees p.a. over a rolling 5 yr period
Pantheon Private Equity	5%	Private Equity	MSCI World Index plus 3.5%	Benchmark
Total	**100%**			

Asset Class	Benchmark	Legal & General Investment Management
UK Equities	FTSE All Share	**13.30%**
North America	FT World Developed North America GBP Unhedged	19.30%
Europe ex UK	FT World Developed Europe X UK GBP Unhedged	6.57%
Pacific ex Japan	FT World Developed Pacific X Japan GBP Unhedged	3.03%
Japan	FT World Developed Japan GBP Unhedged	3.10%
Emerging Markets	FT World Global Emerging Markets GBP Unhedged	8.00%
Global Low Carbon Target	MS World Low Carbon Target Index	6.70%
Total Overseas Equity	**FTA Index Linked Over 5 Years Index**	**46.70%**
Index Linked Gilts	**FTA Index Linked Over 5 Years Index**	**15.00%**
Total L&G		**75.00%**