

Pension Committee Supplementary Agenda



6. Progress Report for Quarter ended 31 December 2021 (Pages 3 - 10)

The Pension Committee is asked to note the performance of the Fund for the quarter ended 31 December 2021.

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Agenda Item 6

REPORT TO:	PENSION COMMITTEE 13 April 2022
SUBJECT:	Progress Report for Quarter Ended 31 December 2021
LEAD OFFICER:	Nigel Cook Head of Pensions and Treasury
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 2021 was £1,750.3m compared to £1,652.1m at 30 September 2021, an increase of £98.2m and a return of 5.02% 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.	
FORWARD PLAN KEY DECISION REFERENCE NO.: N/A	
1 RECOMMENDATIONS	
1.1	The Committee is asked to note the performance of the Fund for the quarter ended 31 December 2021.

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 2021. 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 At the 2019 Triennial Actuarial Valuation the whole of fund funding position was 88% using a future investment return assumption (otherwise described as the discount rate) of 4.0% p.a. The Fund would be 100% funded if an assumed investment return of 4.8% p.a. was used. 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 on the basis that other assumptions remain constant, the funding gap will close.
- 3.2 Since the valuation date the Fund has made a cumulative return of 39.37% against a return of 11.4% assumed by the valuation. This has had a positive impact on the funding level.
- 3.3 Details of the performance of individual components of the portfolio are detailed in the report produced by the Fund's investment advisors in Appendix A.

Section 2: Asset Allocation Strategy

- 3.4 The Pension Committee discussed changes to the current asset allocation strategy at the Committee meeting held on 17 March 2020 (Minute A27/20 refers). However, reviewing the current allocation it is apparent that the target allocation cannot yet be applied as it has not been formally adopted because, as per the Minute – "Officers pointed out that they were not able to give investment advice and the Pension Fund's investment adviser had not been given the opportunity to offer appropriate advice to inform the decision." The prudent option is therefore to measure allocation against the prior allocation. This option is supported by the Scheme's investment advisors. Any proposal to amend this asset allocation will require a period of consultation with other Scheme Employers.

3.4 The target portfolio can be broken down as follows:

Asset Class		Target Allocation	Allowable Tolerance
Equities including allocation to emerging markets.		42%	+/- 5%
Fixed interest		23%	+/- 5%
Alternates		34%	+/- 5%
<i>Comprised of:</i>			
Private Equity	8%		
Infrastructure	10%		
Property	16%		
Cash		1%	
Total		100%	

3.6 Monitoring of asset allocation

3.6.1 **Global Equity** – During the quarter the LGIM Developed World (ex-Tobacco) Equity fund returned 7.4%. The currency hedge enhanced the returns slightly as Sterling strengthened against most other major currencies. The hedge has led to over £26m of excess gains since its implementation.

The LCIV RBC fund continues to perform well and returned 3.64% over the quarter. Officers and Advisers are currently looking at new products offered by the London CIV with the view to decarbonise the equity portfolio further. Officers are conscious of the need to do this, but need to ensure that excess risk this may bring to the Fund, does not impede on returns.

Global equities are now at 46.5% compared to the target allocation of 42% with a 5% tolerance. This has largely been due to equity returns significantly outpacing most of the other areas of the portfolio over the last few years.

3.6.3 **Fixed Interest** – During the quarter fixed interest returns were pretty flat. The allocation is 17.5% which is outside the target allocation of 23% allowing for a 5% tolerance.

3.6.2 **Infrastructure** – Due to the nature of the assets performance of Infrastructure investments and indeed Private Equity, discussed in more detail below, is better measured over a period of time, rather than on a quarter by quarter basis. All the Fund's Infrastructure investments are performing in line with their targets. The Fund has increased commitments with some of its existing managers and is also assessing opportunities with the London CIV. The allocation currently stands at 12% compared to a target of 10%.

3.6.4 **Private Equity** – Our Private Equity managers continue to perform extremely well and have been the main contributor to positive returns over the last few years. The performance of private equity investments tends to follow the same direction as global equities. The allocation is at 10.1% which is above the target allocation of 8%.

3.6.5 **Property** – The Property allocations remained at 12.1% over the quarter. This is well short of the target of 16% and is largely as a result of the excess returns from global equities. Commercial property investments suffered as a result of COVID-19, however the Property portfolio has now returned 10.9% for the year to date.

3.6.6 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 2021

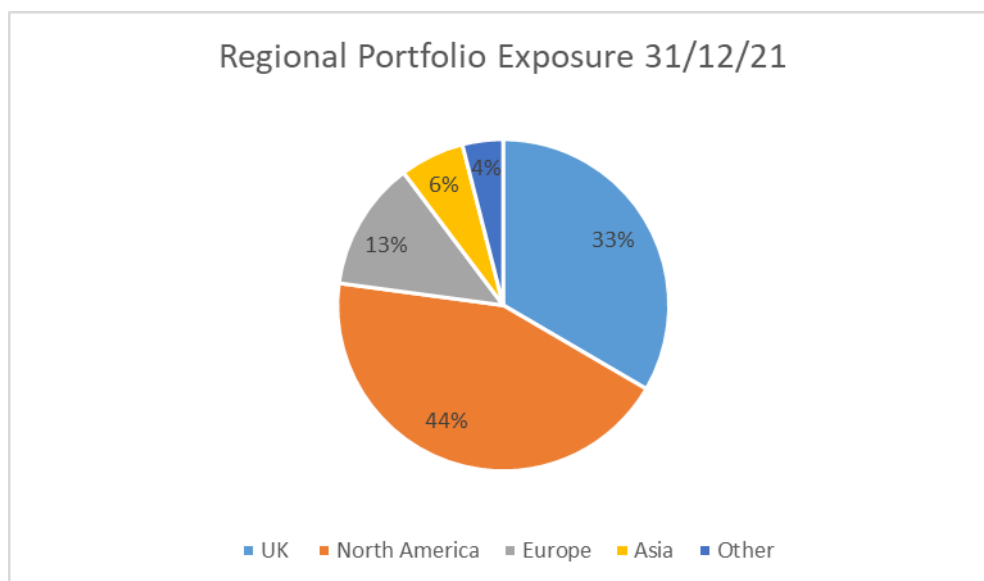
	Valuation at 30/09/2021 £'000	Net cashflow £'000	Gain/Loss £'000	Valuation at 31/12/2021 £'000	Asset allocation Fund percentage	Asset allocation target percentage
Equities					46.5%	42%
Legal & General FTSE World (Ex Tobacco)	671,912	-	49,736	721,648		
LCIV RBC	86,941	-	5,873	92,813		
LCIV	150			150		
Fixed Interest					17.5%	23%
Standard Life	140,118	-	544	139,574		
Wellington	70,348	-	1,228	71,576		
LCIV Global Bond	94,740	-	176	94,564		
Infrastructure					12.0%	10%
Access	28,703	1,439	474	29,667		
Temporis	29,756	27,892	201	57,850		
Equitix	75,256	8	96	75,169		
Macquarie GIG Renewable Energy	20,590	550	3,769	23,809		
I Squared	22,631	-	1,057	23,688		
Private Equity					10.1%	8%
Knightsbridge	59,106	2,416	8,585	65,276		
Pantheon	74,948	4,773	3,149	73,324		
Access	20,359	2,278	158	22,795		
North Sea	12,743	686	1,704	15,133		
Property					12.1%	16%
Schroders	139,651	-	8,553	148,204		
M&G	62,736	113	604	63,226		
Cash					1.8%	1%
Legal & General FTSE4Good Cash	738	-	-	738		
Cash	40,678	9,594	-	31,084		
Fund Total	1,652,104	14,856	83,327	1,750,287	100%	100%

Valuations are based on the bid price as reported by the Fund Managers. The valuations of the Infrastructure and Private Equity funds are the latest available and can be lagged by 3 months.

3.7 Regional Exposure

3.7.1 The Committee asked for an indication of the geographical dispersion of the underlying assets comprising the portfolio. This is set out graphically in the chart below. This information is for illustrative purposes only. It should be noted that there are differences in the period represented as some data is updated far more frequently than others.

Graph 2: Geographic dispersion of funds.



3.7.2 The descriptor Asia includes Japan, Korea and Australia. The rest of the world (RoW) includes the continent of Africa and Latin America.

3.7.3 It should be noted that of the 33% invested in the UK 12.1% is allocated to Property and 8.9% to Infrastructure. The majority of the Private Equity and Global Equity investments are in the US and Canada.

Section 3: Risk Management

- 3.7** 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.
- 3.8** 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.

The Russian Invasion of Ukraine

- 3.9** In response to the unprovoked Russian invasion of Ukraine the Pension team have surveyed all the funds that manage the Croydon LGPS Fund's investments. Many of the steps the industry has taken have been well-publicised; many Blue Chip businesses have closed down outlets in Russia or blocked movements of products. Indices that Fund Managers use to measure performance have valued Russian firms at zero so index trackers do not buy their stock. On the down-side though is the very real risk that Russian business and the state default on loans made to them, or repay in roubles. In addition, investors are seeing pressure to divest themselves of certain holdings but there is no market for such toxic assets and so no obvious path for exits. The picture is complex and constantly changing.

- 3.10 Inevitably the impact of this will affect the global economy with wider implications for the energy sector and commodities including agriculture. For the Pension Fund these events introduce much greater levels of volatility on the eve of a new valuation and the possibility of a reduction in global growth and also significant inflation. This may well impact on forecast funding levels and employer contributions.
- 3.11 The Pension Fund does not invest directly in any companies. All investments are made through vehicles which are managed by regulated businesses. The Pension fund does not have any exposure through its listed equity mandates. It has a very small exposure through its bond and private equity mandates. These exposures are being managed in order to achieve the best outcomes for investors.
- 3.12 This shows the exposure that the Croydon Fund has through Private Equity and through the London CIV, through its Global Bonds Fund and another Fixed Interest Fund. This shows Croydon's exposure to companies located in Russia, Belarus and Kazakhstan.

Direct Exposure to Russia and Belarus

Private Lending: £900,000 at December, 2021
Commercial and Government Bonds £2.3 million at 31st January 2022

By way of context the Fund was valued at £1,651.1 million at a comparable date.

- 3.13 The exposure to Russia and Ukraine (as at 23/2/22) is approximately 1.4% of the value of the portfolio. There is a 0.5% weight in Russian Government bonds and c. 0.4% in the credit of Russian firms. There is a c 0.1% position in Ukrainian Government Bonds, and a c.0.4% weighting in the credit of Ukrainian companies. In terms of an immediate response, we note that portfolio weights have already shifted as a result of the market movements. Looking historically, major conflicts have generally had the biggest impact on the markets in the run up to the action, but have steadily recovered from there – and as such we are inclined not to make major changes to the level of risk we are taking as a short-term response to these events.
- 3.14 Mercer, the Fund's investment adviser, have drafted a Fund Monitoring Report, for the 3 months to 30 September 2021. These reports are included in Part B of this Committee agenda.

Section 4: Investment Manager Visits

- 4.1 During the quarter, Officers met the following managers:
- Equitix October 2021
 - Temporis November 2021
 - Knightsbridge December 2021

These visits help develop the relationship between investor and fund manager and count against training day requirements.

5. 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.

Approved by: Richard Ennis, Interim Corporate Director of Resources (Section 151) and Deputy Chief Executive

6. LEGAL CONSIDERATIONS

- 6.1 The Head of Litigation and Corporate Law comments on behalf of the interim Director of Law and Governance that there are no direct legal implications arising from the recommendations within this report. The Committee must, however, be mindful of their fiduciary duty to obtain the best possible financial return on the investment of the Fund it administers within the investment strategy framework.

Approved by: Sandra Herbert, Head of Litigation and Corporate Law on behalf of the interim Director of Law and Governance and Deputy Monitoring Officer.

7. HUMAN RESOURCES IMPACT

- 7.1 There are no direct workforce implications arising from the recommendations within this report. If any should arise these will be managed under the Council's policies and procedures.

Approved by Gillian Bevan, Head of HR Resources and Assistant Chief Executives, on behalf of Dean Shoesmith, Chief People Officer

8. EQUALITIES IMPACT

- 8.1 There are no equalities impacts arising from this report.

9. ENVIRONMENTAL IMPACT

- 9.1 There are no environmental impacts arising from this report.

10. CRIME AND DISORDER REDUCTION IMPACT

- 10.1 There are no crime and disorder impacts arising from this report.

11. FREEDOM OF INFORMATION/DATA PROTECTION CONSIDERATIONS

- 11.1 This report and Appendices contain 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 and will be reported in the closed part of the agenda. On application of the public interest test it is considered that the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

CONTACT OFFICER:

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Resources Department, ext. 62552.

BACKGROUND DOCUMENTS:

Included in Part B of the agenda.

Quarterly reports from each fund manager (circulated under separate cover to the Committee Members.) Exempt pursuant to Schedule 12A paragraph 3 of the Local Government Act 1972 as amended.

Appendices:

There are no part A appendices.

Part B appendices:

Exempt 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 A: London Borough of Croydon Returns to 31 December 2021, Mercer

Appendix B: Market Background and Market View Q4 2021, Mercer