REPORT TO:	**PENSION BOARD** **10 October 2018**
SUBJECT:	**Progress Report for Quarter Ended 30 June 2018**
LEAD OFFICER:	**Richard Simpson** **Executive Director of Resources**
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 30 June 2018 was £1,188.9m compared to £1,128.5m at 31 March 2018, an increase of £62m and a return of 5.5% over the quarter. The performance figures in this report have been compiled from data provided by each fund manager and are quoted net of fees. 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.

2 EXECUTIVE SUMMARY

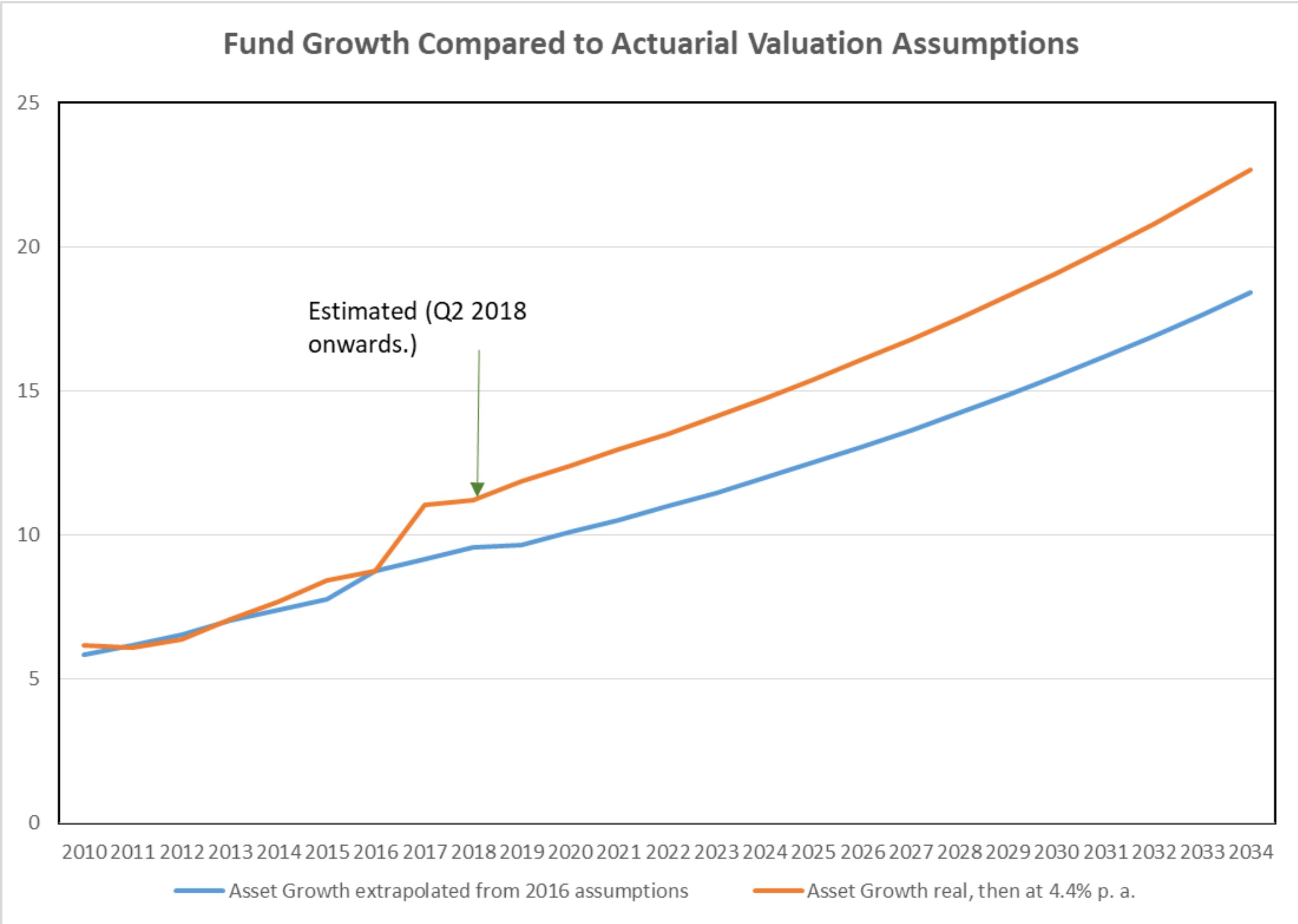
2.1 This report provides an update on the London Borough of Croydon Pension Fund's (the Fund's) performance for the quarter to 30 June 2018. The report falls into four parts. Section 1 addresses performance against strategic goals. The second section considers the asset allocation strategy and how that 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 summarised in Appendix A. The returns for L&G, Standard Life, Wellington and Schroders are calculated on a time series basis. This basis negates the effect of any cash flows made to and from a manager's portfolio (the reason being that the timing of investments and disinvestments is not the manager's decision) and so allows the performance of those managers to be compared fairly with their benchmarks and peers. The returns for the other managers are calculated using the Internal Rate of Return (IRR). Using the IRR considers the effect of cash flows and this is deemed appropriate for these managers as the timing of investments is determined by the manager. Due to the nature of these investments, less emphasis should be put on the performance for immature investments; Temporis, GIB, Access, North Sea Capital and M&G, and more attention should be made to the performance since inception for the more mature investments: Equitix, Knightsbridge and Pantheon. The whole of fund return uses the IRR as this is in line with the Actuary when calculating the valuation. It should be noted that the portfolio has been built on the premise that diversification mitigates the impact of return volatility, the performance of individual investments is less important than the return of the Fund in aggregate and certainly cannot be assessed over less than a full cycle, and the duration of the cycle will vary from asset to asset.

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**

To recap, since the revised asset allocation was agreed £69.2m has been disinvested from global equities and £32.2m from hedge funds. This, along with new cash to the fund has been invested; £20m in private equity, £75m in infrastructure, £25.5m in Private Rental Sector property and £16.4m in traditional property.

3.6.1 **Private Equity –** During the quarter net distributions of £0.5m were paid from our existing private equity managers and positive returns of £11m were generated. The current allocation to this asset class is 8.4% of the Fund. The Fund's Private Equity assets are performing well and the allocation is considered on target.

Allocation: On target.

3.6.2 **Infrastructure –** During the quarter a net contribution of £1.5m was paid to our existing managers and £1.7m was paid to I Squared Capital, this being the first drawdown for this manager. Positive returns of £1.7m were generated in the quarter meaning and the allocation percentage remained constant at 9.9%. The Fund's Infrastructure assets are all performing well and the allocation is on target.

Allocation: On target.

3.6.3 **Traditional Property –** During the quarter positive returns of £2.6m meant the allocation remained on target.

Allocation: On target.

3.6.4 **Private Rental Sector -** The Fund signed a commitment of £25m to the M&G UK Residential Fund in January 2016 and during the quarter ending 31 December 2016 signed a commitment for a further £35m with M&G. The first tranche of £25m was fully drawn by 30 June 2017 and is generating positive returns. M&G have commenced drawdown of the second tranche with £0.5m being drawn in the quarter. A further £9m is to be drawn in the next quarter and we are expecting the final £25.5m to be drawn by 31 December 2018 as planned. The allocation remained at 2.2% over the quarter.

Allocation: On target to meet allocation by 31 December 2018 as planned.

3.6.5 **Global Equities –** The Fund's allocation to equities remained overweight at 52.6% which is 1% more than reported for the previous quarter and still outside of the agreed tolerances. Our Global Equity portfolio increased by 8%, a value of £46.3m over the quarter, so the increase in the overweight allocation was not surprising. After the quarter end £15m was divested from our Global Equity portfolio to meet Fund expenditure and commitment drawdowns from our Infrastructure and Private Rental Sector assets.

3.6.6 £55m is being transitioned from the LGIM fund into a Janus Henderson Emerging Markets fund managed by the London CIV.

3.6.7 **Fixed Interest –** The Fund remains below the lower end of the target range in its fixed income allocation and this is largely due to outperformance of other assets.

3.7 The table below illustrates the movement in the Fund's valuation during the quarter and the current asset allocation against the target.

Fund valuation and asset allocation for the quarter ending 30 June 2018

	Valuation at 31/03/2018 £'000	Net Cashflow £'000	Gain/loss £'000	Valuation at 30/06/2018 £'000	Asset Allocation Fund Percentage	Asset Allocation Target Percentage
Equities					**52.6%**	**42%**
Legal & General FTSE4Good	92	-	71	162		
Lega & General FTSE World (Ex Tobacco)	578,812	-	46,294	625,106		
Fixed Interest					**16.2%**	**23%**
Standard Life	128,716	-	- 342	128,374		
Wellington	63,692	-	395	64,086		
Infrastructure					**9.9%**	**10%**
Access	10,403	- 954	110	9,559		
Temporis	20,586	185	92	20,863		
Equitix	56,842	2,775	646	60,262		
Green Investment bank	24,599	- 532	830	24,897		
I Squared	-	1,730	-	1,730		
Private Equity					**8.4%**	**8%**
Knightsbridge	19,892	749	2,384	23,025		
Pantheon	56,563	- 1,729	8,327	63,161		
Access	11,547	-	380	11,927		
North Sea	786	524	5	1,314		
Property					**10.1%**	**10%**
Schroders	117,334	-	2,634	119,969		
Property PRS					**2.2%**	**6%**
M&G	25,229	494	166	25,888		
Cash					**0.7%**	**1%**
Cash	13,396	- 4,835	15	8,576		
Fund Total	**1,128,487**	**- 1,594**	**62,006**	**1,188,899**	**100%**	**100%**

3.8 The Fund remains over-weight to equities and under-weight to fixed interest to the extent that the proportion in these asset classes are outside the allowable variance. This position is not consistent with the Fund investment strategy. Efforts are being made to further rebalance the portfolio and products available through the London CIV are being considered.

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 30 June 2018. These reports are included in the closed part of this Committee agenda.

Section 4: Investment Manager Visit

3.12 Members of the Pensions Committee visited Equitix in July 2018 and the good progress of the Funds invested in was noted.

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. COMMENTS OF THE COUNCIL SOLICITOR AND MONITORING OFFICER

6.1 The Solicitor to the Council comments that there are no legal implications arising from the recommendations within this report, which is to note.

Approved by: Sandra Herbert, Head of Litigation and Corporate Law, for and on behalf of Jacqueline Harris-Baker, Director of Law and Governance and 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: Nigel Cook – Head of Pensions and Treasury
Resources Department, ext. 62552.

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

APPENDICES:

Part A appendices:
Appendix A: Fund Returns

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 Q2 2018, Mercer

Appendix A

London Borough of Croydon fund returns for the period ending 30 June 2018

EQUITIES						
L&G Ex tobacco	**Quarter**	**1 year**	**3 year**	**5 year**	**inception**	
Fund	8.0%				4.8%	
Benchmark	8.1%				5.0%	
FIXED INTEREST						
Standard Life	**Quarter**	**1 year**	**3 year**	**5 year**	**inception**	
Fund	-0.3%	-0.2%	2.7%	3.3%	4.3%	
Benchmark	0.0%	0.8%	3.0%	3.7%	4.5%	
Wellington	**Quarter**	**1 year**	**3 year**	**5 year**	**inception**	
Fund	0.6%	2.5%	4.9%	5.3%	6.2%	
Benchmark	0.1%	1.6%	4.9%	5.4%	5.9%	
INFRASTRUCTURE						
Equitix	**Quarter**	**1 year**	**3 year**	**5 year**	**inception**	
Fund	1.1%	10.3%	10.9%	12.1%	14.4%	
Benchmark	1.4%	7.4%	6.8%	6.5%	7.2%	
Temporis	**Quarter**	**1 year**	**3 year**	**5 year**	**inception**	
Fund	0.4%	10.3%			5.6%	
Benchmark	1.4%	7.4%			8.0%	
GIB	**Quarter**	**1 year**	**3 year**	**5 year**	**inception**	
Fund	3.6%	5.2%			8.2%	
Benchmark	1.4%	7.4%			8.8%	
PRIVATE EQUTIY						
Knightsbridge	**Quarter**	**1 year**	**3 year**	**5 year**	**inception**	
Fund	14.0%	7.6%	9.7%	6.0%	13.5%	
Benchmark	1.4%	7.4%	6.8%	6.5%	7.2%	
Pantheon	**Quarter**	**1 year**	**3 year**	**5 year**	**inception**	
Fund	18.7%	16.9%	21.5%	16.1%	13.6%	
Benchmark	1.4%	7.4%	6.8%	6.5%	7.3%	
Access	**Quarter**	**1 year**	**3 year**	**5 year**	**inception**	
Fund	3.5%	13.1%			10.8%	
Benchmark	1.4%	7.4%			8.0%	
North Sea Capital	**Quarter**	**1 year**	**3 year**	**5 year**	**inception**	
Fund	0.8%				-20.4%	too early
Benchmark	1.4%				8.8%	too early
PROPERTY						
Schroders	**Quarter**	**1 year**	**3 year**	**5 year**	**inception**	
Fund	2.3%	10.3%	7.0%	11.1%	10.1%	
Benchmark	2.0%	9.7%	7.6%	10.6%	9.4%	
PROPERTY PRS						
M&G	**Quarter**	**1 year**	**3 year**	**5 year**	**inception**	
Fund	0.66%	4.10%			1.13%	
Benchmark	1.71%	7.00%			7.00%	
Total Fund						
	Quarter	**1 year**	**3 year**	**5yr**	**inception**	
Fund	5.50%	8.24%	11.77%	10.42%	8.05%	
CPI + 4%	1.18%	6.42%	5.84%	5.47%	6.29%	

Returns are net of fees and annualised apart from for the last quarter

Returns for Equity, Fixed Interest and Property Funds are calculated on a time weighted basis.

Returns for Infrastructure, Private Equity ,Property PRS funds and the Total return are calculated on an Internal rate of return basis.