Croydon Council

REPORT TO:	**PENSION COMMITTEE** **17 September 2019**
SUBJECT:	**Progress Report for Quarter Ended 30 June 2019**
LEAD OFFICER:	**Nigel Cook** **Head of Pensions and Treasury**
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 31 June 2019 was £1,295 m compared to £1,242 m at 31 March 2019, an increase of £53m and a return of 4.30% 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.

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, 2019. 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 relating to 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 are included as appendices to this report.

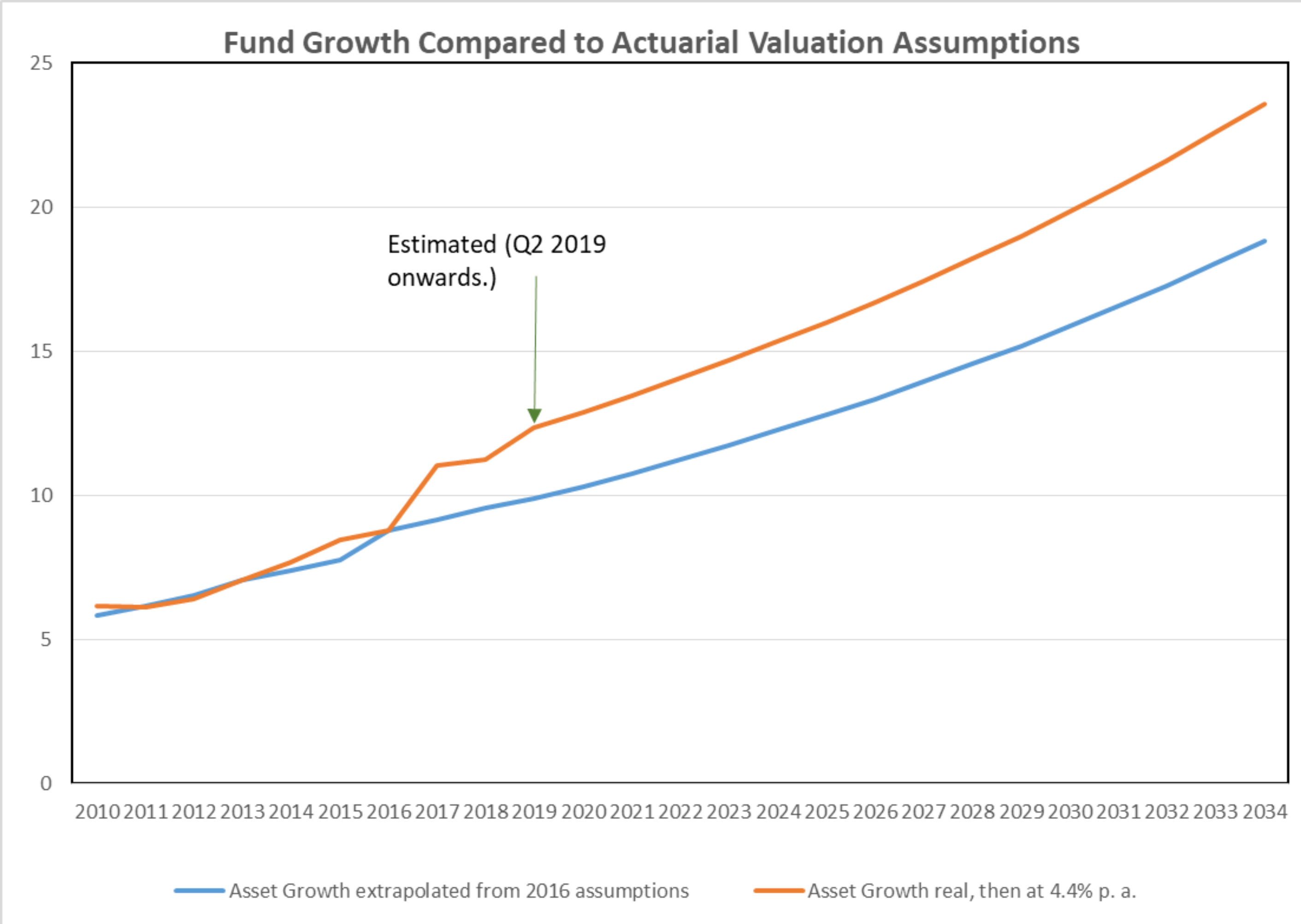
3 DETAIL

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 the assumption used in the valuation and on the basis that other assumptions remain constant, the funding gap will reduce.

3.2 Graph 1 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 it 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.

Graph 1: Fund Growth Compared to Actuarial Valuation Assumptions



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 current asset allocation strategy was approved at the Committee meeting held on 8 September 2015 (Minute A29/15 refers). The portfolio now reflects the proportions described in that strategy, allowing for the vagaries of the market.

3.5 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%
Comprised of:			
Private Equity	8%		
Infrastructure	10%		
Traditional (Commercial) Property	10%		
Private Rental Sector (Residential) Property	6%		
Cash		1%	
Total		**100%**	

3.6 **Monitoring of asset allocation**

3.6.1 **Global Equity –** The Global Equity portfolio had another strong quarter, returning 6.5%; it was the major contributor to the good return of the Fund over the quarter. Equity returns have remained strong, although officers are expecting these to soften as the global economy starts to show signs of weakening. The allocation to Global equities was 42.5%, so considered at the target allocation for the Fund. Post quarter end there were further gains to the equity portfolio and so officers took the opportunity to divest £15m from the LGIM equity fund. This will cover ongoing benefit payments and any net investments to the infrastructure and private equity portfolios.

3.6.2 There have been difficulties with the London CIV Emerging Market equity fund. Following the departure of the portfolio manager and imminent departure of his team from the current provider, Janus Henderson, the London CIV has been through a selection process and appointed JP Morgan to run the London CIV Emerging Market mandate. The JP Morgan fund intends to invest in high quality businesses that compound earnings sustainably over the long-term. This fund aims to achieve long-term capital growth by out-performing the MSCI Emerging Market Index (Total Return Net by 2.5% per annum net of fees annualized over a rolling three-year period. The fees would be 47 bps plus 2.5 bps LCIV fee. The schedule for transitioning into the sub-fund is to commence on 9th to 11th October, 2019.

3.6.3 **Fixed Interest** – The four funds, managed by three managers, represent the target allocation to this asset class. Currently these funds are valued at 22.3% of the overall portfolio and are considered at the target allocation of the Fund.

3.6.4 **Infrastructure** – Performance information relating to Infrastructure investments and indeed Private Equity, discussed in more detail below, is lagged by a quarter. This is due to the process involving collating information from a number of sub-funds and various compliance checks. The table below shows that the Fund is marginally over-exposed (11.1% compared with a target allocation of 10%). Officers are expecting this to continue in the short term as the Fund has had to over commit in order to get to the target allocation. Allocations to Equitix, the Green Investment Bank, Temporis and Access are all yielding cash which will fund new investments and also ensure the allocation comes back into line over the medium term. Post quarter end the Fund made a new commitment of €20m to another renewable energy fund managed by Temporis.

3.6.5 **Private Equity** – .The Fund continued to see distributions during the quarter that served to help with cash flow. This part of the portfolio remained at 8.9% of the Fund which is slightly overweight. This is mainly due to the good performance of the asset class.

3.6.6 **Traditional Property** – The Schroders portfolio is on target compared to the asset allocation target. The portfolio continues to perform relatively well, especially considering the ongoing uncertainty caused mainly by Brexit.

3.6.7 **Private Rental Sector –** The Fund's total commitment of £60 m is now fully invested in the PRS mandate. The allocation is at 4.7% which is below the original target of 6%. This is mainly due to the good performance experienced by the rest of the portfolio and also to the stagnation of UK house prices. The mandate continues to perform well compared to the peer group. Although the Fund is below its target allocation, officers do not consider it appropriate to top up this part of the portfolio further at this time. Officers will continue to monitor the market for suitable opportunities.

3.6.8 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 30 June 2019

	31/03/2019 £'000	Net Cashflow £'000	Gain/loss £'000	30/06/2019 £'000	Fund Percentage	Target Percentage
Equities					**42.5%**	**42%**
Legal & General FTSE4Good	239	-	-61	178		
Lega & General FTSE World (Ex Tobacco)	457,993	-	30,643	488,636		
LCIV Emerging Markets	58,044	-	3,254	61,298		
Fixed Interest					**22.3%**	**23%**
Standard Life	131,228	-	1,927	133,155		
Wellington	67,126	-	1,095	68,220		
LCIV Global Bond	84,066	-	3,178	87,245		
Infrastructure					**11.1%**	**10%**
Access	13,417	-213	821	14,025		
Temporis	34,530	-2,755	-163	31,612		
Equitix	64,045	554	1,095	65,694		
Green Investment bank	24,155	-428	852	24,579		
I Squared	6,807	93	402	7,302		
Private Equity					**8.9%**	**8%**
Knightsbridge	29,219	-	2,203	31,423		
Pantheon	64,552	-3,257	3,954	65,249		
Access	13,151	-	2,306	15,458		
North Sea	3,044	-	276	3,319		
Property					**9.7%**	**10%**
Schroders	124,403	-	1,007	125,410		
Property PRS					**4.7%**	**6%**
M&G	60,245	-	634	60,879		
Cash					**0.9%**	**1%**
Cash	5,536	6,063	19	11,618		
Fund Total	**1,241,799**	**58**	**53,443**	**1,295,300**	**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 lagged by 3 months due to the timing of the reporting of these funds.

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.

3.9 To mitigate against the risk of currency exchange moving against the fund a currency hedge has been put in place for the LGIM Equity fund. As long as sterling continues to weaken equity returns should benefit, specifically as UK firms' outputs appear more attractive. However this phenomenon must eventually end and the hedge is designed to take much of this risk off the table by banking these gains.

3.10 Mercer, the Fund's investment advisor, have drafted a Fund Monitoring Report and Market Background and View Overview Report, for the 3 months to 30 June 2019. These reports are included in Part B of this Committee agenda as they contain commercially sensitive views.

Section 4: Investment Manager Visits

3.11 Members of the Pensions Committee continued with their programme of visits:

- LGIM, April 2019
- North Sea Capital in May 2019 and
- PIMCO in June 2019.

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

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. LEGAL CONSIDERATIONS

6.1 The Head of Litigation and Corporate Law comments on behalf of the Director of Law and Governance that there are no legal considerations arising from the recommendations in this report.

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

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BACKGROUND DOCUMENTS:

Included in Part B of the agenda.
Quarterly reports from each fund manager (circulated under separate cover to the Committee Members.)

Appendices:

There are no part A appendices.

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 A: London Borough of Croydon Returns to 30 June 2019, Mercer

Appendix B: Market Background and Market View Q2 2019, Mercer