



SPECIAL PENSIONS COMMITTEE

24 July 2013

REPORT

Subject Heading:	Investment in Local Infrastructure
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Policy context:	Pensions Investment Strategy
Financial summary:	There are no immediate financial implications. Additional costs may need to be incurred to develop options for consideration by the Committee.

The subject matter of this report deals with the following Council Objectives

Clean, safe and green borough	<input type="checkbox"/>
Excellence in education and learning	<input type="checkbox"/>
Opportunities for all through economic, social and cultural activity	<input type="checkbox"/>
Value and enhance the life of every individual	<input checked="" type="checkbox"/>
High customer satisfaction and a stable council tax	<input checked="" type="checkbox"/>

SUMMARY

To consider and approve the governance arrangements for Investing in Local Infrastructure Assets for the benefit of the Pension Fund.

RECOMMENDATIONS

The Committee is asked to consider and approve:

- a) The operational guidelines (as set out in paragraph 2).
- b) The project selection, evaluation and approval process (as set out in paragraph 3)
- c) The selection criteria (as set out in paragraph 4)
- d) The reporting requirements (as set out in paragraph 5)
- e) The Committee is also asked to recommend to the Governance Committee changes to the constitution relating to the Committee's powers in relation to infrastructure investment (as set out in paragraph 9).

The Committee is also asked to consider whether it wishes to delegate the Investment decision making to a smaller member sub committee (para 3.4)

REPORT DETAIL

1. Background

On the 30 April 2013 the Pensions Committee received an outline report on the creation of a Local Infrastructure Asset class. The Committee agreed to the proposal in principal and requested that officers bring forward a report that would enable it to consider and approve the governance arrangements.

A separate report is included elsewhere on this agenda for the approval of an updated Statement of Investment Principles in order to incorporate a local infrastructure asset class.

2. Operational Guidelines

The following principles have been taken into consideration in establishing the operational guidelines for the management of the new asset class.

- Investments should comply with the Pension Fund's existing investment strategy with regard to the required rate of return and risk appetite.

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- The Investment should not place undue pressure on cashflow.
- The sourcing, execution and management of local investment opportunities should not overburden the Pension Fund's existing resources.
- The Governance arrangements for the portfolio should be clear and well developed.
- The Pension Fund wishes to benefit from both capital appreciation and income generation

It is recommended that the following operational guidelines are established for the management of the portfolio.

Principle	Parameter
Target Sector	Housing: <ul style="list-style-type: none">• Open Market & Affordable/Social Housing• Rental or units for sale Commercial Property Development Leisure Development Public sector infrastructure projects
Target Return	The target return is 2.6% pa net of fees in real terms based upon the latest actuarial report and updated on a triennial basis. The target return will reflect both capital appreciation and income generation.
Risk Appetite	The PF is willing to consider exposure to the following risks, subject to the appropriate due diligence, risk management techniques and adequacy of return. <ul style="list-style-type: none">• Construction risk• Demand risk• Availability Risk• Counterparty credit Risk
Investment Products	The PF is flexible around the type of product it might use.
Leverage	Leverage will be factored into the risk assessment and considered on a project by project basis.
Time Horizon	Both long term and short term investments.
Exclusions	Investments are limited by the target sector and the asset class. Individual projects should be at least £750k in value. No specific products have been excluded
Allocation Limits	The initial allocation is 3% of pension fund assets as set out in the statement of investment principles

3. Project Selection, Evaluation and Approval

3.1 As discussed in the previous report to the committee on 30 April 2013 the current governance arrangements are based upon an external Fund

Manager structure. Due to the localised nature of the proposed portfolio and the relatively small proportion of the fund's allocation to local infrastructure the following arrangements are proposed.

a. Internal Investment Manager

The Group Director (Resources) will appoint the Internal Investment Manager (IIM), initially the Property Services Manager. The IIM will:

- Act as first point of contact for potential investments
- Pro-actively search for new investment opportunities
- Consider investment opportunities brought forward by third parties
- Carry out initial screening of investment opportunities to determine those with potential to meet the Investment criteria
- Refer and present suitable investment opportunities to the Infrastructure Evaluation Panel

b. Infrastructure Evaluation Panel

The Infrastructure Evaluation Panel will consist of the Group Director Resources (chair), Head of Finance and Procurement, Corporate Finance and Strategy Manager and the Assistant Chief Executive (Legal and Democratic Services) or their successor roles where appropriate. The panel will be considered quorate with a minimum of three members. In the absence of the nominated officers deputies may be accepted

The Panel will:

- Consider Investment opportunities presented to it by the IIM.
- Consider whether the investment proposal is subject to the requirements of the public procurement regime.
- Carry out a detailed appraisal of each Investment.
- Approve, by majority, those Investments meeting the required criteria to the Pensions Committee for consideration.

c. Project Approval

- The Pensions Committee will receive recommendations from the panel and will decide whether to proceed with the Investment. The decision to invest in a particular project remains with the Pensions Committee.
- The Committee may approve an investment in principle that is subject to the public procurement regime. As a consequence, the Director of Resources will be instructed to initiate a tender process in accordance with the Council's Procurement Framework.

- Where time is of the essence it may be necessary to call a Special Pensions Committee meeting to consider investment opportunities which might otherwise be lost to the Fund.

3.2 The Director of Resources will ensure that sufficient resources are made available to the panel to ensure that the necessary project evaluation work is carried out robustly. This work may be carried out by internal professional staff but in some instances external specialists may be engaged (see also paragraph 6). The level of resources will be kept under review taking account of the size of the portfolio and the complexity of the project (s).

3.3 These proposed arrangements are consistent with the Pension Fund's Funding Strategy Statement, Governance Compliance Statement and Statement of Investment Principles. However, a revision to the Council's constitution is required in order to allow the Committee to directly manage projects within the infrastructure portfolio. (See also paragraph 9)

3.4 Additional training on investment appraisal will need to be made available to Committee members in advance of the first referral by the IIP. Decisions may also need to be made outside the normal cycle of meetings although it is difficult to evaluate at this early stage. Committee is therefore asked to consider whether it wishes to delegate the project approval process to a smaller Investment sub – Committee consisting of a smaller group of members in order to better focus training needs on investment infrastructure appraisal and enable the decisions to be made promptly, as and when investment opportunities arise.

4. Selection Criteria

The IIM will carry out a simplified first filter in order to screen Investment opportunities. The Panel will need to carry out the second stage testing (due diligence) of schemes under consideration. The precise nature of the assessment will be determined on the characteristics of each scheme. However, the following table sets out the broad framework for the first and second stage tests.

Test	First Filter	Second Filter – Due Diligence
Return Test	Does the potential return on investment meet or exceed the relevant return threshold?	Financial assessment including use of capital investment appraisal techniques.
Risk Test	Are the risks associated with the investment opportunity understood and mitigation strategies under consideration?	Risk measurement including use of sensitivity analysis, ratio analysis, credit ratings and any other appropriate measures. Assessment of options to mitigate risk
Size Test	Does the scheme conform to the size parameters for target investments?	Test the investment requirement to the parameters set out in operational guidelines
Investment Cash Test	Is there sufficient cash available to fund the project?	Financial assessment of Investment requirement Vs. current commitments and cashflow
Resource Test	Are there sufficient internal resources available to manage the proposed scheme?	Assessment of resource requirements to manage project.

Further criteria may be added at a later stage in the event that the Pensions Committee wishes to increase its exposure to Infrastructure. Additional tests may include geographical exposure or the concentration of investments in asset types.

5. Reporting Requirements

5.1 The Pension Committee currently receives reports from its external fund managers. A comparable process is required for the monitoring of the local infrastructure portfolio. The precise format of monitoring reports may vary according to the nature of the approved schemes and it is expected that reporting will be developed over time to meet the requirements of the Pensions Committee and the Evaluation Panel. The IIM will be responsible for the submission of these reports based upon a format to be developed under the guidance of the Panel (and Corporate Finance). However, the following information is expected to be included;

Quarterly

- Investment Record
- Drawdown record
- Returns Record
- Performance record

Annually

- Year-end portfolio valuation
- Portfolio performance compared to benchmark
- Progress report on each project forming the portfolio

5.2. Reporting responsibilities

The Infrastructure Investment Panel will:

- Determine the format and content of investment monitoring reports
- Keep the performance of the portfolio under review
- Report and make recommendations where necessary in relation to the management of the portfolio.

The Internal Investment Manager will;

- Monitor the progress of the projects within the portfolio.
- Prepare and submit reports to the Pensions Committee and Infrastructure Investment Panel on progress and performance of infrastructure assets within the portfolio accordance within agreed timetables.
- Arrange for the formal valuation of assets held within the portfolio in order to comply with statutory and accounting requirements.

6. Engagement of Third Party Expertise

The IIM and the evaluation panel or the Committee may need additional specialist advice which is only available through the engagement of external professional advisors. This may take a number of forms, including:

- a) Valuation: For example it is expected that external valuers will be engaged to carry out an independent valuation of the portfolio at year end.
- b) Technical or financial: For example to assess or evaluate a particular specialised asset or project
- c) Legal : To examine specialised contracts or document or investment in third part contracts

The Director of Resources will engage the necessary support as required. The cost would fall upon the Pension Fund.

7. Role of the Pensions Investment Advisor

Under the existing governance arrangements the Pension Fund has appointed an Investment Advisor, Hymans Robertson to provide independent advice on the Fund's investment activities.

The advisor would be expected to provide advice to the Committee in relation to the infrastructure portfolio, in particular to the impact of the portfolio's performance on overall fund performance.

8. Procurement Framework

Any proposed investments may be subject to the public procurement regime, but this will depend on the characteristics of each investment.

The public procurement regime applies to the purchase of supplies (goods), services or works above specified financial thresholds. The purchase of shares, or land would fall outside the public procurement regime. However, it would be necessary to examine the detailed proposals with great care as they may involve the purchase of associated services, or land development agreements, which could be subject to public procurement rules.

9. Constitution

9.1. The powers delegated to the Pensions Committee under the constitution do not explicitly refer to direct investment through the proposed local infrastructure portfolio. For clarity it is recommended that the following amendments to the constitution be referred to the Governance Committee.

- **Constitution section 1.2. Functions delegated to general council committees**

The following paragraph be added to the Pension Fund powers

Infrastructure Investments

To receive, consider and approve individual infrastructure projects forming the portfolio.

To monitor and review the performance of schemes forming the infrastructure portfolio.

9.2 If the committee is minded to delegate the approval of schemes to a smaller member panel the Constitution would require a further amendment to that effect.

IMPLICATIONS AND RISKS

Financial Implications and risks:

There are no immediate financial implications arising from the approval of the Governance arrangements. However, it is anticipated that additional contributions from the Council will be made available to invest in Infrastructure. In these circumstances the financial impact on the Fund would be as follows:

- An initial increase in Fund Valuation and a corresponding reduction in the Net Pension Liability.
- Increase in revenue stream arising from the use of assets.
- Potential increase in asset values and returns over time.
- Increased fund management and monitoring costs.
- Risk that the portfolio fails to achieve growth objectives for the fund.
- Risk that the cost of the investment in the project exceeds the initial estimate (for construction projects)
- Risk that on-going running costs are greater than planned, offsetting cash flow benefits and required rate of return.
- Risk of fluctuations in assets values or revenue streams which are out of step with actuarial assumptions.
- Risk of counterparty failure.

The cost of additional specialist advice required to support the process will fall on the Pension Fund. The requirements for the on-going selection and monitoring may also create financial pressures on the Fund especially if the portfolio grows over time. For that reason it will be necessary to review the resource requirements over the medium term

Legal Implications and risks:

While investing in the local infrastructure may be of benefit to the Council and local residents, this has to be secondary to the interests of the pension fund in securing a good return on its investment. In the event that the interests of the Pension Fund and the Council are in conflict then the interests of the fund must prevail.

It will be necessary to properly document investments in projects, particularly where they are run by bodies other than the Council, e.g. social landlords, to ensure that the terms of investment and any related security for the Council finance is secured.

Human Resources Implications and risks:

None arising directly from the consultation.

Equalities implications and risks:

None arising directly from the consultation.

BACKGROUND PAPERS