Colleges Bulk Transfer and COVID-19 Update

This paper is addressed to the Officers of the London Borough of Havering Pension Fund ("the Fund"). The purpose of this paper is to set out how the Colleges Bulk Transfer payment to LPFA should be funded, considering the recent impact of COVID-19 on the Fund.

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Recommendation

- The Colleges transfer is estimated to be circa £40m. It has been agreed that the payment to LPFA can be made in stages, if desried, which will reduce risk to the Havering Fund;
- The transfer payment is to be made in cash which will require assets to be liquidated as the current cash balance is insufficient to meet the transfer payment in full;
- The transfer payment should be used to rebalance, where possible, the Fund's underlying asset allocation towards the longer-term strategic target;
- Based on these considerations, and considering the asset allocation position as at 30 April 2020, we propose that the transfer payment be funded as follows:
    - Cash: £10m
    - GMO (full realisation): £5.5m
    - Baillie Gifford: £5m
    - Ruffer: £5m
    - RLAM (investment grade bonds): £9.5m (balance of transfer payment)
- Disinvesting assets in this manner will leave the Fund broadly in line within its long-term target allocation, allowing for the remaining close-ended investments to be funded as originally intended. This leaves a cash buffer of c£14m which, whilst higher than allowed for in the current policy, should provide some further flexibility given the current uncertainties;
- The primary issue remaining to be addressed is the distribution of equity assets. We note that the resultant London CIV (Baillie Gifford) Global Equity allocation will be more than 5% overweight although we propose this be addressed within the forthcoming review.

We look forward to discussing this further with you.

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For and on behalf of Hymans Robertson LLP

Asset allocation update

The spread of COVID-19 and the subsequent lockdown of countries had a dramatic effect on financial markets in February and March. Risk assets, particularly global equities, fell significantly since the final week of February. Conversely, lower risk assets rallied, with government bond yields falling to historic lows, in part buoyed by emergency monetary and fiscal policy actions. Commodities have also fallen sharply, most notably oil.

However, as early signs of turning points arose and the huge levels of government support provided, following the quarter end, markets rallied somewhat. The table below shows the asset allocation as at 31 March 2020 and 30 April 2020, with the Fund's assets increasing by an estimated £45m between these dates.

Manager	31/03/2020 £m	30/04/2020 £m	Actual Proportion 30/4/20	Target Proportion 30/4/20	Diff
Equity	**260.4**	**287.6**	**37.2%**	**35.0%**	**2.2%**
LGIM Global Equity	*51.3*	*55.8*	*7.2%*	*7.5%*	*-0.3%*
LGIM Fundamental Equity	*44.7*	*47.9*	*6.2%*	*7.5%*	*-1.3%*
LGIM Emerging Markets	*28.1*	*30.0*	*3.9%*	*5.0%*	*-1.1%*
Baillie Gifford quity (CIV)	*136.3*	*153.8*	*19.9%*	*15.0%*	*4.9%*
Multi-Asset	**182.8**	**191.3**	**24.8%**	**27.5%**	**-2.7%**
Ruffer Absolute Return (CIV)	*97.7*	*103.0*	*13.3%*	*15.0%*	*-1.7%*
Baillie Gifford DGF (CIV)	*80.0*	*82.8*	*10.7%*	*12.5%*	*-1.8%*
GMO Global Real Return	*5.1*	*5.5*	*0.7%*	*0.0%*	*0.7%*
Real-Assets	**114.9**	**112.5**	**14.6%**	**17.5%**	**-2.9%**
UBS Property	*41.5*	*41.5*	*5.4%*	*6.0%*	*-0.6%*
JP Morgan	*27.0*	*26.1*	*3.4%*	*4.0%*	*-0.6%*
CBRE	*29.0*	*28.5*	*3.7%*	*4.0%*	*-0.3%*
Stafford Infrastructure	*17.4*	*16.4*	*2.1%*	*3.5%*	*-1.4%*
Bonds and Cash	**170.3**	**181.6**	**23.5%**	**20.0%**	**3.5%**
RLAM ILG	*36.3*	*39.8*	*5.2%*	*5.0%*	*0.2%*
RLAM MAC	*33.5*	*34.7*	*4.5%*	*7.5%*	*-3.0%*
RLAM Other	*53.2*	*58.1*	*7.5%*	*0.0%*	*7.5%*
Churchill	*14.0*	*14.9*	*1.9%*	*3.0%*	*-1.1%*
Permira	*5.6*	*5.6*	*0.7%*	*4.5%*	*-3.8%*
Cash	*28.4*	*27.3*	*3.5%*	*0.0%*	*3.5%*
Currency Hedging P/L	*-0.7*	*1.2*	*0.2%*	*0.0%*	*0.2%*
Total	**728.4**	**773.0**	**100.00%**	**100%**	

Source: Northern Trust, LGIM, Baillie Gifford

We note that whilst there were significant falls in values during Q1, since 31 March 2020 markets have recovered to a degree, as highlighted in the table below (returns to 1 May 2020). **Consequently, the estimated value of the Fund's assets as at 30 April 2020 is only around 3% below the 31 December 2019 level.**

UK ASSETS	QTD	Q1 20	YTD	GLOBAL ASSETS	QTD	Q1 20	YTD
EQUITIES	2.6	-25.1	-23.2	**EQUITIES**	8.0	-20.0	-13.6
BONDS				North America	9.8	-19.6	-11.7
Conventional gilts	2.5	6.3	9.0	Europe ex UK	6.3	-20.9	-15.9
Index-linked gilts	4.3	1.6	6.0	Japan	2.1	-17.2	-15.5
Inv Grade Credit	4.5	-3.4	0.9	Dev. Asia ex Japan	5.8	-20.6	-16.1
PROPERTY*	n/a	-1.4	-1.4	Emerging Markets	8.4	-20.2	-13.5
STERLING				**GOVERNMENT BONDS**	0.9	3.2	4.1
v US dollar	1.2	-6.4	-5.3	**HEDGE FUNDS***	n/a	-9.0	-9.0
v Euro	0.8	-4.2	-3.5	**COMMODITIES**	-0.5	-25.6	-26.0
v Japanese yen	0.2	-7.0	-6.9	**OIL (BRENT)**	17.2	-65.9	-60.1

*Source: Datastream. Percentage returns in local currency ($ for Commodities and Hedge Funds). *All returns to 01/05/2020, apart from property and hedge funds (31/03/2020).*

Equity and Multi-Asset funds

The Fund started the year around 2% overweight to equity and multi-asset funds. Following the sharp falls in markets, coupled with falling interest rates, the deviation has altered so that the Fund ended the quarter c.1.8% underweight to the equity and multi-asset funds.

The Baillie Gifford Global Alpha Fund held up relatively well over the quarter and has delivered strong returns since the quarter end, whilst the LGIM Fundamental Indexation fund fell heavily as funds with a 'value' factor tilt struggled.

The Ruffer Absolute Return fund delivered impressive returns in a very distressed market environment and broadly retained capital with only marginally negative returns, boosting values during April. The Baillie Gifford DGF fell almost as much as global equities over the quarter. It should be noted that the value of the GMO holding was further reduced as capital commitments were funded.

Real-Asset funds

The Fund remains underweight to the real-asset funds, although has moved further towards the target allocation as these funds broadly held their value over the quarter, whilst Stafford called additional capital over the period leaving the total committed capital to this fund now 88% drawn.

It should be noted that we have taken asset values from Northern Trust and given the nature of these investments and the relative infrequency with which they are valued, the values shown by Northern Trust could be lagged by up to 3 months. We therefore expect that any impact of COVID-19 on the value of these assets has not yet been fully reflected. For similar real-asset investments, we have seen reductions in value of 5-10%. Such falls, if experienced by the Fund, would translate to a reduction of around 1% in the total asset value.

Bonds and cash

The Fund's overweight position to bonds and cash increased further over the quarter as these funds held their value better than some of the Fund's other asset classes. In addition, Churchill called further capital

Exposure to corporate bonds and multi-asset credit resulted in the Royal London bonds portfolio delivering a negative performance over the quarter, as spreads on higher yield assets widened significantly. However, these assets have demonstrated a recovery over April as credit spreads narrowed again.

Funding of Colleges transfer

Against this backdrop, we consider the funding of the bulk transfer in respect of the New Colleges to LPFA. This bulk transfer amount is estimated to be c£40m and we have used this value in determining our advice. We note that small variations in the amount due are unlikely to affect our advice.

In addition to funding the Colleges transfer, we note that consideration should be given to outstanding cash commitments to the three private markets managers as follows.

Manager	Cash requirement (£m)
Permira	28.9
Churchill	11.2
Stafford	9.3
Net cash requirement	**49.4**

These sums are fixed in absolute terms, rather than being proportionate to the size of the assets and, although allowance was previously made for the Colleges transfer when determining the commitments, the broader fall in values as a consequence of Covid-19 will affect the resultant assets available for transfer.

To date, the intention has been that outstanding allocations to Private Debt be funded from sale of the remaining RLAM corporate bond holdings with the allocation to Stafford being funded from multi-asset mandates. Further, the agreed long-term strategy will see the allocation to multi-asset mandates reduced in favour of a higher strategic allocation to equity assets (albeit preserving the look-through allocation to equity assets at around 45%).

We also note that the Fund has retained a reasonably high cash weighting over the recent past pending payment of the Colleges transfer. This currently amounts to £27.3m with liquidity being needed to meet benefit payments and provide a buffer to meet the Russell FX hedging contracts which will need to be settled over the course of the coming months. As at 1 May, there is an aggregate cash balance due from Russell to settle the underlying contracts of c. £1.2m. The underlying amounts will be settled over the course of the next 3 months.

Proposed sources of funding

Given these considerations, we propose that the transfer payment be funded as follows:

- GMO (full realisation): £5.5m
- Cash: £15m
- Baillie Gifford: £5m
- Ruffer: £5m
- RLAM (investment grade bonds): £9.5m (balance of transfer payment)

Of these allocations, Ruffer and RLAM (Investment Grade bonds) have each delivered positive returns over the year to date and hence there is limited crystallisation of losses against the start year position. The table below illustrates the resultant valuation and asset allocation as at 30 April 2020 compared against the target allocation. We note that, within the equity allocation, we have included an allocation of 5% to “Other Equity”, funded from multi-asset funds, as the Committee has not yet considered the distribution of equity assets.

Manager	Post-transfer £m	Post-transfer Proportion	Target Proportion	Diff
Equity	**287.6**	**39.2%**	**40.0%**	**-0.8%**
LGIM Global Equity	*55.8*	*7.6%*	*7.5%*	*0.1%*
LGIM Fundamental Equity	*47.9*	*6.5%*	*7.5%*	*-1.0%*
LGIM Emerging Markets	*30.0*	*4.1%*	*5.0%*	*-0.9%*
Baillie Gifford Global Equity (CIV)	*153.8*	*21.0%*	*15.0%*	*6.0%*
Other Equity	*0.0*	*0.0%*	*5.0%*	*-5.0%*
Multi-Asset	**175.8**	**24.0%**	**22.5%**	**1.5%**
Ruffer Absolute Return (CIV)	*98.0*	*13.4%*	*12.5%*	*0.9%*
Baillie Gifford DGF (CIV)	*77.8*	*10.6%*	*10.0%*	*0.6%*
GMO Global Real Return	*0.0*	*0.0%*	*0.0%*	*0.0%*
Real-Assets	**112.5**	**15.3%**	**17.5%**	**-2.2%**
UBS Property	*41.5*	*5.7%*	*6.0%*	*-0.3%*
JP Morgan	*26.1*	*3.6%*	*4.0%*	*-0.4%*
CBRE	*28.5*	*3.9%*	*4.0%*	*-0.1%*
Stafford Capital Global Infrastructure	*16.4*	*2.2%*	*3.5%*	*-1.3%*
Bonds and Cash	**157.1**	**21.4%**	**20.0%**	**1.4%**
RLAM ILG	*39.8*	*5.4%*	*5.0%*	*0.4%*
RLAM MAC	*34.7*	*4.7%*	*7.5%*	*-2.8%*
RLAM Other	*48.6*	*6.6%*	*0.0%*	*6.6%*
Churchill	*14.9*	*2.0%*	*3.0%*	*-1.0%*
Permira	*5.6*	*0.8%*	*4.5%*	*-3.7%*
Cash	*12.3*	*1.7%*	*0.0%*	*1.7%*
Currency Hedging P/L	*1.2*	*0.2%*	*0.0%*	*0.2%*
	733.0	**100.0%**	**100%**	**0.0%**

Source: Northern Trust. Valuations as at 30 April 2020 and are adjusted for the proposed sources of funding.

The remaining RLAM (Investment Grade) bond allocation of £48.6m is more than sufficient to meet the outstanding capital calls from Churchill and Permira; the residual balance can be used to top-up the MAC allocation to its 7.5% target. The balance of £9.3m due to Stafford can be met by disinvestment from the multi-asset mandates which will bring this allocation back in line with target.

Taking account of these remaining changes will leave the resultant asset allocation more closely aligned to the Committee's agreed long-term target. As noted, the primarily issue that requires to be addressed is the balance within the Fund's equity mandate. We note that the resultant allocation to the London CIV (Baillie Gifford) Global Equity mandate will be more than 5% above its target weight which would suggest that some rebalancing would be appropriate. However, we propose that this be addressed within the equity review, noting that the Fund has sufficient liquidity to meet cash commitments in the short to medium term.