Havering
LONDON BOROUGH

PENSIONS COMMITTEE 01 October 2020

Subject Heading:	**INVESTMENT STRATEGY UPDATE and EQUITY STRUCTURE REVIEW**
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Policy context:	Regulation 7 of the LGPS (Management and Investment of Funds) Regulations 2016 requires an administrative authority to periodically review this statement
Financial summary:	Implementation of the investment strategy will be met from restructuring existing mandates

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

Communities making Havering	[X]
Places making Havering	[X]
Opportunities making Havering	[X]
Connections making Havering	[X]

SUMMARY

This report includes an update on the progress of the implementation of the Investment Strategy, focussing on a ‘health check’ of the Funds Investment Strategy and Equity structure review.

Appendix A of this report is exempt from publication by virtue of paragraph 3 and 5 of the Access to Information Procedure Rules set out in the Constitution pursuant to Schedule 12A Local Government Act 1972, as amended as it contains information relating to the financial or business affairs of the investment managers already appointed to the Fund and comparisons of financial information to mandates available in the markets.

RECOMMENDATIONS

That the Committee is asked to:

1. Note Hymans report on the Health check of the Investment Strategy and Equity Structure Review attached as **Appendix A (exempt).**

2. To consider and agree recommendations from the options outlined in Section 2 of this Report.

REPORT DETAIL

1. Background

a) The Pensions Committee adopted an Investment Strategy Statement (ISS) at the 28 March 2017 committee meeting and the Fund has made good progress implementing this Strategy, focusing on individual asset classes at various stages of implementation.

b) Subsequently the Pensions Committee agreed an updated Investment Strategy Statement at its last meeting on the 29 July 2020 (postponed from the cancelled March meeting). This statement is a continuation of development of the investment strategy agreed following the previous review in 2017.

c) As part of ongoing development of the Strategy the Fund's Investment Advisor has undertaken a "Health Check" of the investment strategy and a review of equities structure. The key aim of this review is to identify whether the long term strategic asset allocation remains appropriate, and if there is scope to improve outcomes.

d) The attached paper (Appendix A - EXEMPT) has been produced by the Fund's Investment Advisor (Hymans) and summarises their findings from a 'Health Check' of the Funds Investment Strategy and Equity Structure Review. This paper is exempt as it contains information relating to the financial or business affairs of the investment managers already appointed to the Fund and comparisons to mandates available in the markets.

e) As per the executive summary of Hymans report, attached as Appendix A, the Fund's strategy is now largely in line with agreed asset allocation target, other than the distribution of equity assets and the Royal London Asset Management (RLAM) Multi Asset Credit (MAC) Fund. The proposed options for consideration and next steps are also outlined below:

2. Proposed options for consideration and next steps:

2.1 Bonds and Cash - Propose increasing the RLAM MAC allocation from 5% to 7.5% (in line with its long-term target) funded from RLAM corporate bond holdings and profit taking from equity assets. This would equate to a movement of approximately £20m.

Recommendation 1: Recommend bringing the RLAM MAC allocation to 7.5% (in line with its long-term target).

2.2 Real Asset Allocation - Infrastructure - Consideration needs to be given to topping up the infrastructure allocation as capital is repaid from existing Stafford (SISF II) Fund and the allocation to infrastructure falls. In order to maintain the asset allocation of 7.5% to infrastructure the Fund could consider investing in the Stafford (SISF IV) Fund with a commitment of c£18m. This commitment should be primarily funded from capital being returned from SISF II although any short-term mismatches can be funded from the LCIV Diversified Growth (Baillie Gifford) allocation. The Fund could also consider a phased approach of migrating exposure to infrastructure products available through the London CIV, increasing overall infrastructure exposure to 10% by committing to both SISF IV and the LCIV infrastructure fund. This would equate to a movement of approximately £18m.

Recommendation 2: Recommend making a €20m (c. £18m) commitment to the next generation Stafford Fund (SISF IV) in order to maintain the target infrastructure allocation.

Optional, and

Recommendation 3: Agree in principle to increase the Infrastructure asset allocation to 10% and explore the infrastructure options provided by the LCIV, **funded by a reduction in the allocation to the LCIV Diversified Growth Fund (Baillie Gifford). For this increased allocation, we propose considering potential LCIV infrastructure options which include Core Infrastructure, Renewable Energy Infrastructure and the London Fund which may offer exposure to local assets.**

2.3 Equities – Global Alpha – LCIV Baillie Gifford (BG) Global Alpha is significantly over the asset allocation target by 8.7% at 23.7% following strong performance over 2020. It is proposed to take profit from this allocation and rebalance this allocation back to 17.5% in line with the Funds rebalancing policy. (The Fund's rebalancing policy will rebalance where there is more than a 5% overweight but only then back to within 2.5% of the target allocation). The Strategic target asset allocation will remain at 15%.

Recommendation 4: Recommend that the asset allocation to LCIV BG Global Alpha fund be retained at 15% but the allocation be rebalanced back to 17.5% in line with the Fund's rebalancing policy.

2.4 Equities – LGIM Fundamental Equity Fund - within the equity allocation, members are asked to consider replacing the LGIM Fundamental Equity mandate (RAFI index) with a multi-factor mandate in order to diversify exposure away from the value factor. Hymans believe that the LGIM Future World Fund presents a suitable option for the Fund that meets the criteria set out in recommendation 6.

2.5 Equities – LGIM Global Equity - Members are also asked to consider increasing the strategic allocation to the Market Cap Equity (currently known as the LGIM Global Equity Fund) to 10% but defer rebalancing to this target from 8% until further options are developed by the London CIV.

Recommendation 5: Recommend that the strategic allocations to market-cap equity and factor-based equity are both increased from 7.5% to 10.0%. We do not recommend rebalancing the allocation to market cap equity (8.0% vs revised target of 10.0%) as this offsets the retained overweight to Baillie Gifford. We recommend using the proceeds of the equity rebalancing to increase the allocation to multi-factor equity to the revised strategic target.

Recommendation 6: Recommend Replacing the LGIM RAFI mandate with a multi factor strategy in order to diversify exposure to factors. Further recommend that the multi factor strategy embed a "carbon-tilt" in order to reduce exposure to climate risk.

The inclusion of a "carbon-tilt' to the market strategy is aligned with the committee's belief as set out in the approved Investment Strategy Statement: Climate change and the expected transition to a low carbon economy represents a long-term financial risk to Fund outcomes and should be considered as part of the Committee's fiduciary duty. The adviser has included a performance comparison in his report with a multi factor strategy with no carbon tilt.

Recommendation 7: Recommend that the Committee receives a training presentation from LGIM to consider this and other options in greater detail before committing to change.

Recommendations 8: Recommend reviewing the market cap passive allocation in 2021 as further options are developed by the London CIV.

IMPLICATIONS AND RISKS

Financial implications and risks:

The proposal to increase the RLAM MAC allocation from 5% to 7.5% (in line with its long-term target would equate to a movement of approximately £20m which will be funded by profit taking from equity assets.

This commitment of c£18m to the Stafford (SISF IV) will primarily be funded from capital being returned from SISF II although any short term mismatches can be funded from the LCIV Diversified Growth (Baillie Gifford) allocation.

There is a risk that the timings of returning capital from the Stafford II fund will overlap with the capital calls on the Stafford IV fund. The timings will largely depend on opportunities available to Stafford and the rate of progression within individual projects so it is difficult to predict exact timings in advance. Stafford do expect broad alignment between the two funds (as the old fund is returning cash the new fund is calling capital) it is expected that there will be points where there is a cash surplus/deficit between the funds, although any short-term mismatches can be funded from LCIV Diversified Growth (Baillie Gifford).

An amount in the region of £20m will be required to meet an increase in the asset allocation to Infrastructure from 7.5% to 10%. This will be funded from a reduction in the LCIV Diversified Growth Fund (Baillie Gifford).

An increase to Multi Factor and Market Cap up to 20% from 14.6% will cost in the region of c£40m. Rebalancing the LCIV Baillie Gifford (BG) Global Alpha Fund back to 17.5% will generate c£50m at his time which will be used to fund this increased allocation.

There is reliance on the overweight position on the LCIV BG Global Alpha Fund to fund the restructuring. If there was a market downturn it is expected that equity funds would experience relatively similar falls which would retain the BG Global Alpha overweight position within the equity allocation, although may reduce the extent of the overweight position. However, the extent of the position is such that the fund could incur a relatively isolated fall in value and still be overweight compared to the target allocation.

Implementation costs: Hymans have advised that the transaction costs incurred will depend on the individual spreads on the funds on the day of transition. For illustrative purposes Hymans have taken the latest available spread for each fund and applied this to the proposed transition amount which produces an estimated total transaction cost of c£170k (0.06% of assets being transferred). As with any transition, a level of out of market risk would be incurred when transferring the assets. To minimise this risk, it is recommended to line up trades so that the assets are in cash for the minimum time possible.

Advisory costs: The advisory costs of implementing the changes made to the structure will be incurred through the Investment management consultancy services contracts with Hymans. Costs will be ongoing throughout implementation and the final costs will not be known until this has concluded and is dependent on he options taken forward by the Committee.

Costs arising from the implementation of the investment strategy will be met from the Pension Fund.

Legal implications and risks:

The changes proposed will not impact the content of the Investment Strategy Statement as they are within the parameters set out within it. Therefore there is no need to consult on the proposals. Otherwise there are no apparent legal implications of making the proposed amendments.

Human Resources implications and risks:

None arise directly from this report.

Equalities implications and risks:

The Public Sector Equality Duty (PSED) under section 149 of the Equality Act 2010 requires the Council, when exercising its functions, to have due regard to:

(i) The need to eliminate discrimination, harassment, victimisation and any other conduct that is prohibited by or under the Equality Act 2010;

(ii) The need to advance equality of opportunity between persons who share protected characteristics and those who do not, and;

(iii) Foster good relations between those who have protected characteristics and those who do not.

Note: ‘Protected characteristics’ are: age, sex, race, disability, sexual orientation, marriage and civil partnerships, religion or belief, pregnancy and maternity and gender reassignment/identity.

The Council is committed to all of the above in the provision, procurement and commissioning of its services, and the employment of its workforce. In addition, the Council is also committed to improving the quality of life and wellbeing for all Havering residents in respect of socio-economics and health determinants.

An EqEIA is not considered necessary regarding this matter as the protected groups are not directly or indirectly affected
None arising directly.

BACKGROUND PAPERS

None