



## GOVERNANCE COMMITTEE

**Subject Heading:**

**PENSIONS COMMITTEES – Terms of Reference and Constitution**

**CMT Lead:**

Ian Burns  
Acting Assistant Chief Executive  
01708 432442

**Report Author and contact details:**

James Goodwin  
Committee Officer  
James.goodwin@havering.gov.uk  
01708 432432

**Policy context:**

The Terms of Reference require amendment to enable the Group Director Resources to direct investment through the proposed local infrastructure portfolio

**Financial summary:**

There are no direct financial implications

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 type="checkbox"/>
High customer satisfaction and a stable council tax	<input checked="" type="checkbox"/>

### SUMMARY

The Pensions Committee at its meeting on 24 July 2013 considered a further report the proposed governance arrangements for Investing in Local Infrastructure Assets for the benefit of the Pension Fund.

**RECOMMENDATIONS**

That the Committee recommend to Council that:

**The powers of the Director of Resources be extended para 3.71 (e) as follows:**

(vii) To make direct investments in local infrastructure assets as part of the Pension Fund local infrastructure portfolio in consultation with the Chair of Pensions

**REPORT DETAIL**

1. Back in 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.

**2. Operational Guidelines**

The following principles have been taken into consideration by the Pensions Committee 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.
- 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

The following operational guidelines have been agreed by the Pensions Committee for the management of the portfolio.

<b>Principle</b>	<b>Parameter</b>
<b>Target Sector</b>	<ul style="list-style-type: none"><li>• Housing</li><li>• Commercial Property Development</li><li>• Leisure Development</li><li>• Public sector infrastructure projects</li></ul>
<b>Target Return</b>	The target return is 4% pa net of fees in real terms based upon the latest actuarial report and updated on a triennial basis. (i.e. 4% above the prevailing Consumer Price Index rate) The target return will reflect both capital appreciation and income generation.

<b>Risk Appetite</b>	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"><li>• Construction risk</li><li>• Demand risk</li><li>• Availability Risk</li><li>• Counterparty credit Risk</li></ul>
<b>Investment Products</b>	The PF is flexible around the type of product it might use.
<b>Leverage</b>	Leverage will be factored into the risk assessment and considered on a project by project basis.
<b>Time Horizon</b>	Both long term and short term investments.
<b>Exclusions</b>	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
<b>Allocation Limits</b>	The initial allocation is 3% of pension fund assets as set out in the statement of investment principles

### **3. Project Selection, Evaluation and Approval**

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 Pensions Committee adopted the following :

#### **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.
- Agree, by majority, those Investments meeting the required criteria to submit to the Group Director Resources further consideration and approval.

c. Project Approval

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

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).

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 Group Director to approve projects within the infrastructure portfolio.

**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.

<b>Test</b>	<b>First Filter</b>	<b>Second Filter – Due Diligence</b>
<b>Return Test</b>	<b>Does the potential return on investment meet or exceed the relevant return threshold?</b>	<b>Financial assessment including use of capital investment appraisal techniques.</b>
<b>Risk Test</b>	<b>Are the risks associated with the investment opportunity understood and mitigation strategies under consideration?</b>	<b>Risk measurement including use of sensitivity analysis, ratio analysis, credit ratings and any other appropriate measures. Assessment of options to mitigate risk</b>
<b>Size Test</b>	<b>Does the scheme conform to the size parameters for target investments?</b>	<b>Test the investment requirement to the parameters set out in operational guidelines</b>

<b>Investment Cash Test</b>	<b>Is there sufficient cash available to fund the project?</b>	<b>Financial assessment of Investment requirement Vs. current commitments and cashflow</b>
<b>Resource Test</b>	<b>Are there sufficient internal resources available to manage the proposed scheme?</b>	<b>Assessment of resource requirements to manage project.</b>

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**

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

### **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 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**

The powers delegated to the Director of Resources 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.

**The powers of the Director of Resources be extended para 3.71 (e) as follows:**

- (vii) To make direct investments in local infrastructure assets as part of the Pension Fund local infrastructure portfolio in consultation with the Chair of Pensions

## 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 cashflow 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**

None