



Leicestershire County Council Pension Fund - Local Pensions Committee January 2020

Investment Mapping to LGPS Central Pool

Introduction

Since Committee's last review of strategy in January 2019, the Leicestershire County Council Pension Fund ('the Fund') has:

- Transferred its active listed global and emerging markets equities to LGPS Central ('Central')'s equivalent products, and
- Entered into an agreement with Central to provide advisory services for some asset classes. Central undertakes a quarterly review of these mandates and they are monitored regularly by Central's Chief Investment Officer/Risk team.

The assets of the Fund which are currently managed/ advised by Central, or passively managed i.e. deemed to be 'pooled', are as follows:

| Asset Class | Asset Class | % of Fund [1] | | |
|--------------|---|-----------------------------|---------------------------|-------------------|
| | | Central Investment Services | Central Advisory Services | Passive (by LGIM) |
| Equities | Global Equities (Active) | 8% | | |
| Equities | Global Emerging Markets Equities (Active) | 4% | | |
| Equities | Global Equities (Passive & Factor Based) | | | 33% |
| Equity | Private Equity | [Note 2] | | |
| Real Assets | Property | | 9% | |
| Alternatives | Targeted Return | | 12% | |
| Alternatives | Emerging Market Debt | | 3% | |
| TOTAL | | 12% | 24% | 33% |
| TOTAL | | 69% | | |

[1] At 30 September 2019, Source: Portfolio Evaluation.

[2] £10million committed.

During the year, LGPS Central have developed a more formal approach to product development which breaks the process into nine steps. The new process was developed to improve accountability and delivery by improving communication, clarifying responsibility between LGPS Central and partner funds, highlighting key decision-making stages and ensuring appropriate consultation. The protocol and status of the products being developed is attached to this document.

Also attached to this document is a table which shows the assets pooled (including those under Central's advice but excluding passive investments) for each of Central's partner funds. The proportion of partner funds which are deemed to be pooled ranges from 84% (West Midlands) to 3% (Nottinghamshire).

This paper outlines the options and timetable for the Fund to potentially transfer further investments to Central. Due diligence on the funds/arrangements offered would need to be undertaken before investments are made, including the risks faced by Central's business.

Equities

Current allocations are outlined below:

| Manager | Asset Class | % of Fund [1] |
|---------------------|--|---------------|
| LGIM | UK (large cap exposure capped) | 4 |
| LGIM | UK market cap passive | 3 |
| LGIM | Regional market cap passive (ex UK) | 17 |
| LGIM | Factor based - RAFI (N America & Europe) | 9 |
| LGPS Central | Active Global Equities | 8 |
| LGPS Central | Active Emerging Markets | 4 |
| LGPS Central | Private Equity | <1 [Note 2] |
| Various others | Private Equity | 5 |
| Total | Equities | 50 |
| Total Pooled | Including LGIM passive | 45 |
| | Excluding LGIM passive | 12 |

[1] At 30 September 2019, Source: Portfolio Evaluation.

[2] £10million committed, approximately 5% invested.

With the exception of the Fund's unlisted private equity, all the Fund's equity investments are now being managed by Central or by LGIM.

Central launched a private equity product in 2018/2019 and the Fund invested £10m. However, the Private Equity Investment Director left LGPS Central and as a result, no product was launched for 2019/2020. Therefore, in October 2019 the Fund's Investment Sub-Committee agreed to commit approximately £30m to the Adams Street 2019 Global private equity fund. Over a period of up to 10-15 years, private equity investments will be returned to the Fund.

Other equity products managed by Central are as follows:

- Market cap passive mandates for partner funds which were previously managed in-house. They do not intend to develop these for wider use.
- A 'dividend growth' themed portfolio for West Midlands Pension Fund.
- A recently launched 'factor based' fund equity investing which includes carbon-related factors. Central manage this fund on a passive basis against an index provided by FTSE. The investment case for this product as an alternative to the RAFI funds managed by LGIM is covered elsewhere on Committee's agenda. Further due diligence is required, particularly clarifying the permissions to change the index against which the fund is managed.

Real Income Assets

Current allocations are outlined below:

| Manager | Asset Class | % of Fund [1] | |
|--------------|------------------------------------|---------------|-----------|
| Kames | Index linked gilts | 8 | 8 |
| IFM | Infrastructure | 2 | 5 |
| KKR | | 1 | |
| JPM | | 2 | |
| Stafford | Timberland | 3 | 3 |
| Aviva | Property – fund of funds | 4 | 9 |
| Kames | Property – indirect (smaller lots) | 2 | |
| Colliers | Property - direct and indirect | 3 | |
| TOTAL | Real Income Assets | 25 | 25 |

[1] At 30 September 2019, Source: Portfolio Evaluation.

Index linked

- While Central's plans do not include an index-linked gilt bond fund, they do manage listed bonds under bespoke arrangement for other pension funds.
- Kames currently manage this mandate with a low performance target (+0.3%p.a.) and active risk compared the market index.

Infrastructure

- The Fund's existing infrastructure assets is approximately 5%. KKR infrastructure funds are closed-end (i.e. limited life) where capital will be returned over a period of up to 10-15 years. The JPM and IFM infrastructure funds are an open-ended (i.e. unlimited life) fund. Undrawn commitments to these managers are now less than 1% of the Fund.
- Despite extensive discussions between partner funds and Central regarding a potential infrastructure fund, there is limited appetite. Most partner funds appear to be focussing on the potential for Central to provide advisory services on new (and potentially existing infrastructure opportunities) where each partner fund would receive due diligence on potential investments and make their own decisions on whether to invest. Investments would be in the name of individual partner funds. Central hope that the advisory services will build sufficient confidence in their capabilities and appetite for partner funds to commit to an infrastructure fund in the future.
- Under the advisory arrangement, partner funds retain control over specific investments but would need to be sufficiently knowledgeable and resourced for (sometimes quick) decision making and the resulting administration/legal issues. From an investment perspective, the arrangement is sub-optimal primarily due to the uncertainty on investment execution and hence ability to negotiate with investment managers. Central may need additional resource depending on the commonality of partners' requirements.
- Leicestershire has continued to express interest in an infrastructure fund managed by Central and discussions are continuing. The potential commitment from the Fund

is not sufficient in itself, but it is understood that another partner fund may still be interested and the launch may be expected in Q3 2020.

Timberland

- The Fund has a relatively small amount of undrawn commitments to Timberland funds. They are closed-ended funds and hence investments will be returned to the Fund in due course and the allocation will reduce in due course.
- Central has no plans to launch a timberland fund.

Property

- Central currently provide advisory service for the Fund's property mandates. Approximately £100m is invested in direct properties (managed by Colliers) and the remaining in indirect holdings which are managed by three different managers.
- The Aviva mandate is the largest and currently consists of up to 20 property funds. The majority are invested in open-ended funds (i.e. with unlimited life), with the remainder in specialist funds which are typically closed-ended.
- The Fund's direct portfolio of £100m is considered to be sub-optimal in size and the indirect funds are more expensive, given the additional fee charged by Aviva.
- Over recent months Central has been liaising with partner funds to consider options for property management. With the exception of Shropshire and Worcestershire, all partner funds have sizeable direct property portfolios totalling £2.6bn. While there is limited interest in a UK direct property fund from the partners funds who already have direct holdings, there appears be sufficient appetite to make such a fund viable and Leicestershire has expressed interest. Central hope to launch this fund in Q4 2019. Discussions are ongoing regarding indirect property funds, potentially including overseas, niche areas of the UK and/or housing. Potential options to transfer some of the Fund's existing assets to Central funds would need to be considered in due course.

Alternative Investments

The Fund's current investments are outlined below:

| Manager | Asset Class | % of Fund [1] | |
|---------------|--------------------------------------|---------------|-----------|
| Ruffer | Targeted Return | 4 | 12 |
| Aspect | | 3 | |
| Pictet | | 4 | |
| Millennium | Currency Overlay | - | - |
| Ashmore | Opportunities – Emerging Market Debt | 3 | 9 |
| JPMorgan | Opportunities - Credit | 1 | |
| Partners | Opportunities – Private Credit | 5 | |
| M&G | Opportunities – Other | 2 | 3 |
| CRC | Opportunities – Other | 1 | |
| InfraCap | Opportunities – Other | <1 | |
| Standard Life | Opportunities – Other | <1 | |
| TOTAL | Alternative Investments | 24 | 24 |

[1] At 30 September 2019, Source: Portfolio Evaluation.

LGPS Central's plans to launch products are as follows:

- Progress has been made in agreeing the objectives of an actively managed **Emerging Market Debt** fund and a search for 1 to 3 external manager(s) has started. The number of managers will be determined as the search progresses. It is hoped the fund will launch early summer 2020.
- Plans to develop a **Multi Asset Credit** fund are in their early stages. There appears to sufficient interest from partner funds and the launch would be expected to be in Q4 2020.
- Discussions on the possibility of a **Targeted Return** fund are ongoing, focusing on partner funds' required risk and return expectations, whether they are achievable and whether there is consensus from partner funds. Central's analysis has shown that a return of CPI + 3% with risk equivalent to 50% of equities may be achievable. Central are awaiting feedback and agreement from partner funds to decide on whether to progress. Leicestershire could be the largest investor in this fund, alongside only one other partner fund and the viability of this Targeted Return fund is potentially in question. Hence it is important for Committee to give Central a clear steer of its appetite and requirements.
- Central are in the final stages of launching a **Corporate Bond** fund.
- In the absence of any **Private Credit** products from Central, Investment Sub-Committee agreed to commit £100m to the Partners Group Fund V in October 2019.

Other Assets – Currency Hedge

The Fund currently has a currency hedge, implemented by Kames, where Committee decide on the currencies to be hedged and the size of the hedge. Kames overlays active views on those currencies. While Central do not have a currency overlay product, they have the ability to provide an advisory and execution service and they are keen to discuss options with Leicestershire.



Conclusion

Leicestershire's active listed equity holdings were transferred to the equivalent Central products during 2019. Progress on developing other products is taking longer than originally anticipated, partly because they involve more complex asset classes and also because gaining consensus from the partner funds on their requirements has been more difficult.

It is likely to be many years before the majority of the Fund is transferred to LGPS Central. This is partly due to the Fund's unlisted and illiquid investments as well as the time taken by Central to develop investment options.

Potential options for further pooling of Leicestershire's assets in 2020 are currently as follows:

- A recently launched factor-based equity fund managed by Central to replace those currently managed against RAFI indices by LGIM.
- Emerging Markets Debt and Multi-Asset credit products should be available from Central in Q3 and Q4 2020 respectively. These could be potential replacements for the Ashmore and JP Morgan mandates respectively.
- An infrastructure fund could be launched in Q3 2020 for new commitments. An alternative advisory service is being offered by Central, whereby each fund retains decision making rights for each individual investment.
- A UK direct property fund is expected to be available in Q4 2020. The potential to transfer some of the Fund's existing assets would need to be considered in due course.

The Fund's strategic allocation to Targeted Return and risk/return expectations are crucial to Central's plans to develop such a product, potentially launching in Q1 2021.

Leicestershire's could be the largest investor in this fund, alongside only one other partner fund.

Clare Scott
January 2020

Attachments:

- 1. LGPS Centrals' Product Development Protocol as at December 2019
- 2 Assets pooled (excluding passive investments) by Central's partner funds

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