Agenda Item 8

Leicestershire County Council

LOCAL PENSION COMMITTEE – 28 FEBRUARY 2020

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

LGPS CENTRAL PRODUCT DEVELOPMENT UPDATE

Purpose of the Report

1. The purpose of this report is to update the Committee on LGPS Central investment pool product development.

Background

2. LGPS Central (Central), an investment management company jointly owned by eight midlands based Local Government Pension Scheme funds, to deliver investment pooling, successfully went live on 1st April 2018.

3. Pooling will take several years to implement, due to the need to set-up sub-funds by Central and then amalgamate the existing holdings for the eight partner funds. The Leicestershire Fund (the Fund) has currently invested in three Central products, the global active equity fund, global emerging active fund and the 2018 private equity offer.

4. Local management of investments will be required in the medium term for closed-ended funds, whereby an investment manager is appointed to fulfil a specific purpose via a pooled fund which is set up to run for a specified period of time. These investments will be managed locally until the capital is repaid, due to the lack of a natural ability to exit the investment in the event of issues arising.

LGPS Central Update

Investment Grade Corporate Bond Fund

5. The Fund currently does not have an allocation to this specific asset class. During the annual asset allocation review Hymans Robertson, the Fund's Investment Consultants, advised of a 3% (c.£140m) allocation to be initiated, either to a Central sub-fund or LGIM passive.

6. Central are due to launch an Investment Grade Corporate Bond fund, which will be open for investment in Q1 2020/21. The manager selection process followed an open procurement process that resulted in the Investment Committee of LGPSC approving the choice of two managers, Fidelity and Neuberger Berman (Europe) Limited to manage the assets of the sub-fund, with a default position of managing 50/50% of the assets each.

7. The Fund has two options, both of which are classed as pooling. Either invest in a sub fund with LGPS Central as explained above or use a LGIM low cost corporate bond product. A report would be brought to the Investment Subcommittee to recommend which option is best for the Fund.

Emerging Market Debt Fund

8. The Fund currently has exposure to the Emerging Market Debt Fund asset class via Ashmore, the value of the holding at December 2019 is £114million. During the annual asset allocation review Hymans advised of a 2.5% allocation to be maintained.

9. Central are due launch an Emerging Market Debt Fund in Q2 2020/21. The Fund has previously advised Central of our interest and have been involved with the discussions in building a suitable product. Any differences to our current mandate have been discussed with Central and include the following:

    a. Change of benchmark to a to a single JPM GBP hedged benchmark from a combined weighted benchmark.
    b. Stocklending will be permitted.
    c. Leverage will not be permitted, Ashmore are currently allowed to borrow up to 10% of their net assets.

10. The overall effect of changes will be minimal from a risk reward perspective.

11. An open procurement is taking place and is at the second stage of manager assessment having reduced the respondents to the original advert to 12 potential managers.

12. Officers will have relevant due diligence conducted on the final product offered before bringing the paper to Investment Subcommittee later in the year for approval.

Targeted Return

13. The Fund currently has exposure to the Targeted Return asset class via three managers, Aspect Capital, Ruffer and Pictet the total value of the Fund's holdings is £481million at December 2019. As part of the annual asset allocation review it was agreed that the Fund would reduce its allocation to 7.5%, which equates to a reduction of c£130million to the asset.

14. Central are in the early stages of developing a targeted / absolute return product. The Fund has expressed an interest and is currently working with one other partner fund, Central and Hymans Robertson to develop a suitable product.

15. The Fund has retained the asset class it allows investments via active management to take advantage of market opportunities and allows the Fund to be long and short in the market across classes not otherwise accessible. In turn this allows for improved diversification for the Fund.

16. Given that there is only one other partner fund interested in this product at present we are hopeful of reaching consensus on an outline requirement to go to the market with. This should speed up the process of delivering a product.

Multi Asset Credit (MAC) Fund

17. Multi asset credit invests across a broad spectrum of credit instruments including, but not limited to investment grade and high yield corporate bonds, emerging market debt, loans, convertible bonds, securitised credit and government bonds.

18. The Fund already has access to emerging market debt and will have access to investment grade corporate bonds via either a LGIM or Central product. As such this product will be developed with this in mind and will limit exposure as necessary.

19. The Fund also has limited exposure to this asset class via a minor holding totalling 0.5% of the total Fund's value, through JP Morgan's Global Credit fund (c.£30m).

20. The annual asset allocation review advised that the Fund should increase the allocation to this class from 0.5% to 4%. It is deemed to be attractive for a number of reasons:

    a. It provides exposure to multi-asset classes through a single investment strategy.
    b. Managers have the flexibility to move opportunistically between asset sectors, which should allow managers to create excess return by allocating to attractive asset classes. Significant divergence can occur between individual asset class returns and an effective manager will allocate dynamically between asset classes to add value.
    c. MAC strategies can provide yield enhancement compared to traditional fixed income strategies. This is attractive to investors who may need income streams to meet liabilities in a low interest rate environment.

21. Central are developing a product that the Fund has expressed an interest in, and in conjunction with other partner funds will develop a requirement that Central will go to market with.

Direct Property

22. The Fund has a number of property investments totalling £408million at December 2019 or 9% of the Fund's value. This is split across three managers, Colliers, LaSalle and Kames. Of the total holding £99million is classed at direct holdings where individual properties are bought and held for the Fund rather than units in a fund that owns property, known as an indirect holding.

23. The Fund is currently about 1% underweight to property and as such we have instructed Colliers in conjunction with Central under our advisory agreement to search for appropriate investments whilst there is no property sub fund available via Central to invest in.

24. Central are in the early stages of developing a UK Direct Property Fund. Four partner funds including ourselves have expressed an interest to invest. A draft business case will be presented in February 2020 to members of the investment working group (IWG). A draft mandate has been developed with the other

interested partner funds. Property is a long term investment given the round trip of buying and disposing usually absorbs 7-8% of the money invested with stamp duty accounting for 5% on purchase. There is the opportunity to transfer the Fund's current direct property holdings to this new sub fund under government seeding relief, this allows our Fund to transfer our direct property holdings to the sub fund without having to incur stamp duty. The fund is investigating if this would be beneficial to us.

25. Central plan to launch additional property funds to focus on other sectors including international property. These are likely to be held on an indirect basis, similar to our current holdings with LaSalle where they hold units in other specialised funds which we would otherwise find harder to directly invest in at scale, for example in niche debt funds or student housing.

Infrastructure

26. The Fund has a £421 million allocation to Infrastructure; this is managed by IFM, KKR, JP Morgan, Infracapital and Stafford. The KKR and Stafford investments are closed ended with capital not expected to be fully returned until 2027. The IFM and JP Morgan fund are semi open, with matching by the manager of clients seeking to invest / divest providing some liquidity.

27. The Fund has an allocation target of 9.75%, at December 2019 had an allocation of 9.1%. There is c£47million of commitment to be called between KKR, Stafford and Infracapital to reach the set target so officers are comfortable with the Fund's current.

28. Central are in the very early stages in the development of an Infrastructure Fund. They are looking to develop an offering to bring to the Investment Working Group (IWG). There is Government desire to increase infrastructure investment which bodes well for long term investors like pension funds however, at present there is no incentive offered to invest in the UK and so we are likely to maintain our current global focus to ensure the best for the Fund.

Other Matters

29. LGPS Central has identified and appointed a 4th non-executive director, Susan Martin. The recruitment process was led by the Nominations committee of LGPS Central's Board, which consists of three non-executive directors. Partner Funds were involved in the recruitment process. Susan will sit on all three boards, remuneration, nominations and audit risk & compliance.

Recommendation

30. It is recommended that the Local Pension Committee notes the report.

Equality and Human Rights Implications

31. None.

Appendix

None

Background Papers

None

Officers to Contact

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