



LOCAL PENSION COMMITTEE – 11 SEPTEMBER 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 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 transition the existing holdings for the eight partner funds. The Leicestershire Pension Fund (the Fund) has currently invested in four Central products, the global active equity fund, global emerging active fund, the 2018 private equity offer and the Investment Grade Corporate Bond Fund most recently. In addition, our Fund has advisory agreements for Property, Targeted Return and Emerging Market Debt.
4. Local management of investments will continue in the medium term for closed-ended funds, whereby an investment manager is appointed to fulfil a specific purpose via fund that 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

Global Active Emerging Market Bond Fund

5. Currently the Fund has exposure to the Emerging Market Debt (EMD) asset class via Ashmore, the value of the holding at June 2020 is £109 million. During the annual asset allocation review Hymans advised of a 2.5% allocation to be maintained.
6. The Ashmore fund invests in mainly sovereign and corporate bonds denominated in both local currency and US dollar. Ashmore take large active weight positions and as such volatility versus benchmark returns are to be expected. Active weight refers to the difference in allocation of an individual holding and the benchmark.

7. Central are due to launch the Emerging Market Debt Fund in Q3 2020/21 having appointed Amundi Asset Management and M&G in April 2020. The Fund has previously advised Central of our interest and Hymans have produced due diligence on the suitability of the product for the Fund.
8. A separate paper regarding the decision to invest in the Central EMD fund will be taken during a private session of today's meeting.

Targeted Return

9. The Fund currently has exposure to the Targeted Return asset class via three managers, Aspect Capital, Ruffer and Pictet.
10. Central are at stage 1 (requirements capture) in developing a targeted / absolute return product. The Fund has expressed an interest and is currently working with one other partner fund, LGPS Central and Hymans Robertson to develop a suitable product. Progress has been slow during the Covid19 lockdown, the Fund has responded with information requests from Central in a timely manner and is pushing for progress.
11. The Fund has retained the 'Targeted Return' asset class given it allows investments via active management to take advantage of market opportunities and allows the Fund to be long and short (ie being able to profit whilst market prices are falling) in the market across classes not otherwise accessible. In turn this allows for improved diversification for the Fund. The three managers the Fund currently employs have contrasting approaches, Aspect Capital trades frequently and has low correlation to equity, Ruffer have a preservation of capital focus, have a long standing on higher inflation and position themselves accordingly whilst Pictet operate a long only diversified fund able to invest in a wide variety of asset classes.

Multi Asset Credit (MAC) Fund

12. 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. Compared to the recently invested in Investment Grade Corporate Bond product this ability to investment in a wide pool of securities results in overall higher risk and expected return.
13. The Fund already has investments in emerging market debt and investment grade corporate bonds. This product will be developed with this in mind and will limit exposure as necessary where there is overlap.
14. 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.£28m).
15. The annual asset allocation review advised that the Fund should increase the allocation to this class from 0.5% to 4.0%. 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.
16. The Fund took the opportunity in May 2020 to review with our advisor the Selection Questionnaire (SQ) and advert including the general fund mandate before it was sent to the market. The review allowed the Fund to address areas that would not meet our objectives. Central have now received the responses to the SQ which have now been marked. The next stage will be to finalise the mandate.

Direct Property

17. The Fund has a number of property investments totalling £378 million at June 2020 or 8.4% of the Fund's value. This is split across three managers, Colliers, LaSalle and Kames. Of the total holding, £97 million is classed as 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.
18. The current direct holdings are not expected to transfer to Central when the property sub fund is launched, due to taxation and transition cost concerns. As such there is little detriment to the Leicestershire Fund to maintaining its direct holdings.
19. Central have presented a business case to IWG (Investment Working Group) for a UK Direct Property Fund. It has been approved at IWG and by Central's Investment Committee and Executive Committee. Three partner funds including ourselves have expressed a soft commitment to invest at the last IWG. The current estimate for launching a sub fund is Q1 2021.
20. Central plan to launch additional property funds to focus on other sectors including international property in the future. These are likely to be held on an indirect basis, similar to our current holdings with LaSalle where they hold units in non-UK and other specialised funds which we would otherwise find harder to directly invest in at scale.

Infrastructure

21. The Fund has a £395 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.
22. The Fund has an allocation target of 9.75%, at June 2020 the Fund has an allocation of 8.7%.

23. A two sleeve structure is proposed, a core sleeve (investing in safer more traditional schemes with stable cashflows for example) with a lower return and an opportunistic sleeve with higher risks and returns. Investors will be able to allocate funds to either sleeve in line with their risk and reward profile. Core / core plus returns are targeted at CPI + 3.5% with opportunistic / value add returns targeted at CPI + 5%. UK CPI (June 2020) is currently at 0.8% having come down from 1.4% in December 2019.
24. Officers have shared the investment case with the Fund's advisors to allow them to comment further on the details and discuss any amendments to the proposal before Central complete a business case that is planned to come to IWG in Q3 of this calendar year.
25. Discussions are ongoing between the interested Partner Funds and Central in order to finalise the details with the Central business case having been brought to the July Investment Working Group (IWG). Central envisage this fund to be made available earlier than the Direct Property offering

Other Matters

26. The Director of Responsible Investing has resigned and will be leaving at the end of September 2020. Central have advertised the role.
27. The Head of Private Markets position at Central has not yet been filled. Central have commenced interviews for the position with second interviews taking place in mid August. This position would oversee both Private Equity and Private Debt investment classes. With that in mind the Fund may, later in the year propose a further allocation to Private equity or debt that require investment outside the pool.

Recommendation

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

Equality and Human Rights Implications

29. None.

Appendix

None

Background Papers

None

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