



INVESTMENT SUB-COMMITTEE – 28 JULY 2021

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

STRATEGIC ASSET ALLOCATION UPDATE AND CASH DEPLOYMENT PLANS

Purpose of the Report

1. The purpose of this report is to update the Investment Sub Committee (ISC) on the cash holding of the Leicestershire County Council Pension Fund (Fund) and the plans for its deployment for the rest of 2021.

Background

2. Hymans Robertson, the Fund's Actuary, completed the 2021 Strategic Asset Allocation (SAA) as part of the Funds annual investment review. The Strategy was reviewed by officers and was approved by the Local Pension Committee at the January 2021 meeting.
3. The Fund, as a part owner of LGPS Central (Central), has an aim to transition investments to cost effective and relevant products at Central as and when they are made available.
4. Over the next 12 months, the Fund is working with Central to progress the following products where the Fund may, pending due diligence make an investment:
 - a. Central Infrastructure Fund
 - b. Central Private Debt vintage 2021
 - c. Central Private Equity vintage 2021
 - d. Central Direct Property Fund
 - e. Central Targeted Return Fund
5. In some cases, owing to the complex nature of building products suitable for a variety of partner funds, delays have been experienced. As a result the Fund has been conscious of making investments outside of Central in order to not stray further from the strategic allocation whilst maintaining an interest in any potential Central product when it becomes available.

SAA 2021 Recap

6. The Fund's 2021 SAA was approved at the January 2021 Pension Committee. A reminder of the 2021 SAA is shown in the table below.

	Proposed target weight (%)	Comments
Growth (55.25%)	55.25	
Listed equity	42.0 (40.0-44.0)	Broad factor based passive allocation implemented December 2020, using LGPS Climate multi-factor sub-fund
Private equity (inc secondaries)	5.75	Increase in strategic target reflecting existing allocations Consider opportunistic investment in Adam Street Secondaries
Targeted return	7.5	Currently higher allocation. Use to fund sub-inv grade credit allocation; Review LGPS sub-fund when details available
Income (36.75%)	36.75	
Infrastructure (inc timberland)	9.75	Review and use LGPS sub-fund
Property	10.0	Consider introducing residential property; Consider LGPS Central proposals
Emerging market debt	2.5	-
Global credit – liquid sub inv grade markets	4.0	Existing JP Morgan fund holding and reduction in Target Return used to fund allocation, subject to due diligence
Global credit - private debt	10.5	Review M&F DOF team mid-year to decide whether to make further allocation to distressed debt
Protection (8%)	8.0	
Inflation-linked bonds	4.5	0.5% reduction in strategic allocation, reflecting recognition of cash held to manage currency hedge
Investment grade credit	3.0	Including up to c.0.5% retained by Aegon to support currency hedge programme
Currency hedge cash	0.5	Recognition of cash held by Aegon for this mandate. Adjust benchmark hedge ratios used by Aegon from 50% to 30%
Total	100.0	

Current cash holding & plans

7. The Fund at 31st March 2021 £170m in cash, or 3.3% of total Fund assets. As at June 2021 end the balance was c£220m. Owing to the positive cashflow nature of the Fund, due to payments to pensioners or dependants being lower than pension contributions and closed end funds returning money, the cash balance grows without regular re investment to realign to the SAA.
8. The table below best describes the change in cash between March 31st and June 30th:

	£m	
March 31st cash balance	170	
Net cash expended for LGPS Central MAC	-17	£200m commitment less sales of targeted return managers (102m) & JP Morgan credit (£31m) and recalling £50m of currency hedge collateral
Partners distributions	27	Net distributions from Partner Group
Change in USD account	17	Combination of multiple managers calls and distributions
Net pension contributions less pensions paid	15	Fund pays out less in pensions than it collects in contributions
Other	8.5	£6m is Property distribution
30th June cash balance	220	

9. Whilst waiting for new products to be made available the cash balance has grown over the last 12 months.
10. As described earlier there are a number of new products that the Fund is interested in that would reduce the cash balance which are described later in this paper. The table below illustrates the position of the Fund at 31st March 2021 versus the strategic asset allocation.

	31/03/2021			31/3/20 Actual		Difference, actual to 2021 SAA	£m to target weight	Net commitments approved	Difference to target post commitments agreed £m
	£m	2021 SAA	weight %	weight %	weight %				
Growth									
Listed Equity - Active and Passive	2,329	42.00%	45.2%			3.2%	-166		-166
Targeted Return Funds	536	7.50%	10.4%			2.9%	-150	-90	-60
Private Equity	339	5.75%	6.6%			0.8%	-43	27	-70

	31/03/2021			31/3/20 Actual		Difference, actual to 2021 SAA	£m to target weight	Net commitments approved	Difference to target post commitments agreed £m
	£m	2021 SAA	weight %	weight %	weight %				
Income									
Infrastructure	381	9.75%	7.4%			-2.4%	121	25	96
Global credit - private debt	379	10.50%	7.4%			-3.1%	162		162
Property	392	10.00%	7.6%			-2.4%	123		123
Global Credit - liquid sub inv grade	31	4.00%	0.6%			-3.4%	175	170	5
Emerging market debt	108	2.50%	2.1%			-0.4%	21		21

	31/03/2021			31/3/20 Actual		Difference, actual to 2021 SAA	£m to target weight	Net commitments approved	Difference to target post commitments agreed £m
	£m	2021 SAA	weight %	weight %	weight %				
Protection									
Inflation linked bonds	235	4.50%	4.6%			0.1%	-3		-3
Investment grade (IG) credit	106	2.50%	2.1%			-0.4%	23		23
Short dated IG credit	25	0.50%	0.5%			0.0%	1		1
Active currency hedge collateral	119	0.50%	2.3%			1.8%	-93		-93

Rebalancing to target asset allocation

- Overall, the Fund is overweight growth assets and underweight income assets. The income assets are dominated by illiquid products such private debt, infrastructure and property all of which the Fund has potential to invest in.
- It is generally easier to invest into and out of the growth assets (except private equity) given their liquidity provided by stock markets. As such rebalancing lower would take far less time if the Fund needed additional cash to fund investment in the underweight income assets class.

Central Infrastructure

13. A proposal is being taken to the ISC as part of today's agenda that would reduce the cash holding if approved by £70m over a period of time that would depend on Central's ability to appoint underlying managers. Officers in consultation with Central expect the majority to be called within 36 months with open ended underlying investments being called within 18 months and closed ended investments taking longer. Given the time to call money and the return of capital from the Fund's existing managers there will be a continual assessment each year of the amount to reinvest in infrastructure.

Central Private Debt and Partners Group

14. A further proposal is being taken to the ISC as part of today's agenda for an investment into two private debt products. The combined proposal totals £160m, about a third to a half (£50m-£80m) could be called before the end of 2021 if approved.
15. The Fund's existing private debt holdings comprising of investments with Partners Group, M&G and CRC. Partners group and CRC will be returning cash over the next 12 months and as such officers plan to take a further paper later in the year or after the SAA for 2022 is agreed in January 2022 to assess the need for a further allocation to this asset class. This additional allocation later this year is likely to be cashflow neutral.

Private Equity

16. There is need to re-invest into the private equity class each year, the Fund has a mature list of investments which are continually returning money. Officers plan to take a paper to the October ISC. Early indications suggest a c£30-40m commitment would be appropriate to maintain the target portfolio weight and vintage diversification.
17. Central are launching a 2021 private equity vintage and this will be considered as part of due diligence. Depending on the actual product selected investing money could take up to five years and as such officers do not expect a commitment to decrease cash holdings significantly.

Property

18. Central have commenced a search for a direct property manager. The Fund at March 31st is underweight by 2.4% or c£120m. The Fund has been waiting for a Central product to be launched and in the meantime has committed a further £35m to its indirect property manager LaSalle who invest in funds rather than direct property. This allocation to LaSalle is in line with the approved target asset allocation.
19. LaSalle aim to invest the money by the end of the calendar year which would decrease the cash holdings.
20. In addition, the Fund's direct property manager has an instruction to bring to the attention of the Fund any direct property that would fit the profile of its existing direct property portfolio.

Targeted Return

21. Central are developing a product which is due to be available for investment in early 2022. This investment if approved will be funded by the Funds existing holdings (Pictet, Aspect and Ruffer) and not by cash.

22. It is worth noting that the investment into the Central product will return c£60m cash given the Fund is currently overweight to this asset class all other things being equal.

Summary of changes 2021:

23. The following tables summarises the decisions taken and planned in 2021 where there is a net change in asset class weight forecasted. In some cases where a commitment is made there may not be a net reduction given the distributions from the manager.

	Difference to target post commitments agreed £m	July ISC recommendation	Distributions / future commitments	Diff to target weight post changes £m	% diff to SAA
Growth					
Listed Equity - Active and Passive	-166			-166	3.2%
Targeted Return Funds	-60			-60	1.2%
Private Equity	-70		-30	-40	0.8%

	Difference to target post commitments agreed £m	July ISC recommendation	2021: Other / future changes	Diff to target weight post changes £m	% diff to SAA
Income					
Infrastructure	96	70		26	-0.5%
Global credit - private debt	162	160	-30	32	-0.6%
Property	123		35	88	-1.7%
Global Credit - liquid sub inv grade	5			5	-0.1%
Emerging market debt	21		20	1	0.0%

	Difference to target post commitments agreed £m	July ISC recommendation	2021: Other / future changes	Diff to target weight post changes £m	% diff to SAA
Protection					
Inflation linked bonds	-3			-3	0.1%
Investment grade (IG) credit	23		20	3	-0.1%
Short dated IG credit	1			1	0.0%
Active currency hedge collateral	-93		-50	-43	0.8%

24. Officers expect that if the above amounts are committed, cash will be reduced from the £220m held at the end of June 2021 to less than £150m by year end. Calls in 2022 are expected for certain asset class commitments which will not be fully called in 2021 such as private debt and infrastructure.

25. Whilst it may appear the Fund is over committed; the timing of calls will allow the Fund to build up cash each month as distributions are received and a forecasted net c£30m from net contributions in expected by the year end. (pension contributions less pension payments)

26. If cash accumulates further then additional rebalancing can take place similar to that described for EMD and IG credit.

27. There are assumptions made for illiquid investments will contain a margin of error given it is unknown when managers will call funds or distribute accurately.

Recommendation

28. It is recommended that the Investment Subcommittee notes the report.

Equality and Human Rights Implications

29. None.

Appendix

None

Background Papers

None

Officers to Contact

Mr C Tambini, Director of Corporate Resources
Tel: 0116 305 6199 Email: Chris.Tambini@leics.gov.uk

Mr D Keegan, Assistant Director Strategic Finance and Property
Tel: 0116 305 7668 Email: Declan.Keegan@leics.gov.uk

Mr B Kachra, Senior Finance Analyst - Investments
Tel: 0116 305 1449 Email: Bhulesh.Kachra@leics.gov.uk