INVESTMENT SUB-COMMITTEE – 27 APRIL 2022

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 next 12 months.

2. The Committee will also receive a presentation from DTZ International, appointed property managers for the LGPS Central UK direct property fund.

Background

3. Hymans Robertson, the Fund's investment advisor, completed the 2022 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 2022 meeting.

4. 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.

5. Over the next 12 months, there is one product that is being delivered that the Fund is currently interested in, the LGPS Central Targeted Return Fund. There are of course new vintages of closed ended products that Central will look to deliver, these are the private debt and private equity products which are available to invest in on an 18 month cycle at present,

6. 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.

Current cash holding

7. The Fund, as of 31st March 2022 held £116m in cash, or 2.0% of total Fund assets (based on the £5.8bn valuation as at 31st December 2021). In addition, the Fund held £51m as collateral with Aegon for the active currency hedge mandate.

8. Owing to the positive cashflow nature of the Fund, due to payments to pensioners or dependants being lower than pension contributions and funds returning money, the cash balance grows without regular re investment to realign to the SAA.

9. The Fund has held a higher amount of cash during 2021 whilst awaiting to deploy funds into underweight areas of the asset allocation. These underweight areas have been within the income portion of the portfolio and mainly within the more illiquid investments, property, infrastructure and private credit.

SAA 2022 Recap

10. The Fund's 2022 SAA was approved at the January 2022 Pension Committee. A reminder of the SAA is shown in the table below.

	Proposed target weight (%)	Comments
Growth (55.25%)		
Listed equity	42.0 (40.0-44.0)	Review to be carried out Q4 2022/Q1 2023
Private equity (inc secondaries)	5.75	Director of Corporate Resources to manage ongoing commitments as required
Targeted return	7.5	Review LGPS sub-fund when final details confirmed with expectation to transition holdings in H1 2022 (subject to due diligence)
Income (36.75%)		
Infrastructure (inc timberland and infracap)	9.75	Enhanced monitoring of Infracapital; Review allocation to LGPSC Infrastructure Fund (Value-Add/Opportunistic) sleeve; Explore potential allocation to social infrastructure and infrastructure secondaries; Potential to increase target allocation to 12.5% (funded from listed equity) subject to review once current target has been achieved
Property	10.0	Review of property allocation to be carried out in H1 2022
Emerging market debt	2.5	-
Global credit – liquid sub inv grade markets	4.0	-
Global credit - private debt (inc M&G/CRC)	10.5	Review allocation to distressed debt in mid-2022
Protection (8%)		
Inflation-linked bonds	4.5	-
Investment grade credit	3.0	-
Currency hedge	0.5	-
Total	**100.0**	

Current allocation versus SAA

11. The allocation versus the 2022 SAA using the 31st December Fund valuations is shown below.

	Benchmark SAA 2022	Actual Dec-21	Difference Dec-21
Growth assets			
Listed Equity Passive	30.0%	33.20%	3.20%
Listed Equity Active	12.0%	12.70%	0.70%
Private Equity	5.75%	7.55%	1.80%
Targeted Return	7.50%	7.84%	0.34%
Income assets			
Infrastructure	9.75%	7.26%	-2.49%
Global credit - private debt / CRC	10.50%	5.83%	-4.67%
Property	10.00%	7.84%	-2.16%
Global Credit - liquid MAC	4.00%	3.50%	-0.50%
Emerging market debt	2.50%	2.26%	-0.24%
Protection			
Inflation linked bonds	4.50%	4.48%	-0.02%
Investment grade (IG) credit	2.50%	2.33%	-0.17%
Short dated IG credit	0.50%	0.43%	-0.07%
Active currency hedge collateral	0.50%	1.05%	0.55%
Cash	0.00%	3.72%	3.72%

12. A simple summary of the above is that the Fund is overweight growth assets and underweight income assets. Income assets which the Fund is underweight are generally invested in illiquid investments and take time to be called by the underlying managers once commitments are made.

13. There have a been a number of actions taken in 2021 which are described below to address the underweights within infrastructure, global credit and property.

14. All three areas received approval to invest in 2021 during various meetings, however commitments made to managers will take time to be called. A summary of the 2021 commitments made to these three asset classes are detailed below:

    a. £100m, LGPS Central Private Debt low return – July 2021 ISC
    b. £60m, Partners Private Debt MAC6 – July 2021 ISC
    c. £70m, LGPS Central Infrastructure Core/Core plus – July 2021 ISC
    d. £60m, LGPS Central Private Debt high return – Oct 2021 ISC
    e. £52m, CRC's bank risk sharing fund, CRF5 – Oct 2021 ISC
    f. £35m, top up to existing LaSalle indirect property mandate

15. The combined commitments above total £377m. As at 31st March 2022 the amount to be drawn by the managers is £263m.

16. The small underweight position of 0.5% within global credit liquid MAC was addressed in March 2021 with a top up of c£30m to the LGPS Central Multi Asset Credit (MAC) fund. At the same time a £60m investment was made to the Aegon short dated corporate bond fund. Both investments were made from cash and in line with the 2022 SAA.

17. The £60m investment into short dated corporate bonds was deemed an appropriate place to park cash whilst there was not a need from commitments made. This £60m will be redeemed as and when cash is needed to fund commitments made to investments.

<u>Plans for 2022</u>

18. The table below shows the expected decisions the Fund is considering at this point in time in order to align to the SAA. Bear in mind that market value changes of asset classes throughout the year will affect the actual weightings considerably and these forecasts will change as the year progresses.

Growth	31/12/21 £m	2022 SAA	31/12/21 Actual weight %	Difference, actual to 2022 SAA	£m to target weight	Commitments approved	2022: other cashflow	Future ISC commitments	Diff to target weight post changes £m	% diff to SAA
Listed Equity - Active and Passive	2,663	42.00%	45.9%	3.9%	227			-200	27	0.5%
Targeted Return Funds	455	7.50%	7.8%	0.3%	20				20	0.3%
Private Equity	438	5.75%	7.6%	1.8%	104	65	-50		119	2.1%

Income	31/12/21 £m	2022 SAA	31/12/21 Actual weight %	Difference, actual to 2022 SAA	£m to target weight	Commitments approved	2022: other cashflow	Future ISC commitments	Diff to target weight post changes £m	% diff to SAA
Infrastructure	421	9.75%	7.3%	-2.5%	-145	67	-20	125	27	0.5%
Global credit - private debt / CRC	338	10.50%	5.8%	-4.7%	-271	178	-100	150	-43	-0.7%
Property	455	10.00%	7.8%	-2.2%	-125			125	0	0.0%
Global Credit - liquid MAC	203	4.00%	3.5%	-0.5%	-29	29			0	0.0%
Emerging market debt	131	2.50%	2.3%	-0.2%	-14				-14	-0.2%

Protection	31/12/21 £m	2022 SAA	31/12/21 Actual weight %	Difference, actual to 2022 SAA	£m to target weight	Commitments approved	2022: other cashflow	Future ISC commitments	Diff to target weight post changes £m	% diff to SAA
Inflation linked bonds	260	4.50%	4.5%	0.0%	-1				-1	0.0%
Investment grade (IG) credit	135	2.50%	2.3%	-0.2%	-10				-10	-0.2%
Short dated IG credit	25	0.50%	0.4%	-0.1%	-4	60			56	1.0%
Active currency hedge collateral	61	0.50%	1.1%	0.6%	32				32	0.6%

Cash	216	0.00%	3.7%	3.7%	216	-89			127	

19. Changes to be considered:

    a. Reduction in listed equity – a c£200m reduction in this asset class would align to the SAA target. There is a listed equity review planned with Hymans towards the end of 2022. The details regarding how best to reduce this allocation will be part of the review alongside the wider scope.

    b. Private equity – there are recent outstanding commitments to LGPS Central and Adam Street Partners. The timing of calls is more difficult to gauge as it is dependant on market conditions and the underlying managers ability to source deals. We do however expect regular returns of capital from Adam Street and expect c£50m to be returned to March 2023. At present there is no requirement to make a new commitment to this asset class.

    c. Infrastructure – commitments outstanding amount to c£70m. The Fund expects c£20m to be returned from existing investments that are closed ended. Officers estimate a further £125m commitment is needed to align to SAA. This underweight will be picked up by the infrastructure review that Hymans will be bringing a proposal to the July 2022 ISC.

    d. Global Credit – commitments outstanding amount to £178m. Officers expect c£100m to be returned to the Fund to March 2023 from existing private credit investment with Partners, CRC and M&G. This asset class will therefore require further commitments of c£150m in order to not fall behind to the SAA target. Officers have been in touch with LGPS Central regarding their plans for the next vintages of Private debt products and will update the committee when more is known. It is currently planned to bring an investment proposal to the October ISC which could be a Central product offering, an offering from an existing manager or if neither are suitable a new manager product offering may be considered.

e. Property – there are minimal commitments outstanding to this asset class. There is a property strategy review on the agenda today that Hymans will present that will, amongst other things propose how to address this underweight position which would require a significant investment to close the gap to the SAA target.

LGPS Central UK Direct Fund – DTZ

20. Attached is the presentation that will be delivered by DTZ international (DTZ), who are the appointed property managers for the new LGPS Central Direct UK property fund. The Fund's officers have been involved with the development of this fund in conjunction with other partner funds and Central.

21. LGPS Central ran a procurement for a UK direct property mandate for which DTZ have been appointed. The mandate characteristics are shown in the table below.

Characteristics	
Benchmark	MSCI UK Quarterly Property Index – Total Return
Investment Objective	To invest directly in a diversified portfolio of commercial real estate assets in the UK
Performance Target	To outperform the benchmark by 0.5% p.a. over rolling 3 year periods
Anticipated Launch	June/July 2022
Fund Structure	Open-ended Authorised Contractual Scheme
Minimum Subscription	£10 million
Fund Currency	Sterling
Subscriptions	Monthly, with a 3 year lock-in period from the fund's launch
Redemptions	Semi-annual, on 30 June and 31 December each year subject to 3 months' notice
Gating Mechanisms	Gating will be implemented if the redemption queue exceeds 15% of AUM or market conditions are abnormal
Distributions	Quarterly income distributions (there is no automatic reinvestment per Partner Fund preferences)
Expected number of holdings	Will vary with fund size. Expectations are: • • £200 million fund size – minimum of 10 holdings • • £500 million fund size – minimum of 20 holdings • • £750 million fund size – minimum of 25 holdings
Investment Restrictions	• All investments are to be made into UK direct property • Sector exposures must be within 20% of the benchmark weightings • Cash may not exceed 10% of the fund (excluding redemption proceeds)* • No single investment shall exceed 10% of the portfolio's value • No ground up development shall exceed over 10% of the portfolio's value* • No single tenant can comprise more than 5% of the rent roll at the point of acquisition* • The void rate should not exceed 10% * denotes that the restriction does not apply within the first 3 years of the fund)

22. The presentation will be delivered by three personnel from DTZ including the UK CEO. The presentation will cover
    a. DTZ – who they are
    b. Responsible investment (RI) including net zero plans and their RI achievements
    c. Review of the mandate they have been appointed to manage
    d. Investment performance
    e. Market outlook

Effect on cash to March 2023

23. Including the effect of commitments already made and any that may be called during the course of 2022/23 means that the Fund will expect to have a similar cash position to the current position at the 1st April 2022 per the table below.

24. A new commitment forecast to be called from the underweight positions as described above is that for property given that the proposals are due to be presented at the April ISC and therefore have nearly 12 months to be invested. No commitments that may be proposed at the July ISC for infrastructure have been assumed to be called prior to March 2023.

25. Officers have assumed £50m of a new private debt commitment will be called prior to March 2023 from a proposal that will be bought to ISC in November. If the underlying managers in the proposed Fund do not call commitments as quick as expected then cash will be higher than forecast.

26. Although cash could be reduced by overcommitting to certain asset classes, officers are mindful of becoming over concentrated in any particular fund or vintage year which could increase investment risk. With a largely unchanged cash position at March 2023 the Fund would be holding c2% cash (assuming similar sized total value of Fund) as a percentage of total Fund assets.

27. The cash position does not include collateral held at Aegon for the active currency hedge which is £50m. Adding this to the closing position gives a cash position of £176m or 3% of total Fund assets based on a £5.8bn portfolio value.

28. The table below illustrates the major changes through the year to March 2023.

Opening cash position	**116**	As at 1st April 2022, excludes cash held as collateral for currency hedge.
Management expenses	-5	These are investment management expenses paid directly by the Fund. Majority of fees are paid from the investments held with the managers.
Investment income	30	Primarily from property and infrastructure investments

Currency Hedge	0	No cashflow forecast estimated given the inherent difficulty in doing so. The Fund currently has c£50m in collateral. This deemed adequate and would provide enough collateral for a 10% adverse movement in the Fund's 3 major foreign currency exposures, US Dollar, Euro and Yen. No forecast cashflow effect given no strong view on whether the Pound will strengthen or weaken over 22/23.
Non investment cashflow	60	Employer and employee contributions exceed the benefit payments made. Only moves gradually compared to the previous year, unless a step change following the tri-annual valuation.
Commitments drawn	-240	Represents existing commitments made forecast to be drawn in the next 12 months.
Expected capital distribution	165	Forecast distribution expected from holdings in private equity, private debt infrastructure in the main
Forecast closing cash position 31st March 2023	**126**	Aim is to keep cash as low as possible and keep fully invested in line with the SAA approved at the start of each year.

Recommendation

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

Supplementary Information

30. An exempt paper which is of a sensitive nature is included elsewhere on the agenda and contains supplementary information on the Property Portfolio Review and Proposed Investments.

Equality and Human Rights Implications

31. None.

Appendix

Appendix 1: DTZ international presentation

Background Papers

None

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