Agenda Item 7

INVESTMENT SUB-COMMITTEE – 27 JULY 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.

Background

2. 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.

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, 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.

5. At the April 27th 2022 ISC the Sub Committee approved an investment to LGPS Central's Direct property fund which will be managed by DTZ International.

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.

Cash holdings at 31st March 2022

7. The Fund, as of 31st March 2022 held £116m in cash, or 2.0% of total Fund assets (based on the £5.76bn valuation as at 31st March 2022). In addition, the Fund held £52m 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 and 2022 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 March Fund valuations is shown below.

	Benchmark SAA 2022	Actual Mar-22	Difference to SAA
Growth assets			
Listed Equity Passive	30.0%	32.42%	2.42%
Listed Equity Active	12.0%	12.22%	0.22%
Private Equity	5.75%	7.63%	1.88%
Targeted Return	7.50%	8.47%	0.97%
Income assets			
Infrastructure	9.75%	7.76%	-1.99%
Global credit - private debt / CRC	10.50%	6.23%	-4.27%
Property	10.00%	8.47%	-1.53%
Global Credit - liquid MAC	4.00%	3.85%	-0.15%
Emerging market debt	2.50%	2.08%	-0.42%
Protection			
Inflation linked bonds	4.50%	4.27%	-0.23%
Investment grade (IG) credit	2.50%	2.19%	-0.31%
Short dated IG credit	0.50%	1.48%	0.98%
Active currency hedge collateral	0.50%	0.90%	0.40%
Cash	0.00%	2.01%	2.01%

	31/3/22 £m	2022 SAA	31/3/22 Actual weight %	Difference, actual to 2022 SAA
Growth	3,500	55.25%	60.7%	5.5%
Income	1,636	36.75%	28.4%	-8.3%
Protection	509	8.00%	8.8%	0.8%
Cash	116	0.00%	2.0%	2.0%
	5,761	100.00%	100.0%	

12. The Fund is overweight growth assets (+5.5%) and underweight income assets (-8.3%). 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 which are described below to address the underweights within infrastructure, global credit and property.

14. All three areas received approval to invest in 2021 and 2022 during various meetings, however commitments made to managers will take time to be called. A summary of 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
g. Two £60m investments to the LGPS Central direct property fund – April 2022 ISC

15. The combined commitments above total £497m. As at 31st March 2022 the amount yet to be called by the managers is £263m. Since the 31st March portfolio valuation date a number of commitments have been called and as such net in roads have been made to reduce the underweight income asset class position which stood at c10% based on the 31st December 2021 portfolio valuation and is 8.3% at 31st March 2022.

16. If all remaining commitments and expected distributions were made by 31st March 2023 the underweight to the income asset class fund would reduce from 8.3% to 4.2%. There is a proposal on today's agenda to commit to the infrastructure asset class and it is planned to bring a proposal to the October ISC for private debt, both of which will further reduce the underweight as they are called.

17. In particular net cash calls at the following managers have occurred:

a. CRC CRF5 - £32m
b. Partners MAC6 – net £8m
c. LGPS Infrastructure core/core plus - £6m
d. LPGS Private debt low return - £5m
e. LPGS Private debt high return - £3m

18. In addition, a further £20m has been sent to Aegon to maintain collateral on the currency hedges they maintain for the Fund. The Fund has a benchmark hedge position of 30% of unhedged foreign currency assets and Aegon exercise their judgement on which currency pairs to hedge, partially, fully or leave unhedged.

<u>Plans for 2022</u>

19. 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	31/3/22 £m	2022 SAA	31/3/22 Actual weight %	Difference, actual to 2022 SAA	£m to target weight	Commitments approved	2022/23: other cashflow	Future ISC changes	Diff to target weight post changes £m	% diff to SAA
Listed Equity - Active and Passive	2,572	42.00%	44.6%	2.6%	152			-150	2	0.0%
Targeted Return Funds	488	7.50%	8.5%	1.0%	56			-50	6	0.1%
Private Equity	440	5.75%	7.6%	1.9%	109	59	-43		125	2.2%

Income	31/3/22 £m	2022 SAA	31/3/22 Actual weight %	Difference, actual to 2022 SAA	£m to target weight	Commitments approved	2022/23: other cashflow	Future ISC changes	Diff to target weight post changes £m	% diff to SAA
Infrastructure	447	9.75%	7.8%	-2.0%	-115	61	-20	170	96	1.7%
Global credit - private debt / CRC	359	10.50%	6.2%	-4.3%	-246	155	-75	150	-16	-0.3%
Property	488	10.00%	8.5%	-1.5%	-88	120			32	0.6%
Global Credit - liquid MAC	222	4.00%	3.9%	-0.1%	-8				-8	-0.1%
Emerging market debt	120	2.50%	2.1%	-0.4%	-24				-24	-0.4%

Protection	31/3/22 £m	2022 SAA	31/3/22 Actual weight %	Difference, actual to 2022 SAA	£m to target weight	Commitments approved	2022/23: other cashflow	Future ISC changes	Diff to target weight post changes £m	% diff to SAA
Inflation linked bonds	246	4.50%	4.3%	-0.2%	-13				-13	-0.2%
Investment grade (IG) credit	126	2.50%	2.2%	-0.3%	-18				-18	-0.3%
Short dated IG credit	85	0.50%	1.5%	1.0%	56				56	1.0%
Active currency hedge collateral	52	0.50%	0.9%	0.4%	23				23	0.4%
Cash	116	0.00%	2.0%	2.0%	116					

20. Changes to be considered:

a. Reduction in listed equity – a c£150m 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. It is not expected that sales of assets will be needed to raise cash for existing commitments, but if needed, listed equity alongside the slight overweight to targeted return would be the natural place to raise cash from by selling underlying listed equity and targeted return holdings in an as equal manner as possible.

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 dependent 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£45m to be returned to March 2023. At present there is no requirement to make a new commitment to this asset class. Given valuations of underlying private equity holdings they are likely to reduce over the coming quarters in line with the falls for most listed equity indices.

c. Infrastructure – commitments outstanding amount to c£60m. The Fund expects c£20m to be returned from existing investments that are closed ended. Officers, alongside the Fund's investment advisor Hymans estimate a further £170m commitment is needed to align to SAA target of 9.75% over a number of years. There is a paper on today's agenda that will address this underweight position together with an implementation plan to manage a transition to a potential higher infrastructure allocation which was mentioned within the January 2022 SAA paper delivered by Hymans.

d. Global Credit – commitments outstanding amount to c£155m. Officers expect c£75m to be returned to the Fund to March 2023 from existing private credit investments with Partners, CRC and M&G. This asset class will therefore require further commitments of c£150m in order to not fall further behind the SAA target. Officers have been in contact with LGPS Central regarding their plans for the next releases 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 – £120m of commitment remains to this asset class which was approved at the June 2022 ISC. This commitment is to the LGPS Central direct property fund and will be drawn once the product is available for partner fund investments. It is estimated that LGPS Central will receive all regulatory approvals in the coming months.

Effect on cash to March 2023

21. 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 opening position at the 1st April 2022 which was £116m. The cash position at the time of writing is £68m.

22. A £25m commitment has been assumed will be called for infrastructure investments proposed at this meeting. At the time of writing, it is unclear exactly how much will be called by managers, and as such a prudent estimate has been included.

23. Officers have assumed £30m of a new private debt commitment will be called prior to March 2023 from a proposal that will be bought to ISC in October. If the underlying managers in the proposed Fund do not call commitments as quick as expected, then cash at year end will be higher than forecast.

24. 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.

25. The cash position does not include collateral held at Aegon for the active currency hedge which is £30m at the time of writing (28th June 2022). Adding this to the closing position gives a cash position of £112m or 1.9% of total Fund assets based on a £5.8bn portfolio value.

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

28th June 2022 cash position	**68**	As at 28 June 2022, excludes cash held as collateral for currency hedge.
Management expenses	**-4**	These are investment management expenses paid directly by the Fund. Majority of fees are paid from the investments held with the managers.
Investment income	**23**	Income distribution paid to the Fund, 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£30m 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	**45**	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	**-173**	Represents existing commitments made forecast to be drawn to next March year end
Expected capital distribution	**123**	Forecast distribution expected from holdings in private equity, private debt infrastructure in the main
Forecast closing cash position 31st March 2023	**82**	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

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

Supplementary Information

28. An exempt paper which is of a sensitive nature is included elsewhere on the agenda and contains supplementary information on the Infrastructure review and proposed investments.

Equality and Human Rights Implications

29. None.

Appendix

None

Background Papers

None

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