Leicestershire County Council

INVESTMENT SUBCOMMITTEE – 12 OCTOBER 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 Subcommittee (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 its meeting in January 2022.

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 officers are considering proposing the Fund invests in, the LGPS Central Targeted Return Fund. When the product is ready officers will bring a proposal to the relevant committee. 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 its meeting on the 27 April 2022, the Subcommittee approved an investment to LGPS Central's Direct property fund which will be managed by DTZ International.

6. At the following meeting on the 27 July 2022, the Subcommittee approved investments to the JP Morgan's infrastructure investment Fund, LGPS Central's Core / Core plus infrastructure fund, Quinbrook Net Zero power fund and Stafford Capital's Carbon Offset Opportunities Fund pending further due diligence by the Fund's Investment advisor Hymans Robertson.

7. 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 agreed by the Pension Committee whilst maintaining an interest in any potential Central product when it becomes available.

Cash holdings at 30th June 2022

8. The Fund, as of 30th June 2022 held £68m in cash, or 1.2% of total Fund assets (based on the £5.5bn valuation as at 30th June 2022). In addition, the Fund held £29m as collateral with Aegon for the active currency hedge mandate. The cash holdings have reduced during 2022 as commitment made have been called.

9. 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.

10. 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

11. 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

12. The allocation versus the 2022 SAA using the 30th June Fund valuations is shown below.

Growth	30/6/22 £m	2022 SAA	30/6/22 Actual weight %
Listed Equity - Active and Passive	2,390	42.00%	43.2%
Targeted Return Funds	503	7.50%	9.1%
Private Equity	441	5.75%	8.0%

Income	30/6/22 £m	2022 SAA	30/6/22 Actual weight %
Infrastructure	488	9.75%	8.8%
Global credit - private debt / CRC	401	10.50%	7.2%
Property	506	10.00%	9.1%
Global Credit - liquid MAC	206	4.00%	3.7%
Emerging market debt	106	2.50%	1.9%

Protection	30/6/22 £m	2022 SAA	30/6/22 Actual weight %
Inflation linked bonds	203	4.50%	3.7%
Investment grade (IG) credit	114	2.50%	2.1%
Short dated IG credit	83	0.50%	1.5%
Active currency hedge collateral	29	0.50%	0.5%

Cash	68	0.00%	1.2%

	30/6/22 £m	2022 SAA	30/6/22 Actual weight %	Difference, actual to 2022 SAA
Growth	3,334	55.3%	60.2%	5.0%
Income	1,706	36.8%	30.8%	-5.9%
Protection	429	8.0%	7.7%	-0.3%
Cash	68	0.0%	1.2%	1.2%
	5,537	100.0%	100.0%	

13. The Fund is overweight growth assets (+5.0%) and underweight income assets (-5.9%). The income underweight has reduced over the year and will continue to do so as recent commitments are called. 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.

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

15. 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. £120m investments to the LGPS Central direct property fund – April 2022 ISC
    h. £30m, LGPS Central Core / core plus infrastructure, £30m JP Morgan infrastructure fund, £27.5m to Quinbrook Net Zero power fund and £27.5m to Quinbrook Net Zero power co-investment fund – July 2023 ISC
    i. £55m to Stafford Capital Carbon Offset Opportunities Fund – pending satisfactory due diligence from the Fund's investment advisor – July 2023 ISC

16. The combined commitments above total £667m. As at 30th June 2022 the amount yet to be called by the managers is £480m. Since the 30th June portfolio valuation date a number of commitments have been called and as such net in-roads will have been made to reduce the underweight income asset class position which stood at c10% based on the 31st December 2021 portfolio valuation. At 30th June 2022 this underweight was 5.9%.

17. The underweight to the income class is reducing in a controlled manner. The Fund does not want to overcommit in any given year in order to rapidly close the underweight position which could lead to poor returns in the event of economic conditions or investment manager selection proving to be unfavourable in hindsight.

18. There is a proposal on today's agenda to commit to the private debt asset class which will further reduce the underweight.

19. In particular net cash calls at the following managers have occurred to the quarter ending 30th June 2022:

    a. CRC CRF5 - £42m
    b. Partners MAC programmes – net £8m
    c. LGPS Infrastructure core/core plus - £6m
    d. LPGS Private debt low return - £5m
    e. LPGS Private debt high return - £3m

20. In addition, £20m has been sent to Aegon to maintain collateral on the currency hedges they maintain for the Fund during July 2022 as the pound weakened. During late September the pound weakened further against the dollar amid heightened volatility post the Chancellors mini budget. Sterling reached a multi decade low of £1.04/$1 on 26th September which required the Fund to add an

additional £45m to support the hedge. 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.

21. Whilst the Fund has had to support the currency hedge by sending cash to Aegon, other parts of the portfolio will have seen currency translation gains which will have more than compensated the amounts sent to Aegon recently.

22. Current positioning by Aegon for currency hedges (as at end of September) implies a slight underweight to sterling (Aegon expect sterling to weaken). Aegon have kept the US Dollar hedged at 30% of the Fund's total US dollar exposure. Given the US dollar is the Fund's primary foreign exposure careful consideration is given to movements in the proportion of this hedge.

Plans for 2022

23. 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	30/6/22 £m	2022 SAA	30/6/22 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	2,390	42.00%	43.2%	1.2%	64			-60	4	0.1%
Targeted Return Funds	503	7.50%	9.1%	1.6%	88		-30	-60	-2	0.0%
Private Equity	441	5.75%	8.0%	2.2%	123	34	-35		122	2.2%
Income	**30/6/22 £m**	**2022 SAA**	**30/6/22 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	488	9.75%	8.8%	-0.9%	-52	231	-20		158	2.9%
Global credit - private debt / CRC	401	10.50%	7.2%	-3.3%	-181	149	-60	280	189	3.4%
Property	506	10.00%	9.1%	-0.9%	-48	120			72	1.3%
Global Credit - liquid MAC	206	4.00%	3.7%	-0.3%	-16				-16	-0.3%
Emerging market debt	106	2.50%	1.9%	-0.6%	-33				-33	-0.6%
Protection	**30/6/22 £m**	**2022 SAA**	**30/6/22 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	203	4.50%	3.7%	-0.8%	-47				-47	-0.8%
Investment grade (IG) credit	114	2.50%	2.1%	-0.4%	-24				-24	-0.4%
Short dated IG credit	83	0.50%	1.5%	1.0%	55				55	1.0%
Active currency hedge collateral	29	0.50%	0.5%	0.0%	1				1	0.0%
Cash	68	0.00%	1.2%	1.2%	68					

24. Changes to be considered:

a. Reduction in listed equity – a c£60m reduction in this asset class would align to the SAA target. There is a listed equity review planned with Hymans which will now be conducted once the Net zero Climate Strategy (NZCS) is approved. The details regarding how best to reduce this allocation will be part of the listed equity review which is planned to take place in 2023. 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. Reduction in targeted return – a c£60m reduction in this asset class would align to the SAA target. Since the June 30th valuation officers instructed one of the three targeted return managers, Aspect Capital to divest £30m and return cash to the Fund to satisfy cash calls elsewhere. Aspect Capital were selected given their significant outperformance versus the other two managers within this asset class where the benchmark allocation to each of the three managers is one third each.

c. Private equity – there are 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. It is however expected that regular returns of capital from Adam Street will be received and expect c£35m 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.

d. Infrastructure – commitments outstanding amount to c£230m. The Fund expects c£20m to be returned from existing investments that are closed ended. At the July 2022 meeting of the ISC, a combined £170m was approved (with £55m pending due diligence) which would over a number of years be called and address the underweight position to this asset class.

e. Global Credit – commitments outstanding amount to c£150m. Officers expect c£60m to be returned to the Fund to March 2023 from existing private credit investments with Partners, CRC and M&G although the timing of capital distributions is uncertain. This asset class will therefore require further commitments in order to not fall further behind the SAA target. There is a paper on today's agenda that addresses the underweight to this asset class and plans for future year commitments in order to maintain a relatively flat commitment and distribution profile so that large commitments are not required once the target allocation is reached. The £280m shown on the table above is based on the combined forecast commitment in 2022 needed to align to the SAA over the course of the next three years.

f. Property – £120m of commitment remains to this asset class which was approved at the April 2022 meeting of the 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

25. 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 lower cash

position to the opening position at the 1st April 2022 which was £116m. The cash position at the time of writing is £42m.

26. A £20m commitment has been assumed will be called for infrastructure investments. At the time of writing, it is unclear exactly how much will be called by all infrastructure managers, and as such a prudent estimate has been included.

27. Officers have assumed £150m of private debt commitments will be called prior to March 2023 from a proposal for existing and new private debt investments being made at today's ISC meeting. 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. The Fund has existing uncalled commitments totalling c£140m with Central private debt products for which a prudent call estimate has been included within the £150m estimate above.

28. 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.

29. The table below illustrates the major changes through to March 2023 from a starting cash position in late September.

26th September cash position	**42**	As at 26 September 2022, excludes cash held as collaterall for currency hedge and cash held by managers for reinvestment
Management expenses	-3	These are investment management expenses paid directly by the Fund. Majority of fees are paid from the investments held with the managers.
Investment income	15	Income distribution paid to the Fund, primarily from property and infrastructure investments
Currency Hedge	0	No cashflow foreast 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 wether the Pound will strengthen or weaken from current position
Non investment cashflow	30	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	-117	Represents existing commitments made forecast to be drawn to next March year end
Expected capital distribution	73	Forecast distribution expected from holdings in private equity, private debt infrastructure in the main
Forecast closing cash position 31st March 2023	**41**	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.

30. Officers expect closing cash to be lower than the opening position at the start of the financial year. Large calls from managers or later than expected calls will have an impact on the forecast as will any large movements in the cash generated or lost by the hedge managed by Aegon.

Bond underweight actions

31. Bonds in general are underweight having had a poor quarter to 30th June 2022. The fund has the following 'bond' holdings. £118m is the underweight to the four 'bond' portfolios.

		30.06.22		SAA	Diff £m
Fund		**£m**	**%**	**%**	
Central EMD		106	1.9%	2.50%	32
Central MAC		206	3.7%	4.00%	15
Central IG bond		114	2.1%	2.50%	24
Aegon Index linked bonds		203	3.7%	4.50%	46
					118

32. Officers have been in communication with Hymans regarding topping up the underweight position during the September. At present Hymans are assessing the most recent economic news (post the Chancellors mini budget announcement on the 22nd September) and pricing for bonds and will report to officers in mid October. In addition, Hymans will be mindful of decisions that require equity divestments given the relative valuation changes that will have occurred during the recent general market sell.

33. Officers will then assess the implications if the Fund is guided to top up any bond positions via raising cash from the overweight positions in listed equity and targeted return. These two asset classes are highly liquid and are the main source of overweight positions versus the SAA and as such make perfect

34. Should a change be required, the Director of Corporate Resources will use his delegated powers, following consultation with the Chairman of the Local Pension Committee, with the decision being reported to the Local Pension Committee at its meeting in November.

Recommendation

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

Supplementary Information

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

Equality and Human Rights Implications

37. None.

Appendix

None

Background Papers

None

Officers to Contact

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