Leicestershire County Council

INVESTMENT SUB-COMMITTEE – 19 APRIL 2023

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

CASH DEPLOYMENT, STRATEGIC ASSET ALLOCATION UPDATE AND INFRASTRUCTURE INVESTMENT TOP UPS

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 against the strategic asset allocation (SAA).

2. To provide background regarding commitments to three infrastructure investments.

Background

3. Hymans Robertson, the Fund's investment advisor, completed the 2023 Strategic Asset Allocation (SAA) as part of the Fund's annual investment review. The Strategy was reviewed by officers and was approved by the Local Pension Committee at its meeting on 20 January 2023.

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 are new vintages of closed ended products that Central will look to deliver. These are likely to be private debt and private equity products.

6. At its meeting on 27 April 2022, the Investment Sub-Committee approved an investment to LGPS Central's Direct property fund which will be managed by DTZ International.

7. At the following meeting on 27 July 2022, the Sub-Committee 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. This due diligence has now been completed and the Fund has made its commitment.

8. At the previous meeting on 12 October 2022, the ISC approved multiple investments into the private debt asset class with commitments to Central's low return and real assets products and Partners Group multi asset credit fund 7. These approvals covered immediate commitments as well as commitments in future years.

9. 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 on 31 December 2022

10. The Fund, as of 31 December 2022 held £97m in cash, or 1.7% of total Fund assets (based on the £5.5b valuation as of 30 December 2022). In addition, the Fund held £20m as collateral with Aegon for the active currency hedge mandate. The cash holdings have reduced during 2022 as commitments made have been called.

11. 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.

12. 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. During 2022 the underweight positions were addressed with approvals at the April, July and October ISC meetings as previously stated.

SAA 2023

13. A new 2023 SAA was approved at the January Local Pension Committee meeting. As such it makes sense to compare future deployment plans versus this. The new SAA is shown below.

Asset Group	Asset Class	Current SAA	Proposed SAA	Change
Growth	Listed equities	42.00% (40% - 44%)	37.50%	- 4.5%
Growth	Private equity	5.75%	7.50%	+ 1.75%
Growth	Targeted return	7.50%	5.00%	- 2.5%
Income	Infrastructure (incl. timber)	9.75%	12.50%	+ 2.75%
Income	Property	10.00%	10.00%	
Income	Emerging market debt	2.50%	0.00%	- 2.5%
Income	Global credit – liquid sub inv grade markets	4.00%	9.00%	+ 5%
Income	Global credit - private debt (inc M&G/CRC)	10.50%	10.50%	

Protection	Inflation-linked bonds	4.50%	4.50%	
Protection	Investment grade credit	3.00%	2.75%	-0.25%
Protection	Currency hedge	0.50%	0.75%	+0.25%
Protection	Cash / cash equivalent	0.00%	0.00%	

Current allocation versus SAA

14. Given this is the first update post the new 2023 SAA the table below compares the actual allocations to asset classes versus both the 2022 and 2023 SAA. The main changes as approved in January 2023 are highlighted in yellow.

	Actual Dec-22	Benchmark SAA 2022	Difference to 2022 SAA	Benchmark SAA 2023	Difference to 2023 SAA
Growth assets					
Listed equity	43.63%	42.0%	1.63%	37.5%	6.13%
Private Equity	8.24%	5.8%	2.49%	7.5%	0.74%
Targeted Return	7.90%	7.5%	0.40%	5.0%	2.90%
Income assets					
Infrastructure	9.50%	9.75%	-0.25%	12.5%	-3.00%
Global credit - private debt / CRC	7.36%	10.5%	-3.14%	10.5%	-3.14%
Property	7.55%	10.0%	-2.45%	10.0%	-2.45%
Global Credit - liquid MAC & EMD	5.73%	6.5%	-0.77%	9.0%	-3.27%
Protection					
Inflation linked bonds	4.35%	4.5%	-0.15%	4.5%	-0.15%
Investment grade (IG) credit	2.59%	2.5%	0.09%	2.5%	0.09%
Short dated IG credit	1.02%	0.50%	0.52%	0.25%	0.77%
Active currency hedge collateral	0.35%	0.50%	-0.15%	0.75%	-0.40%
Cash	1.74%	0.00%	1.74%	0.0%	1.74%

15. The Fund had made good in roads to closing the gaps to the 2022 SAA by the end of the year, with shortfalls in private debt and property underweight but having approvals and commitments in place to close those. The overweight positions mainly reside within the equity portion of the Fund which exist given there is no obvious underweights to address other than those awaiting capital calls from managers.

16. The Fund now has three primary areas to address during 2023 versus the 2023 SAA:

   a. Reducing the growth assets weighting, particularly within listed equity and targeted return. A paper is included on the agenda to start to address the listed equity and targeted return changes. It is important to note that these are significant changes and as such will be carefully considered, and it is likely they will not have been fully completed by the end of the current financial year.

   b. Addressing the increase in infrastructure allocation. The increase to 12.5% of total Fund assets was highlighted in advance by Hymans when they were proposing the 2022 SAA. As such the move to 12.5% has been planned by officers and a recommendation is included as part of this paper based on the work bought to ISC in July 2022 where a framework for controlling infrastructure was developed.

c. An increase to the global credit liquid credit and EMD (Emerging Market Debt) asset class from 6.5% to 9%. Officers are in discussions with LGPS Central (Central) and other partner funds regarding making changes to existing Central mandates before the Fund will consider making additional allocations.

17. The existing underweight to private debt of circa 3% will close during 2023 all else being equal due to calls from significant commitments made during 2022 to Central's low return, high return and real assets sleeves. At present there is c£300m left to call against the commitments made to those three products.

18. The underweight to property is awaiting details of transition of the legacy managers direct property portfolio before commitments are made to the Central direct property fund. Officers expect the first tranche of commitments to be made in the first half of 2023. The total approved amount to the Central Direct Property fund is £120 million which would close the underweight all other things being equal.

20. 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. For example, an investment into property since the second half of 2022 would have been at better valuations than the years prior.

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

Plans for 2023/24

24. The table below shows the expected changes the Fund is considering at this point in time in order to align to the SAA. Given that market value changes of asset classes throughout the year will affect the actual weightings considerably, these forecasts will change as the year progresses. Many of the approvals needed to close the underweight to the income asset group have been taken with an additional three recommended commitments included on this paper.

25. Included on the agenda are reports for equity and targeted return changes, the recommendations for which will address the overweight to the growth asset group which has arose as a result of the SAA review approved in January 2023.

	31/12/22 £m	2023 SAA	31/12/22 Actual weight %	Difference, actual to 2023 SAA	£m to target weight	Commitments approved	2023/24: other cashflow	Future ISC changes	Diff to target weight post changes £m	% diff to SAA
Growth										
Listed Equity - Active and Passive	2,420	37.50%	43.7%	6.2%	343		-40		303	5.5%
Targeted Return Funds	437	5.00%	7.9%	2.9%	160		-160		0	0.0%
Private Equity	456	7.50%	8.2%	0.7%	41	35	-45	25	56	1.0%
Income										
Infrastructure	526	12.50%	9.5%	-3.0%	-167	239	-20		52	0.9%
Global credit - private debt / CRC	407	10.50%	7.4%	-3.1%	-174	300	-55		71	1.3%
Property	418	10.00%	7.5%	-2.5%	-136	120			-16	-0.3%
Global Credit - liquid MAC	208	9.00%	3.8%	-5.2%	-291				-291	-5.2%
Emerging market debt	109	0.00%	2.0%	2.0%	109				109	2.0%
Protection										
Inflation linked bonds	241	4.50%	4.3%	-0.2%	-8				-8	-0.2%
Investment grade (IG) credit	143	2.50%	2.6%	0.1%	5				5	0.1%
Short dated IG credit	56	0.25%	1.0%	0.8%	42		-20		22	0.4%
Active currency hedge collateral	20	0.75%	0.4%	-0.4%	-22				-22	-0.4%
Cash	97	0.00%	1.7%	1.7%	97					

Effect on cash to March 2024

26. When including the effect of commitments already made and any that may be called during 2023/24, the Fund will expect to have a relatively low cash holding at the end of March 2024. If cash is needed in advance of the changes being implemented to the growth assets part of the portfolio, officers will assess the areas that are most overweight to the approved SAA. Any changes will be reported at the next Local Pension Committee meeting.

27. Additional commitments to the infrastructure asset class have been assumed with a conservative portion expected to be called in this financial year based on recommendations within this paper. In addition, existing commitments to infrastructure are included with a conservative estimate also. It is difficult to accurately predict private market capital calls, so an element of judgement is applied.

28. The other main assumption is regarding private debt commitment capital calls. Officers have assumed £150m of private debt commitments will be called prior to April 2024. The Fund has existing uncalled commitments totalling c£300m (at April 2023) with Central private debt products (Low Return £171m, high return £49m, real assets £87m) for which a prudent call estimate has been included.

29. The table below illustrates the major changes through to the end of March 2024.

	£m	Description
6th April 2023 cash position	**74**	Excludes cash held as collateral for currency hedge and cash held by managers for reinvestment
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	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£35m in collateral. This is 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 from current position
Non investment cashflow	55	Employer and employee contributions exceed the benefit payments made. Only moves gradually compared to the previous year.
Reduction to listed equity & short dated IG bonds	60	Is overweight to SAA (37.5% target) by c340m, some of this will be divested as needed by capital calls that have been made
Targeted return reduction to 5% of all assets	160	Reducing the overweight in line with SAA when targeted return review is complete
Commitments drawn	-422	Represents existing commitments made forecast to be drawn to next March year end
Expected capital distribution	117	Forecast distributions expected from holdings
Forecast closing cash position 31st March 2024	**69**	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.

Change in cash to year end	-5	

30. Officers expect closing cash to be of a similar level to the opening position at the start of the next financial year. Any large movements in the cash generated or lost by the hedge managed by Aegon will have an impact on the overall ending position.

Infrastructure underweight proposals

31. At the January 2023 Local Pension Committee, an increase to the infrastructure allocation was approved to 12.5% of total fund assets. Using the latest available valuations for the infrastructure managers resulted in a c£130m underweight. The proposal is to commit £100m at this stage and then reassess later in 2023/24 to make a further investment if needed. The Fund has 8 infrastructure managers, 6 of which are open for new investment.

32. The actual commitments to managers for the £100m are calculated by referring to the infrastructure review taken to the ISC in July 2022, where a framework covering risk targets and geographic targets was presented. Officers have used the targets for risk and geographical allocation to recommend the three commitments. Existing commitment forecasts and capital returns have been considered.

33. Officers contacted managers to confirm plans on capital calls, where the funds will be investing (geographical) and what proportion will be within each risk class. The

framework targets are shown below. Hymans were contacted to review the rationale and proposed commitments.

34. Hymans stated the proposals are suitable and confirmed no changes to their ratings for the proposed managers.

	Allocation range
By risk	70-90% core / core plus infrastructure 10-30% value add and opportunistic infrastructure
By geography	10-30% UK 60-80% developed overseas 0-10% advanced emerging markets

35. To attain the allocation per the framework three commitments are proposed to existing managers. The estimated outcomes from these three investments in adhering to the framework limits is shown below.

    a. LGPS Central Core/core+ fund - £35m additional commitment

    b. JPM Infrastructure investment fund (IIF) - £20m additional commitment (this will be committed in USD which is the base currency for the fund)

    c. Quinbrook Net Zero Power Fund - £45m additional commitment (this will be committed in USD which is the base currency for the fund)

	By Risk		**By Geography**		
	Core / core+	**Value add / opp**	**UK**	**Developed overseas**	**Advanced emerging**
Middle of Hymans target	80%	20%	20%	70%	5%
Forecast allocation by September 2024	82%	18%	14%	75%	11%
Difference	2%	-2%	-6%	5%	6%

36. These three commitments add positively to the Fund's net zero ambitions and improved UK investments via the LGPS Central fund, which has the highest forecast UK allocation from the existing managers the Fund can invest with.

37. The forecast allocations by September 2024 as shown above are in line with the ranges as proposed by Hymans other than a slight overweight (1%) to advanced emerging economy exposure (upper limit 10%). Some of this exposure comes from the existing investment being made to the Quinbrook net zero power fund whose advanced emerging allocation is derived from Australian investments. The largest advanced emerging exposure comes from the IFM global infrastructure fund which estimates a 19% exposure which is one of the reasons there is no advanced emerging markets allocation to IFM.

Recommendation

38. It is recommended that the Investment Sub-Committee approves:

    a. An additional £35m commitment to the LGPS Central Core / core plus infrastructure fund bringing the total commitment to £135m

    b. A $24m commitment to the JPM IIF fund

    c. A $54m commitment to the Quinbrook Net Zero Power Fund split equally between the main fund and co-investment fund

Supplementary Information

39. None

Equality and Human Rights Implications

40. The cash update and infrastructure top up is a high-level document and there are no direct Equality and Human Rights implications. The Fund considers issues around Equality and Human Rights as part of responsible investment which incorporates environmental, social and governance factors in all investment decisions. The Fund will not appoint any manager unless they can show evidence that responsible investment considerations are an integral part of their decision-making processes. This is further supported by the Fund's approach to stewardship and voting through voting, and its approach to engagement in support of a fair and just transition to net zero.

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