Investing in Leicestershire Programme – review of investment strategy

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Aim and scope of review

Aim of the review was to undertake a high-level review of the investment strategy for the Investing in Leicestershire Programme (“IiLP”) taking into account:

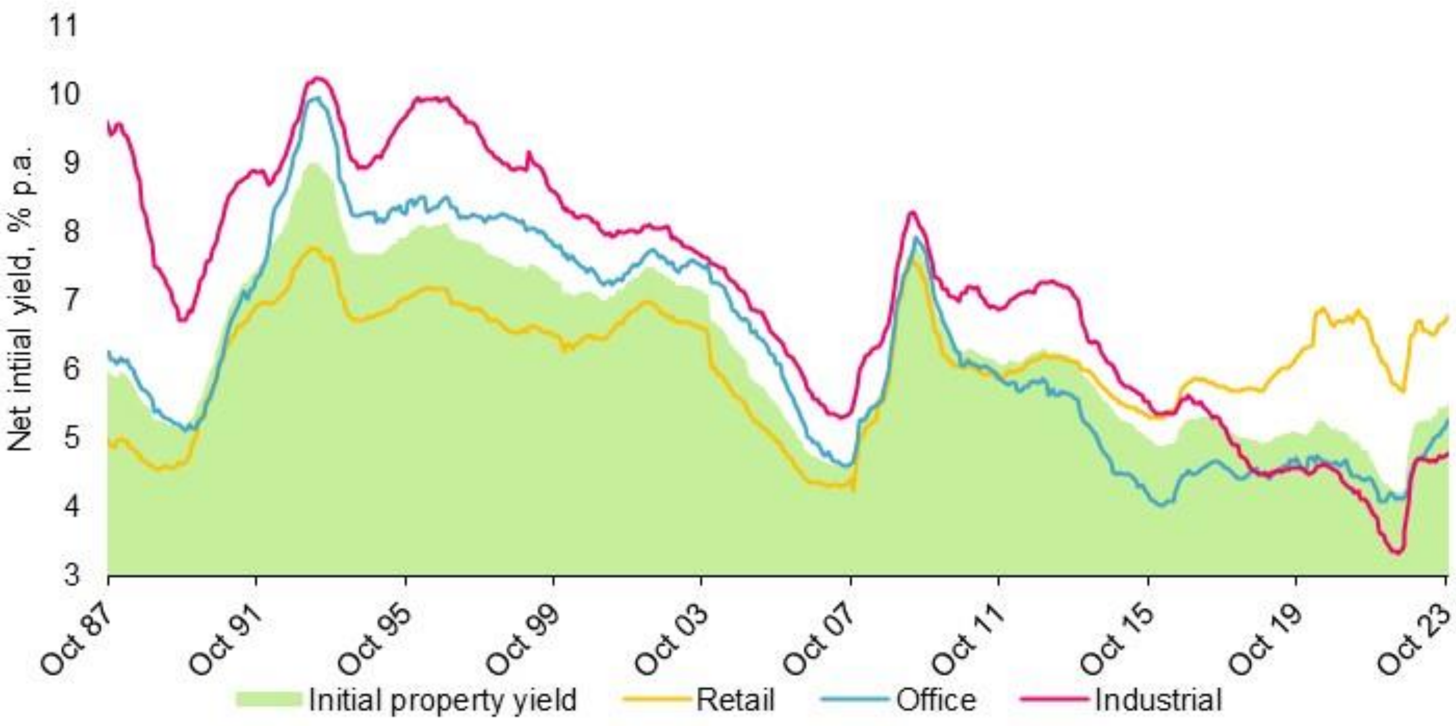
- Investment objectives of IiLP in the context of LCC’s objectives, strategy and policies
- Applicable regulations including the CIPFA Prudential Code and PWLB Lending Criteria, both revised since the last strategy review
- Recent developments in relevant asset markets
- Climate change and the transition to a low-carbon economy
- Composition and performance of the current portfolio
- High-level implementation considerations

Agenda

- Property market update
- Key conclusions
- Recommended changes to the structure of the IiLP portfolio

Property market update

- Sharp correction in UK property yields (=rental income/capital value) across all sectors, 2H22 – see chart below
- Offices remain expensive given current headwinds and historical experience
- Industrial/logistics and retail assets appear now to offer better value



Source: MSCI, March 2023

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Current portfolio

Asset Class	Value at 31-Mar-23 (£m)	% of Total Fund	Net Income Return (1 Year)	Capital Return (1 Year)	Net Income Return (3 Y p.a.)*	Capital Return (3 Year p.a.)**
Offices	£53.1m	22.7%	5.9%	-7.6%	4.7%	0.8%
Industrials	£29.3m	12.6%	4.7%	8.1%	4.8%	6.7%
Distribution	£0.6m	0.3%	-	-	-	-
Rural	£24.2m	10.4%	-0.1%	25.8%	-1.7%	16.1%
Other	£4.6m	2.0%	5.3%	-2.4%	4.9%	2.2%
Direct Portfolio (exc. Dev.)	£111.8m	47.9%	4.2%	2.5%	3.7%	5.3%
Development	£46.2m	19.8%	-0.5%	25.2%	-0.4%	9.0%
Direct Portfolio (inc. Dev.)	£158.0m	67.7%	3.0%	9.1%	2.7%	6.7%
Property	£22.5m	9.6%	3.4%	-19.8%	3.4%	-3.3%
Private Debt	£28.7m	12.3%	0.9%	4.4%	4.8%	0.7%
Infrastructure	£8.7m	3.7%	n/a	n/a	n/a	n/a
Bank Risk Transfer	£15.5m	6.7%	n/a	n/a	n/a	n/a
Diversifying Portfolio (Pooled funds)	£75.4m	32.3%				
Total	£233.4m	100.0%				

* based on geometric average of annual returns, assuming a steady capital value
** based on geometric average of annual returns, assuming income re-invested

Key conclusions

- Objectives, target return and high-level strategy remain appropriate given IiLP’s aims
- Overall portfolio composition remains suitable, notably the direct property:diversifers mix (68%:32%) and the level of commitments to development (29% direct portfolio)
- Exposure to certain diversifiers will fall as capital is returned to investors
    - Lothbury Property Trust is being liquidated, although UBS has proposed a merger with its Triton Balanced Property Fund
    - Partners Group Multi-Asset Credit funds and CRC Capital Relief Fund V are closed-end funds and capital will be returned to investors as underlying investments are realised
- Pooled property, infrastructure and private debt are still considered to be good diversifiers, but we understand no further commitments can be made to the first two under revised PWLB lending criteria
- Performance of the direct property portfolio has been strong in difficult market conditions
- Performance of the diversifying portfolio has been mixed
- Portfolio is projected to deliver the target return over the long-term

Recommendations – portfolio composition

Asset Class	Current allocation (%)	Strategic Recommendation
Offices	22.7%	Maintain or reduce
Industrials	12.6%	Increase
Distribution	0.3%	Increase
Retail	0.0%	Selectively invest
Rural	10.4%	Maintain
Other	2.0%	Cap Residential at 15% of direct portfolio Increase other Alternatives
Direct Portfolio (exc. Dev.)	47.9%	
Development	19.8%	Maintain
Direct Portfolio (inc. Dev.)	67.7%	
Property	9.6%	Maintain above 25% of diversifiers portfolio, if possible
Private Debt (incl Bank Risk Transfer)	19.0%	Increase and diversify; allow Bank Risk Transfer exposure to reduce
Infrastructure	3.7%	Maintain at 10-15% of diversifiers portfolio
Diversifiers Portfolio (Pooled Funds)	32.3%	
Total	**100.0%**	

Other recommendations

Direct property portfolio

- Set ranges/limits on exposure to individual assets, tenants, sectors, asset classes etc
- Explore opportunities to dispose of selected properties
- Consider local Infrastructure and Corporate Lending opportunities, in partnership with specialist managers
- Consider putting in place systems to track the economic and social impacts achieved by portfolio investments and consider setting targets
- Regularly review the refurbishment plans and associated capex requirements, particularly in the prospective environmental regulations

Diversifiers portfolio

- Undertake due diligence on the combined Lothbury and UBS Triton investment proposition and merger terms
- Consider opportunities to diversify the Private Debt exposure including Real Asset-backed Senior Debt, Trade Finance and Short-dated, Listed Credit
- Add a second Corporate Lending manager in order to diversify manager risk

Overall portfolio

- Undertake further work to identify what additional actions need to be taken to deliver LCC’s Net Zero objective

Reliances, limitations and risk warning

Reliances and limitations

- IiLP's asset allocation and performance as at 30 March 2023 has been sourced from the programme's annual reports.

- In this report we have provided our estimate of expected asset class returns. The expected returns are based upon 20-year median returns derived from our proprietary economic scenario generator (ESS) asset model. As with all modelling, the results are dependent on the model itself, the calibration of the model and the various approximations and estimations used. These processes involve an element of subjectivity. This model uses probability distributions to project a range of possible outcomes for the future behaviour of asset returns and economic variables. Some of the parameters of the model are dependent on the current state of the financial markets and are updated to reflect metrics that can be measured in markets, such as yields, while other more subjective parameters do not change with different calibrations of the model.

Risk warning

- Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investments in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.

Thank you