Leicestershire County Council

INVESTMENT SUB-COMMITTEE – 1 MAY 2024

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

CASH POSITION 31 MARCH 2023 AND DEPLOYMENT AGAINST THE STRATEGIC ASSET ALLOCATION

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).

Background

2. Hymans Robertson, the Fund's investment advisor, completed the 2024 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 26 January 2024.

3. Cash balances are reported to the Local Pension Committee alongside Fund investment values by investment managers each quarter. At the last update presented to the Local Pension Committee (8 March 2024), the cash balances as at 31 December 2023 totalled £421m with an additional £48m with the Fund's currency hedging manager, Aegon asset management (Aegon) which acts as collateral for the Fund's currency hedge. As at 31st March 2024 cash balances stood at £328m. Although numerous investments and redemptions have occurred during the quarter the Fund commenced the investment into the LGPS Central multi asset credit (MAC) fund which involved investing £120m into this product.

4. The Fund does not have a specific cash allocation as part of the SAA other than to set a limit of 0.75% of total Fund assets to reflect the cash held at Aegon to act as collateral for the currency hedge.

5. As a result of making changes to lower equity holdings towards the 37.5% of total Fund assets, as approved at the January 2023 Local Pension Committee meeting, the Fund has held higher levels of cash and as such a Cash Management Strategy (CMS) for the fund was approved at the meeting of the ISC on 11 October 2023.

Cash Management Strategy (CMS) update

6. The CMS contains a number of allowable investment products, together with maximum terms and maximum sums that can be invested either into a single product or investment class, for example, money market funds.

7. Given the level of cash held within the Fund, officers made applications to three money markets funds (MMF) during the remainder of 2023/24 in order to comply with the new CMS which allows up to £250m to be invested within MMFs with no more than £50m in a single MMF. As at 31 March 2024 the Fund has access to four MMFs into which £118m was invested at the year end.

8. The Fund also utilises other allowable investments within the CMS. These include term deposits with rated institutions and certificates of deposit with credit rated institutions. The CMS allows for investments with maturities of up to one year for both. As at the year end the Fund had a combined £210m invested in fixed term deposits and certificates of deposit, with maturities (from the investment date) ranging from three months to nine months.

9. Officers meet regularly to discuss the known calls on cash from commitments made by the Fund and decide how much of the overall cash balance to invest into fixed term products and how much next day liquidity to maintain within MMFs.

10. At the financial year end (31 March 2024) the Fund is in adherence with the CMS. The CMS is included below for reference.

Investment	**Level of security**	**Maximum period**	**Maximum sum invested**
Money Market Funds: Low Volatility and constant NAV(2) Triple A rated fund	At least as high as acceptable credit rated banks	Same day redemptions and subscriptions	£250m (max £50m in each MMF) Minimum use of two MMFs(1) with each MMF having a minimum size of £3bn GBP
Term deposits with credit-rated institutions with maturities up to 1 year (including both ring-fenced and non ring-fenced banks)	Varied acceptable credit ratings, but high security	1 year	£250m(2)
Term deposits with overseas banks domiciled within a single country	Varied acceptable credit ratings, but high security	1 year	£100m(3)
Certificates of Deposit with credit rated institutions with maturities of up to 1 year	Varied acceptable credit ratings, but high security	1 year	£250m
Term deposits with the Debt Management Office	UK Government backed	1 year	£500m
UK Government Treasury Bills	UK Government backed	1 year – held to maturity	£500m

Term Deposits with UK Local Authorities up to 1 year	LA's do not have credit ratings, but high security	1 year	£50m

[1] Limits can be extended higher temporarily by the Director of Corporate Resources and will need to be reported to the next meeting of the Local Pension Committee.

[2]Funds will be invested in constant or low volatility NAV MMFs. Constant NAV MMFs where the capital value of a unit will always be maintained at £1. These funds have to maintain at least 99.5% of their assets in government backed assets. Low volatility NAV MMFs are those where the MMFs are permitted to maintain the unit price at £1 as long as the net asset value does not deviate by more than 0.20% from this level.

[3]Limits per counterparty as advised by the treasury advisor will be used up to a total for all term deposits of £350m

11. For completeness, the management of excess cash is not an Investment Sub-Committee decision and as such pension fund cash will be managed by officers in line with the CMS.

Cash holdings as at 31 March 2024

12. The Fund, as of 31 March 2024 held a total of £328m in cash. In addition, the Fund held £50m as collateral with Aegon for the active currency hedge mandate. Cash is forecast to reduce over the course of the calendar year and is currently expected to be around £250m at the end of December 2024

13. 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 Fund's cash balance grows without regular reinvestment to realign to the SAA.

14. With interest rates elevated in comparison to the period from 2009 to 2022 the Fund has been receiving interest payments on average in excess of 5% during the 2023/24 financial year. At the time of writing (15 April 2024) the weighted average interest rate on fixed term deposits is 5.25%. Rates on the four money market funds range between 5.1% and 5.3%.

15. The Fund has held a higher amount of cash during the past two years 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 within the illiquid investments, property, infrastructure and private credit where managers call on cash as they make investments.

16. The level of commitments made to underweight asset classes is discussed later within this paper.

SAA 2024

17. The Local Pension Committee at its meeting in January agreed that the SAA approved in January 2023 remained fit for purpose. The 2024 SAA is shown below with changes from the 2022 SAA shown in the final column of the table below. It

was noted that there were a number of changes in progress from the 2022 to 2023 SAA and it would take the remainder of 2024 to complete these changes.

Asset Group	Asset Class	2022 SAA	2023 & 2024 SAA	Change from 2022 SAA
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 investment 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 (31 December 2023) versus 2024 SAA

18. The main changes as approved by the Local Pension Committee in January 2023 were:
    a. a reduction to listed equity,
    b. an increase to infrastructure
    c. and an increase to liquid global credit.

As stated previously these changes are in progress but will take the remainder of 2024 to complete fully. The table below shows the 31 December 2023 actual position versus the current 2024 SAA and the overweight or underweight position for each asset class. The main changes over the quarter to 31 March 2024 include investments of £120m into the LGPS MAC fund

Growth	31/12/23 £m	2024 SAA	31/12/23 Actual weight %	Difference, actual to 2024 SAA	£m to target weight
Listed Equity - Active and Passive	2,480	37.50%	40.7%	3.2%	197
Targeted Return Funds	313	5.00%	5.1%	0.1%	9
Private Equity	422	7.50%	6.9%	-0.6%	-35

Income	31/12/23 £m	2024 SAA	31/12/23 Actual weight %	Difference, actual to 2024 SAA	£m to target weight
Infrastructure	654	12.50%	10.7%	-1.8%	-107
Global credit - private debt / CRC	513	10.50%	8.4%	-2.1%	-126
Property	431	10.00%	7.1%	-2.9%	-177
Global Credit - liquid MAC	226	9.00%	3.7%	-5.3%	-322
Emerging market debt	121	0.00%	2.0%	2.0%	121

Protection	31/12/23 £m	2024 SAA	31/12/23 Actual weight %	Difference, actual to 2024 SAA	£m to target weight
Inflation linked bonds	240	3.50%	3.9%	0.4%	27
Investment grade (IG) credit	158	3.50%	2.6%	-0.9%	-55
Short dated IG credit	60	0.25%	1.0%	0.7%	45
Active currency hedge collateral	48	0.75%	0.8%	0.0%	3

Cash	421	0.00%	6.9%	6.9%	421

19. The plans to align to the target SAA is best described below:

Listed equity: The Fund is overweight to this asset class, a number of changes are planned to complete during 2024:

a. Divestment from the LGPS Central active emerging equity fund:
b. Investment into the LPGS Central active global equity fund: and
c. Divestment from the Legal and General all world equity fund.

The net effect of these changes will be a reduction to the 37.5% target weight for listed equity and a net return of cash to the Fund, which based on the 31 December 2023 valuation point would add c£200m to cash balances.

Infrastructure: the Fund is underweight by around £100m but has (at the time of writing) c£170m in uncalled commitments. The apparent over commitment should be considered in light of existing closed ended infrastructure funds that will be gradually returning money.

Global credit private debt: the Fund is underweight by c£130m but like infrastructure has (at the time of writing) around £210m in uncalled commitments. The apparent over commitment is also explained by the forecasted return of capital from existing investments.

Property: the Fund is underweight by around £175m. This is due to the poorer performance of the property market in general when compared to other assets classes and the existing underweight the Fund had whilst awaiting the LGPS direct property fund to be setup. The underweight will have been reduced by around £20m since 31 December owing to an investment made to the LGPS Central direct property fund. In addition, the Fund has £50m of uncalled commitments and is in the process of making an additional commitment to the LaSalle property fund.

Global Credit Liquid multi asset credit (MAC): the Fund is underweight to this asset class by around £320m. The Fund was awaiting the FCA (financial conduct authority) approval for a change to the MAC mandate which allowed changes to the underlying investment class limits the MAC managers could invest in. This was received by LGPS Central in early 2024 and the Fund has been gradually closing the underweight position. Two separate investments have been made so far in 2024 totalling 120m. Planned investments at regular intervals through 2024 are planned to take the Fund to the target 9% of total Fund assets.

Emerging market debt (EMD): the Fund is overweight to this asset class by £120m. At the January 2023 meeting of the Local Pension Committee it was approved to reduce the weighting to this asset class to nil. The exposure to EMD would be derived from the MAC product which was planning to increase its allowable investment into EMD. Now that this change to the MAC mandate has been approved by the FCA it is planned to reduce the EMD exposure to nil whilst scaling into the MAC investment. At the time of writing the half the exposure has been redeemed in cash with the other half planned for later in 2024.

In summary, the underweight exists within the income asset group where it will take over a year to fully align to the SAA whilst outstanding commitments made a called by the managers of the funds.

Outstanding calls

20. At the time of writing there is over £0.6billion in outstanding calls to managers which will need to be satisfied over the coming years. Much of the uncalled amount is to products managed by LGPS Central with c£380m awaiting to be called by various LGPS Central investment products.

Forecast cash holdings at year end 24/25

21. The effect of gradual calls from the commitments made, changes planned through the year as described at paragraph 19, and return of capital from existing closed ended investments means that cash is expected to reduce from the current £328m (31 March 2024) to c£220m at 31st March 2025.

Private Credit investment approval update

22. The Fund has two outstanding private credit approvals made at the July 2023 meeting of the Investment Sub-Committee to:

a. Commit to invest £180m to the LGPS Central low return sleeve
b. Commit to invest £100m to the LGPS Central real assets sleeve

Both of these approvals are on hold at present whilst LGPS Central replace a key member of staff who sadly passed away earlier this year.

LGPS Central and officers are in regular contact with developments to raise the two new funds and make a key appointment. If officers are not satisfied on the progress, alternative options for investing will be investigated with the Fund's investment consultant Hymans Robertson.

Recommendation

23. The Sub-Committee is asked to note the report.

Supplementary Information

24. None

Equality Implications

25. There are no direct equalities implications arising from the recommendations in this report. The Fund incorporates financially material Environmental, Social and Governance ("ESG") factors into investment processes. This has relevance both before and after the investment decision and is a core part of the Fund's fiduciary duty. 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. There are no changes to this approach as a result of this paper.

Human Rights Implications

26. There are no human rights implications arising from this report.

Background Papers

20 January 2023 Local Pension Committee, Annual Review of the Asset Strategy and Structure – https://politics.leics.gov.uk/ieListDocuments.aspx?CId=740&MId=7201&Ver=4

26 January 2024 Local Pension Committee, Overview of the current asset strategy and proposed 2024 asset strategy – https://democracy.leics.gov.uk/documents/s180890/SAA%20Jan%202024%20public%20copy.pdf

11 October 2023 Investment Sub Committee, Cash forecast to year end 23/24 and Cash management Strategy – https://democracy.leics.gov.uk/documents/s179003/Cash%20update%20and%20cash%20mgt%20strategy.pdf

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