Leicestershire County Council

INVESTMENT SUB-COMMITTEE – 24 JULY 2024

REPORT OF THE DIRECTOR OF CORPORATE RESOURCES

CASH POSITION 31 MARCH 2024, DEPLOYMENT AGAINST THE STRATEGIC ASSET ALLOCATION, PROPOSED PRIVATE EQUITY COMMITMENTS

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. The report also provides information regarding a proposed commitment to private equity in order to maintain alignment to the SAA.

Background

3. 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.

4. 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 (19 June 2024), the cash balances as at 31 March 2024 totalled £386m with an additional £51m with the Fund's currency hedging manager, Aegon asset management (Aegon) which acts as collateral for the Fund's currency hedge.

5. 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.

6. As a result of making changes to lower listed 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.

7. Private equity is an illiquid asset class, with investors required to commit capital for ten years or more. The commitments made to a fund of funds (FoF) PE manager are called by the underlying managers that the Adams Street Partners (ASP) team commit to. ASP's global funds programme is an annual vintage which the Leicestershire Fund has committed to ten times with a total commitment of $591m.

8. The Fund last invested into an ASP global fund in 2023 totalling $49million. One other recent investment was made in 2022 to the ASP global secondary fund 7 for $38million, which invests in a smaller niche area of PE called secondary investments.

9. The LGPS Central PE vintages are similar in nature investing with PE managers, with each new vintage currently planned to launch every 18-24 months. The Fund has previously committed to the 2018, 2021 and 2023 programmes. The total amount committed to the three Central vintages totals £80million.

10. The majority of the Fund's PE exposure comes from ASP £377million. The £80million committed to Central is still in the process of being invested and as such currently totals £12m. The Fund also has a smaller exposure to PE from a legacy manager totalling £24million at the latest valuation date. This will reduce over time as capital is returned to the Fund.

11. At the 11 October 2023 meeting of the ISC it was recommended that the Fund commit £80m into private equity products with Adams Street Partners and LGPS Central with the exact split to be confirmed closer to the time in accordance with the private equity allocation framework agreed.

Cash holdings as at 31 March 2024

12. The Fund, as of 31 March 2024 held a total of £386m in cash. In addition, the Fund held £51m as collateral with Aegon for the active currency hedge mandate. Cash is forecast to reduce over the course of the calendar year and assuming ISC approvals through the calendar year are approved, officers forecast cash to reduce to c£225m 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 and so far into the 2024/25 financial year. At the time of writing (2 July 2024) the weighted average interest rate on fixed term deposits is 5.24% on a weighted average maturity of around 3 months. Rates on the four money market funds range between 5.1% and 5.2%.

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. This paper recommends adding to existing commitments in order to facilitate closing the underweight positions in a controlled manner.

SAA 2024

16. A recap of the current SAA is included below. The Local Pension Committee at its meeting in January agreed that the SAA approved in January 2023 remained fit for purpose in 2024 and this was approved at the meeting of the Local Pension Committee on 26 January 2024. 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 March 2024) versus 2024 SAA

17. The main changes as approved by the Local Pension Committee in January 2023 and carried forward to 2024 were:

    a. a reduction to listed equity,
    b. and an increase to liquid global credit.

    Both changes at the time of writing are in their final stages of being completed.

Listed equity update

18. On 11 October 2023 the ISC received an update on the listed equity transition which it approved in April 2023.This summarised:

    a. The decision taken to re organise the listed equity holdings and reduce the total Fund weight to 37.5%;
    b. The appointment of a transition advisor; and
    c. Described a four-phase plan to reorganise and reduce the listed equity weight to 37.5% of total Fund assets.

19. Phase one of this plan was completed in September 2023 and £220million was received by the Fund when the LGPS Central climate multi-factor fund holding was reduced to the target weight of 12% of total Fund assets.

20. Phase two, which was the reorganisation of the LGIM passive holdings, was completed in mid-November 2023 which collapsed the LGIM geographic holdings

and single stock holdings into just three funds, a UK passive index fund, an all world passive fund and a low carbon transition (LCT) fund.

21. Phase three will have been concluded by the end of July 2024 as the Fund will have added £120m to the LGPS Central global equity fund (target weight of 12% of total Fund assets) and divested in full (around £185m) from the LGPS Central global emerging markets fund.

22. The final phase is a controlled reduction over time from the LGIM all world equity fund which would then bring the Fund's listed equity weighting to 37.5% of total assets. It is planned that this final phase will be completed gradually over 2024/25.

Liquid global credit update

23. The increase to this asset class refers to the decision to add to an existing LGPS Central product, multi asset credit and take the Fund to the target weight of 9% of total Fund assets.

24. At the time of writing, three more investments will be made to this product in roughly equal value with three already having taken place in 2024 when the Fund invested a total of £175m.

Overall allocations versus target

25. The table below illustrates a similar story to the previous updates. The Fund is currently overweight growth assets and cash and underweight income assets. Considerable commitments have been made to address this which will take many quarters to be called. In the meantime the Fund will be underweight income assets and overweight cash and growth assets. The proposed commitments to infrastructure that are to be presented later on today's agenda are not included on the tables below.

	31/3/24 £m	2024 SAA	31/3/24 Actual weight %	Difference, actual to 2024 SAA	£m to SAA weight	Commitments / investments approved	2024/25: other cashflow / divests	Diff to target weight post changes £m	% diff to SAA
Growth	3,410	50.0%	53.7%	3.7%	232	173	-388	18	-0.3%
Income	2,054	42.0%	32.3%	-9.7%	-616	619	-172	-169	2.7%
Protection *	506	8.0%	8.0%	0.0%	-2	0	-1	-3	0.1%
Cash	386	0.0%	6.1%	6.1%	386				
	6,355	**100.0%**	**100.0%**						

Growth	31/3/24 £m	2024 SAA	31/3/24 Actual weight %	Difference, actual to 2024 SAA	£m to target weight	Commitments / investments approved	2024/25: other cashflow / divests	Diff to target weight post changes £m	% diff to SAA
Listed Equity - Active and Passive	2,697	37.50%	42.4%	4.9%	314		-328	-14	-0.2%
Targeted Return Funds	299	5.00%	4.7%	-0.3%	-18			-18	-0.3%
Private Equity	414	7.50%	6.5%	-1.0%	-63	173	-60	51	0.8%

Income	31/3/24 £m	2024 SAA	31/3/24 Actual weight %	Difference, actual to 2024 SAA	£m to target weight	Commitments / investments approved	2024/25: other cashflow / divests	Diff to target weight post changes £m	% diff to SAA
Infrastructure	666	12.50%	10.5%	-2.0%	-129	140	-20	-9	-0.1%
Global credit - private debt / CRC	525	10.50%	8.3%	-2.2%	-142	200	-85	-27	-0.4%
Property	452	10.00%	7.1%	-2.9%	-184	99	-4	-89	-1.4%
Global Credit - liquid MAC	348	9.00%	5.5%	-3.5%	-224	180		-44	-0.7%
Emerging market debt	63	0.00%	1.0%	1.0%	63		-63	0	0.0%

Protection	31/3/24 £m	2024 SAA	31/3/24 Actual weight %	Difference, actual to 2024 SAA	£m to target weight	Commitments / investments approved	2024/25: other cashflow / divests	Diff to target weight post changes £m	% diff to SAA
Inflation linked bonds	235	3.50%	3.70%	0.2%	13		-16	-3	-0.1%
Investment grade (IG) credit	159	3.50%	2.50%	-1.0%	-63		60	-3	-0.1%
Short dated IG credit	60	0.25%	0.95%	0.7%	44		-45	-1	0.0%
Active currency hedge collateral	51	0.75%	0.81%	0.1%	4			4	0.1%

Cash	386	0.00%	6.1%	6.1%	386				

26. Infrastructure: the Fund is underweight by around £130m but has at 31 March 2024 c£140m in uncalled commitments but with additional commitments proposed as part of the recommendations contained within today's agenda on a separate exempt paper. Any commitment made can take a significant amount of time to be called depending on the manager and strategy employed by the underlying fund and as such assessing future cashflows in from existing investments is important when making commitments.

27. Global credit private debt: the Fund is underweight by c£140m but like infrastructure has around £200m in uncalled commitments. In addition, the Fund has approval to commit a further £280m over two separate LGPS Central products once the relevant products are launched. These two products were delayed whilst a key post was filled by LGPS Central. The £280m is not included as yet on the table above given no formal commitment has been made by the Fund.

28. Property: the Fund is underweight by around £180m. 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. It would seem conceivable that if interest rates were to fall then property may exhibit a larger rebound than other asset classes. The Fund has c£100m of uncalled commitments. Whilst this still leaves the class underweight any increases in value of property assets ahead of other asset classes would close this gap. At present the Fund is mindful of making additional commitments to the two open products (LGPS Central's Direct property fund and LaSalle's property fund) which could close the gap.

Proposed top up investments to private equity

29. As previously mentioned within this paper an £80m recommendation was approved at the ISC meeting on the 11 October 2023 with a split between Adams Street global funds programme and LGPS Central PE vintage 2023 to be decided based

on the geography, lifestyle origination channel framework as agreed at the meeting and described below.

30. The framework, current and target allocations are shown below. Given the short amount of time between October 2023 and new valuations from the Fund's largest private equity manager being available as at 31 December 2023, an update versus target allocations would show minimal changes and as such an identical split to last year is proposed in order to meet the framework allocation shown below alongside target allocation ranges for the two proposed funds. A further review will be commissioned as part of the work for 2025 when future years commitments will need to be planned for 2025 and 2026.

	Segment	**Target allocation %**	**Allocation reported in October 2023 %**	**LGPS Central PE 2023 target allocation %**	**ASP 2024 vintage target allocation % ***
Geography	North America	30-60	71	30-50	30-60
	Europe	20-40	18	30-50	20-40
	Asia Pacific	10-30	10	10-39	10-30
	Emerging Markets	0-10	1	n/a	0-10
Lifestage	Venture	10-30	37	0	10-30
	Growth	10-30	4	30-50	10-30
	Buy out	40-70	58	40-80	40-70
	Special Situations	0-10	1	0	0-10
Origination	Primary Funds	40-60	68	100	50-70
	Secondaries	10-30	16	0	10-30
	Co invs	15-25	17	0	15-25

*the global funds programme can invest up to 10% each into private credit and direct growth equity. To date, the Funds ASP allocation to both these areas is a combined 8% as at 31 December 2023.

31. The proposed allocation of £80m, split 50% to LGPS Central's 2023 vintage and 50% to ASP global funds vintage together with distributions from older PE vintages (estimated at £95m pa for the next 3 years) together with newer commitments made to the ASP programmes and LGPS Central vintages should help realign the minor imbalances to the framework above.

32. The Fund will need to make further commitments to PE in 2025 and 2026 given the nature of the PE exposure the Fund has currently where distributions are currently forecast to be higher than calls. Over time the Fund would target a position where distributions and calls would be of a similar size and, therefore, would help attain a target weight to PE. In practice achieving the aim of similar sized commitments each year is made harder by a number of factors, including performance of the PE market versus the general market (which will affect the weighting of PE within the Fund), the receptiveness of the market to bring private companies to the public markets and the ability of underlying PE fund managers to find opportunities to invest into.

33. The Fund does have the option to invest into either the Adams Street Partners Global Funds 2024 vintage which will hold its final close in September or invest into

the same managers 2025 vintage which opens soon after with the first close planned for December 2024. Both vintages follow the same strategy.

34. The Fund has consulted with the investment advisor and given the current underweight to the target SAA of 7.5% it would seem appropriate to invest the additional proposed amount to the current 2024 vintage.

Recommendation

35. It is recommended that the Investment Subcommittee approves:

a. An additional £40m GBP commitment to the LGPS Central Private Equity 2023 vintage;

b. A $50m (£40m at a 1.25£/$ exchange rate) USD commitment to the Adams Street Partners global funds 2024.

Supplementary Information

36. None

Equality Implications

37. 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

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

Background Papers

Local Pension Committee 26 January 2024, Overview of the Current Asset Strategy and Proposed 2024 Asset Strategy (Agenda item 6)
https://democracy.leics.gov.uk/ieListDocuments.aspx?CId=740&MId=7538&Ver=4

Officers to Contact

Mr D Keegan, Director of Corporate Resources
Tel: 0116 305 7668 Email: Declan.Keegan@leics.gov.uk

Simone Hines, Assistant Director Finance, Strategic Property and Commissioning
Tel: 0116 305 7066 Email: Simone.Hines@leics.gov.uk

Mr B Kachra, Senior Finance Analyst - Investments
Tel: 0116 305 1449 Email: Bhulesh.Kachra@leics.gov.uk

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