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Governance and Human Resources
Town Hall, Upper Street, London, N1 2UD

AGENDA FOR THE PENSIONS SUB COMMITTEE

Members of the Pensions Sub Committee are summoned to a meeting which will be held in Committee Room 4, Town Hall, Upper Street, N1 2UD on **11 April 2016 at 7.30 pm.**

John Lynch
Head of Democratic Services

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Despatched	:	1 April 2016

Membership 2015/16	Substitute Members
Councillor Richard Greening (Chair)	Councillor Alex Diner
Councillor Andy Hull	Councillor Jean Roger Kaseki
Councillor Michael O'Sullivan	Councillor Alice Perry
Councillor Rupert Perry	Councillor Paul Smith

Quorum is 2 members of the Sub-Committee

A.	**Formal Matters**	**Pages**
1.	Apologies for absence	
2.	Declaration of substitutes	
3.	Declaration of interests	

If you have a Disclosable Pecuniary Interest* in an item of business:
- if it is not yet on the council's register, you must declare both the existence and details of it at the start of the meeting or when it becomes apparent;
- you may choose to declare a Disclosable Pecuniary Interest that is already in the register in the interests of openness and transparency.

In both the above cases, you must leave the room without participating in discussion of the item.

If you have a personal interest in an item of business and you intend to speak or vote on the item you must declare both the existence and details of it at the start of the meeting or when it becomes apparent but you may participate in the discussion and vote on the item.

*(a) Employment, etc - Any employment, office, trade, profession or vocation carried on for profit or gain.
(b) Sponsorship - Any payment or other financial benefit in respect of your expenses in carrying out duties as a member, or of your election; including from a trade union.
(c) Contracts - Any current contract for goods, services or works, between you or your partner (or a body in which one of you has a beneficial interest) and the council.
(d) Land - Any beneficial interest in land which is within the council's area.
(e) Licences- Any licence to occupy land in the council's area for a month or longer.
(f) Corporate tenancies - Any tenancy between the council and a body in which you or your partner have a beneficial interest.
(g) Securities - Any beneficial interest in securities of a body which has a place of business or land in the council's area, if the total nominal value of the securities exceeds £25,000 or one hundredth of the total issued share capital of that body or of any one class of its issued share capital.

This applies to all members present at the meeting.

4.	Minutes of the previous meeting	1 - 4
B.	**Non-exempt items**	
1.	Pension Fund performance - 1 October to 31 December 2015	5 - 42
a.	(a) Quarterly WM Company performance report	
b.	(b) Presentation from AllenbridgeEPIC Investment Advisers on quarterly performance	43 - 60

2. London CIV update 61 - 64

3. Carbon risk management 65 - 76

4. Pension Fund Forward Plan 2016 77 - 80

C. Urgent non-exempt items

Any non-exempt items which the Chair agrees should be considered urgently by reason of special circumstances. The reasons for urgency will be agreed by the Chair and recorded in the minutes.

D. Exclusion of press and public

To consider whether, in view of the nature of the remaining items on the agenda, any of them are likely to involve the disclosure of exempt or confidential information within the terms of Schedule 12A of the Local Government Act 1972 and, if so, whether to exclude the press and public during discussion thereof.

E. Confidential/exempt items

1. The London CIV update - exempt appendix 81 - 92

F. Urgent exempt items

Any exempt items which the Chair agrees should be considered urgently by reason of special circumstances. The reasons for urgency will be agreed by the Chair and recorded in the minutes.

The next meeting of the Pensions Sub Committee will be on 13 June 2016

London Borough of Islington

Pensions Sub Committee - 9 November 2015

Non-confidential minutes of the meeting of the Pensions Sub Committee held at the Town Hall on 9 November 2015 at 7.30 pm.

Present:	**Councillors:**	Richard Greening (Chair), Andy Hull and Michael O'Sullivan
Also Present:		Maggie Elliott (observer) David Bennett (observer) Vaughan West (observer)
		Nick Sykes and and Nikeeta Kumar, Mercer Investment Consulting Karen Shackleton, AllenbridgeEpic Investment Advisers

Councillor Richard Greening in the Chair

The Chair apologised for the late circulation of the Performance report for this meeting.

He referred to the Chancellor's recent statement calling for the creation of six 'British wealth funds' of £30bn and Islington's Pensions Sub-Committee's decision to invest in the Common Investment Vehicle (CIV) in order to pool assets. Given the increasing importance of the CIV, he asked that regular updates on progress be submitted to the Sub-Committee. The Chair also requested that a report on the Markets in Financial Instruments Directive II be submitted to the Sub-Committee.

1 APOLOGIES FOR ABSENCE (Item 1)

Received from Councillor Rupert Perry.

2 DECLARATION OF SUBSTITUTES (Item 2)

Councillor Jean-Roger Kaseki substituted for Councillor Rupert Perry.

3 DECLARATION OF INTERESTS (Item 3)

None.

4 MINUTES OF THE MEETING HELD ON 14 SEPTEMBER 2015 (Item 4)

RESOLVED:

That the minutes of the meeting held on 14 September 2015 be confirmed as a correct record and the Chair be authorised to sign them.

5 PENSION FUND PERFORMANCE FROM JULY TO SEPTEMBER 2015 (Item B1)

The Chair apologised for the fact that the Performance report (agenda item B1) had not been available for circulation with the agenda and was still incomplete, as final figures for some managers were not yet available and therefore the total fund estimate could not be estimated by WM Company.

The Head of the Pension Fund and Treasury Management explained the reason in the delay in the figures from WM Company. Unfortunately a period of time after quarter end was required to generate manager reports and the timing of this Sub-Committee was too early in the cycle to have allowed sufficient time for this. In addition, WM Company had had to wait for the first full quarter figures from Schroders, the Fund's new Diversified Growth Fund manager, for inclusion in the total fund estimate.

Following discussion, it was agreed that the report in its current form, although incomplete, should be considered by the Sub-Committee. For the future, meetings of the Sub-Committee were to be arranged on a date which fell approximately six weeks after quarter end.

Given the lack of final financial information in the report, the Sub-Committee agreed that there were certain recommendations in the report of the Corporate Director of Finance and Resources that could not be approved at this meeting viz recommendations 2.1 and 2.3.

It was noted that the final total fund figures from WM Company would be circulated to members of the Sub-Committee and Board once they became available.

RESOLVED:
(a) That the report by AllenbridgeEpic Investment Advisers on fund managers' quarterly performance, detailed in Appendix 2 to the report of the Corporate Director of Finance and Resources, and their presentation be noted.
(b) That £150,000 be paid to the London Common Investment Vehicle to subscribe for 150,000 non-voting redeemable shares of £1 each in the capital of the Company and that the Shareholders' Agreement and Articles of Association detailed in Appendix 3 of the report be noted.
(c) That the information on investment management fees prepared by Mercers (Exempt appendix 4 to the report) be noted.

8 PRESENTATION - FRANKLIN TEMPLETON - GLOBAL PROPERTY (Item B2)

The Sub-Committee welcomed Chris Orr, Witsard Schaper and Marc Weidner, representing Franklin Templeton Investments, to the meeting. A presentation on Islington's Fund was circulated to members.

They updated the Sub-Committee on progress on Private Real Estate Fund I and Fund II. Fund I was fully committed and the results were good. Fund II had made three investments to date in Europe and no capital drawdowns had been requested.

On behalf of the Sub-Committee, the Chair thanked the representatives from Franklin Templeton for their presentation and for the performance on Fund I.

9 PRESENTATION - HEARTHSTONE - RESIDENTIAL PROPERTY (Item B3)

The Sub-Committee welcomed David Gibbins, Christopher Down and Jeff Pulsford, representing Hearthstone Investments, to the meeting. A presentation on Islington's Fund was circulated to members.

The Sub-Committee were informed that there had been solid investment performance in this investment, with strong opportunities ahead.

The Sub-Committee noted that a number of staff has recently left the firm and questioned whether the remaining six employees was a viable number. Christopher Down stated that

he thought that the team was the right size for the business, though they hoped to recruit a Fund Operator within a month.

The Chair noted that Islington held over half of the total assets in the Fund. In response to a question, Mr Doon said that he was very confident that the growth detailed on page 9 of the presentation was achievable.

Noted.

10 PENSIONS SUB-COMMITTEE - FORWARD PLAN 2015/16 (Item B4)

RESOLVED:
(a) That the contents of Appendix A, attached to the report of the Corporate Director of Finance and Resources, and detailing proposed agenda items for future meetings, be noted.
(b) That the update on the process to procure and appoint an Emerging/Frontier Market manager, detailed in paragraph 3.1 of the report, be noted.
(c) That a session be added to the proposed training schedule for the Sub-Committee and Board on the Actuarial Valuation.

11 ALLIANZ - TRANSFER OF ASSETS TO THE LONDON COMMON INVESTMENT VEHICLE (Item B5)

RESOLVED:
(a) That the information contained in the report of the Corporate Director of Finance and Resources on the proposed launch of the London Common Investment Vehicle (CIV) with nine sub funds be noted.
(b) That, subject to being satisfied that the Council will not incur costs in excess of the transition fee, the current Allianz equity portfolio be transferred to the London CIV platform by December 2015 and that it be reviewed after 12 months of operation.

12 INFRASTRUCTURE IMPLEMENTATION PROPOSAL VIA THE LONDON CIV (Item B6)

RESOLVED:
(a) That the latest Government trend on investment policy of local government pension funds, as detailed in the report of the Corporate Director of Finance and Resources, be noted.
(b) That Islington's pension fund's investment strategy to invest up 15% on infrastructure and social housing be reaffirmed.
(c) That confirmation be sought from the London CIV that they will develop an infrastructure sub fund or investment vehicle, ideally including social housing, covering Islington's mandate specification over the next 12 to 18 months.
(d) That if confirmation is not forthcoming from the London CIV as described in resolution (c) above, alternative plans of implementation be sought.

13 RESPONSIBLE INVESTMENT IN EQUITIES - DISINVESTMENT FROM SOCO INTERNATIONAL (Item B7)

Members discussed the Fund's investment policy on social and responsible investment and possible options to exclude unethical investments, having regard to their fiduciary duty and legal position.

RESOLVED:
(a) That the Corporate Director of Finance and Resources be authorised to disinvest the pension fund from its investment in SOCO International and to reinvest the proceeds in other FTSE All share Companies as part of the In-House Tracker Fund, as far as it is legal and adhering to its fiduciary duty.
(b) That officers request Fund Managers to detail the Environmental, Social and Governance standards used in their investment decisions in order that similar holdings ie where there are serious human rights, environmental and long-term sustainability of assets issues may be reviewed by the Sub-Committee as necessary.

14 ALLIANZ - TRANSFER OF ASSETS - EXEMPT APPENDIX (Item E1)

RESOLVED:
That the contents of the exempt appendix be noted.

The meeting closed at 9.50 pm

CHAIR

ISLINGTON

Finance Department
7 Newington Barrow Way
London N7 7EP

Report of: Corporate Director of Finance and Resources

Meeting of:	**Date**	**Agenda item**	**Ward(s)**
Pensions Sub-Committee	11 April 2016		

Delete as appropriate	~~Exempt~~	Non-exempt

Subject: PENSION FUND PERFORMANCE 1 OCTOBER TO 31 DECEMBER 2015

1. Synopsis

1.1 This is a quarterly report to the Pensions Sub-Committee to allow the Council as administering authority for the Fund to review the performance of the Fund investments at regular intervals and review the investments made by Fund Managers quarterly.

2. Recommendations

2.1 To note the performance of the Fund from 1 October 2015 to 30 December 2015

2.2 To receive the presentation by Allenbridge EPIC Investment Advisers, our independent investment advisers, on our fund managers' quarterly performance attached as Appendix 2.

2.3 To note the WM Company quarterly report (enclosed as Annex A)

2.4 To note for information the Mercer bulletin- LGPS Current Issues-March 2016" attached as Appendix 3.

2.5 To note that notice has been received from State Street, WM performance measurement service provider, of their termination of contract effective from March 2016. State Street has made the decision to discontinue providing performance measurement services to third-party clients in the UK and Netherlands.

3. Fund Managers Performance for October to December 2015

3.1 The fund managers' latest quarter net performance figures compared to the benchmark is shown in the table below.

Fund Managers	Asset Allocation	Mandate	Latest Quarter Performance (Oct-Dec'15 Net of fees		12 Months to December 2015 Performance Net of fees	
			Portfolio	Benchmark	Portfolio	Benchmark
LBI-In House	24%	UK equities	3.9%	4.0%	2.1%	1.0%
AllianzGI (RCM)	7%	Global equities	8.6%	8.1%	6.4%	4.0%
Newton	14%	Global equities	9.5%	8.1%	10.3%	4.0%
Legal & General	6%	Global equities	3.3%	3.4%	-10.6%	-10.4%
Standard Life	20%	Corporate bonds	0.4%	0.5%	0.6%	0.7%
Aviva (1)	5%	UK property	1.6%	-1.7% 3.1%	7.6%	0.6% 13.8%
Columbia Threadneedle Investments (TPEN)	7%	UK commercial property	3.1%	2.8%	12.9%	12.5%
Hearthstone	2%	UK residential property	1.6%	1.9%	14.4%	5.2%
Schroders	9	Diversified Growth Fund	2.6%	1.6%	n/a	n/a

(1) -1.7% and 0.6% = original Gilts benchmark; 3.1% and 13.8% are the IPD All property index; for information

3.2 The WM Company quarterly report (enclosed as Annex A) gives a detailed analysis of our fund managers' latest quarter performance as well as the combined fund performance. The fund's December 2015 market value and asset allocation is also shown in this report. Members are asked to note this report.

3.3 The combined fund performance for the last quarter ending December 2015 is shown in the table below. The Fund's quarterly over performance of 0.4% was attributable to 0.2% of stock selection and 0.2% of strategic asset allocation.

Combined Fund Performance	Latest Quarter Performance **Net** of fees		12 Months to December 2015 Performance Net of fees	
	Portfolio %	Benchmark %	Portfolio %	Benchmark %
LB of Islington Fund	3.4%	3.0%	3.3%	2.1%

3.4 Copies of the latest quarter fund manager reports are available to members for information if required.

3.5

The WM local authority universe is group of pension funds of similar characteristics but different sizes and deemed as a peer group for comparison. The Islington combined fund performance over the 1, 3 and 5 years period to December 2015 compared to its customised benchmark and percentile ranking are shown in the table below.

Period	1 year per annum	3 years per annum	5 years per annum
Combined LBI fund performance	3.3%	8.3%	7.1%
LBI customised benchmark	2.1%	7.8%	7.1%
Percentile ranking in the peer group	56	79	66

A summary page showing the fund's long term returns at asset class level with its rankings in the WM LA Universe peer group is attached as Appendix 1.

3.6 **AllianzGI (RCM)**

3.6.1 AllianzGI (formerly known as RCM) is the fund's global equity manager with a mandate to outperform the FTSE All World Index Benchmark by 3% per annum, gross of fees, measured over a 3-year rolling period from 8 June 2011.

3.6.2 On 2 December, the portfolio was transferred to the London CIV platform to Allianz sub fund as agreed by Members at the November 2015 meeting. The new benchmark is to outperform the MSCI World Index. The outperformance target is MSCI World +2% per annum over 2 years gross of fees.

3.6.3 Since inception in 1 December 2008 to 30 November 2015, the portfolio returned 12.3% against a benchmark of 13.3% net of fees with a relative underperformance of -1.0% per annum.

This quarter there was an outperformance of 1.3%. Performance attribution is not available yet from the London CIV because of reporting and compliance teetering issues.

3.7 **Newton Investment Management**

3.7.1 Newton is the fund's other global equity manager with an inception date of 1 December 2008. The objective of the fund is to outperform the FTSE All World Index by 2.0% per annum over rolling 3 year periods, net of fees.

3.7.2 The fund outperformed by returning 9.5% net of fees against a benchmark of 8.1% for the December quarter. Since inception the fund has delivered a relative over performance of 0.88% per annum.

3.7.3 The outperformance this quarter was driven mainly by stock selection and asset allocation within technology and oil and gas sectors. North America was beneficial at a regional level as well.

3.8 **In House Tracker**

3.8.1 Since 1992, the UK equities portfolio of the fund has been managed in-house by officers in the Loans and Investment section by passive tracking of the FTSE 350 Index. The mandate was amended as part of the investment strategy review to now track the FTSE All Share Index within a +/- 0.5% range per annum effective from December 2008. The fund returned 3.9% against a benchmark of 4.0% for the December quarter.

3.8.2 The fund currently holds 296 stocks and the main activities were corporate actions over the period.

3.9 **Standard Life**

3.9.1 Standard Life has been the fund's corporate bond manager since November 2009. Their objective is to outperform the Merrill Lynch UK Non Gilt All Stock Index by 0.8% per annum over a 3 year rolling period. During the December quarter, the fund returned 0.4% against a benchmark of 0.5% and a 3 year relative return of 0.3% per annum.

3.9.2 The main driver behind the underperformance during the quarter was overweight positions in collateralised debt.

3.9.3 The forward strategy is to continue with an overweight credit risk profile relative to the benchmark index, at the expense of an underweight exposure to bonds issued by supranationals and higher quality industrials. Duration and curve positioning are being kept relatively neutral.

3.10 **Aviva**

3.10.1 Aviva manages the fund's UK High Lease to Value property portfolio. They were appointed in 2004 and the target of the mandate is to outperform their customised gilts benchmark by 1.5% (net of fees) over the long term. The portfolio is High Lease to Value Property managed under the Lime Property Unit Trust Fund.

3.10.2 The fund for this quarter delivered a return of 1.8% against a gilt market of -1.7%. The All Property IPD benchmark returned 3.1% for this quarter. Since inception the fund has delivered an absolute return of 7.27% net of fees.

3.10.3 This December quarter saw the purchase of Premier Inn, Portsmouth. The fund has maintained an unexpired average lease term of 20.03 years and increased diversification. Lime is well positioned to deliver attractive returns over the medium term.

3.10.4 The fund now holds 69 assets with 43 tenants and a 0% void. It also has £120m of new investor commitments in the current queue.

3.11 **Columbia Threadneedle Property Pension Limited (TPEN)**

3.11.1 This is the fund's UK commercial pooled property portfolio that was fully funded on 14 October 2010 with an initial investment of £45 million. The net asset value at the end of December was £69.3million.

3.11.2 The agreed mandate guidelines are as listed below:

- Benchmark: AREF/IPD All Balanced Property Fund Index (Weighted Average) since I January 2014.
- Target Performance: 1.0% p.a. above the benchmark (net of fees) over three year rolling periods.
- Portfolio focus is on income generation with c. 75% of portfolio returns expected to come from income over the long term.
- Income yield on the portfolio at investment of c.8.5% p.a.
- Focus of portfolio is biased towards secondary property markets with high footfall rather than on prime markets such as Central London. The portfolio may therefore lag in speculative/bubble markets or when the property market is driven by capital growth in prime markets.

3.11.3 The fund returned 3.1% against its benchmark of 2.8% for the December quarter and a rental income yield of 6.1%. The cash balance now stands at 8.2% of the fund and the aim is to maintain it within a range of 6 to 9% for the 2016 year. During the quarter there were two acquisitions and one sale. There is a strong asset diversification at portfolio level with a total of 260 properties. The medium to long

term prospects of commercial property will be dominated by rental income supported by modest capital value growth and the Fund is well positioned to benefit from this.

3.11.4 Officers reviewed the fees with the Manager and managed to receive a 15 basis point reduction from current fees effective from January 2016, a saving of around 100k a year.

3.12 **Passive Hedge**

3.12.1 The fund currently hedges 50% of its overseas equities to the major currencies dollar, euro and yen. The passive hedge is being run by BNY Mellon our custodian. At the end of the December quarter, the hedged overseas equities returned 7.3% compared to the unhedged combined return of 8.8%. The hedged position delivered an under performance in market value of around £4.3million.

3.13 **Franklin Templeton**

3.13.1 This is the fund's global property manager appointed in 2010 with an initial investment commitment of £25million. Members agreed in September 2014 to re-commit another $40million to Fund II to keep our investments at the same level following return of capital through distributions from Fund I. The agreed mandate guidelines are listed below:

- Benchmark: Absolute return
- Target Performance: Net of fees internal rate of return of 15%. Preferred rate of return of 10% p.a. with performance fee only applicable to returns above this point.
- Bulk of capital expected to be invested between 2 – 4 years following fund close.

- Distributions expected from years 6 – 8, with 100% of capital expected to be returned approximately by year 7.

3.13.2 Fund I has now been fully committed. The remaining capital commitments $7.9m will be drawn down in the future as per business plans. The final portfolio is comprised of nine funds and five co-investments. The funds is well diversified as shown in table below:

Commitments	Region	% of Total Fund
5	Americas	36
4	Europe	26
5	Asia	38

During the quarter there was a capital call of $3.5m and a distribution of $3.1m, bringing total distribution received to $27.1m

3.13.3 Fund II has made 3 investments to date in Europe, USA and Asia, in the retail and office sector. The projected geographic exposure is 42% Asia, US 26% and 32% Europe. $6.6m capital drawdown was requested during the quarter.

3.14. **Legal and General**

3.14.1 This is the fund's passive overseas equity index manager. The fund inception date was 8 June 2011 with an initial investment of £67million funded from transfer of assets from AllianzGI (RCM). The funds are managed passively against regional indices to formulate a total FTSE All World Index series. The portfolio returned 3.3% net of fees against a benchmark of 3.4% for the quarter with a 12 months relative return -0.2%. The 3 year absolute return is -0.3%. The market value is now £63.7m.

3.15 **Hearthstone**

3.15.1 This is the fund's residential UK property manager. The fund inception date was 23 January 2013, with

an initial investment of £20million funded by withdrawals from our equities portfolios. The agreed mandate guidelines are as follows:

- Target performance: UK HPI + 3.75% net income.
- Target modern housing with low maintenance characteristics, less than 10 years old.
- Assets subject to development risk less than 5% of portfolio.
- Regional allocation seeks to replicate distribution of UK housing stock based on data from Academics. Approximately 45% London and South East.
- 5-6 locations per region are targeted based on qualitative and quantitative assessments and data from Touchstone and Connells.
- Preference is for stock which can be let on Assured Shorthold Tenancies (ASTs) or to companies.
- Total returns expected to be between 6.75% and 8.75% p.a., with returns split equally between income and capital growth. Net yields after fund costs of 3.75% p.a.
- The fund benchmark is the LSL Academetrics House Price Index

3.15.2 For the December quarter the value of the fund investment was £25.5m and total funds under management is £41.8million. Performance net of fees was 1.6% compared to the benchmark of 1.9%., and 12 month relative return 8.8%. The income yield after cost was 4.1%. The portfolio has 122 properties, 18 are let on licence and leaseback agreement to house builders and 99 properties let on assured short term agreements.

3.15.3 5 properties have received notices to vacate by end of January and February, 1 will be sold and the rest marketed to let. There were 5 vacant properties at the end of December, 3 of which are newly acquired properties to be let.

3.16 **Schroders-**

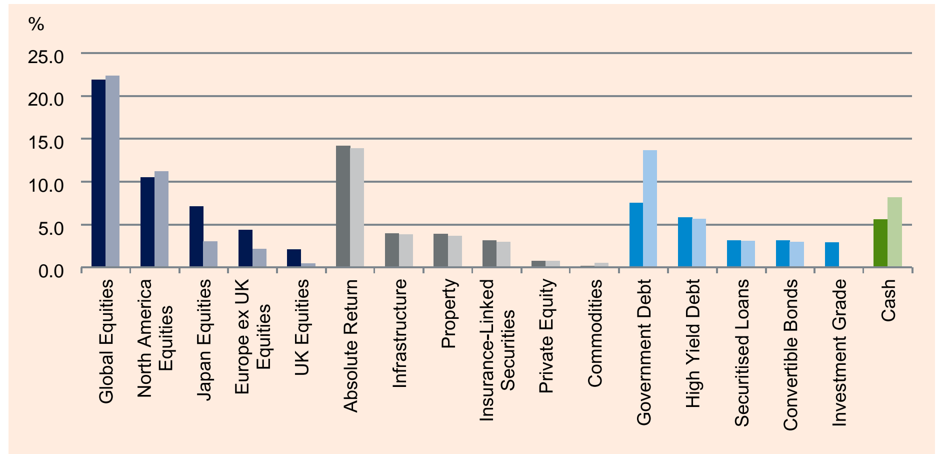
3.16.1 This is the Fund's diversified growth fund manager. The fund inception date was 1 July 2015, with an initial investment of £100million funded by withdrawals from our equities portfolios**.** The agreed mandate guidelines are as follows:

- Target performance: UK RPI+ 5.0% p.a.,
- Target volatility: two thirds of the volatility of global equities, over a full market cycle (typically 5 years).
- Aims to invest in a broad range of assets and varies the asset allocation over a market cycle.
- The portfolio holds internally managed funds, a selection of externally managed products and some derivatives.
- **Permissible asset class ranges (%):**
    - 25-75: Equity
    - 0- 30: Absolute Return
    - 0- 25: Sovereign Fixed Income, Corporate Bonds, Emerging Market Debt, High Yield Debt, Index-Linked Government Bonds, Cash
    - 0-20: Commodities, Convertible Bonds
    - 0- 10: Property, Infrastructure
    - 0-5: Insurance-Linked Securities, Leveraged Loans, Private Equity.

3.16.2 This is the second full quarter since funding and the value of the portfolio is now 97.6m**.** The aim is to participate in equity market rallies, while outperforming in falling equity markets. The December quarter performance after fees was 2.6% against the benchmark of 1.6% (inflation+5%).

3.16.3 The performance was predominately due to equities and alternatives. Meanwhile interest rate sensitive assets such as governments bonds, investment grade and high yield offset some of the gains. The portfolio's asset allocation at 30 December and 30 September is show in the graph below.

Asset allocation as at 31 Dec 2015 (shown first) and 30 Sep 2015 (shown second)



4. Implications

4.1 **Financial implications:**

The fund actuary takes investment performance into account when assessing the employer contributions payable, at the triennial valuation.

Fund management and administration fees and related cost are charged to the pension fund.

4.2 **Legal Implications:**

As the administering authority for the Fund, the Council must review the performance of the Fund investments at regular intervals and review the investments made by Fund Managers quarterly.

4.3 **Equality Impact Assessment:**

The Council must, in carrying out its functions, have due regard to the need to eliminate unlawful discrimination and harassment and to promote equality of opportunity in relation to disability, race and gender and the need to take steps to take account of disabilities, even where that involves treating the disabled more favourably than others (section 49A Disability Discrimination Act 1995; section 71 Race Relations Act 1976; section 76A Sex Discrimination Act 1975."

An equalities impact assessment has not been conducted because this report is an update on performance of existing fund managers and there are no equalities issues arising**.**

4.4 **Environmental Implications**

None applicable to this report.

5. Conclusion and reasons for recommendations

5.1 Members are asked to note the performance of the fund for the quarter ending December 2015 as part of the regular monitoring of fund performance and note the Mercer bulletin LGPS March 2016 .

Background papers:

1. Quarterly management reports from the Fund Managers to the Pension Fund.
2. Quarterly performance monitoring statistics for the Pension Fund – WM Company

Final report clearance:

Signed by:

	Corporate Director for Finance	Date
Received by:		
	Head of Democratic Services	Date

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APPENDIX 1

Summary of Long Term Returns

LONDON BOROUGH OF ISLINGTON - TOTAL COMBINED
Benchmark - LOCAL AUTHORITY UNIVERSE

Periods to end December 2015

Pound Sterling

This page summarises the long term returns at asset class level
A ranking against the peer group is shown in brackets.

Return %	2013 Q1	2013 Q2	2013 Q3	2013 Q4	2014 Q1	2014 Q2	2014 Q3	2014 Q4	2015 Q1	2015 Q2	2015 Q3	2015 Q4	1yr	3yrs % pa	5yrs % pa
Total Equity	10.9	-0.6	4.3	4.6	0.1	2.9	0.2	1.7	5.4	-1.2	-6.7	5.1	2.1	8.8	6.8
	(97)	(67)	(19)	(75)	(56)	(1)	(95)	(85)	(97)	(1)	(69)	(97)	(85)	(86)	(79)
Private Eq	3.7	6.9	0.6	-1.6	2.6	0.6	1.2	0.9	-0.5	3.8	-0.2	-2.8	0.2	5.1	5.3
UK Equities	10.8	-1.7	5.5	5.5	-0.3	2.3	-0.9	0.8	4.8	-1.2	-5.5	4.1	1.9	8.0	6.8
	(39)	(75)	(74)	(56)	(28)	(26)	(37)	(53)	(39)	(52)	(32)	(23)	(32)	(51)	(50)
O/S EQ Hedge	12.3	-0.4	3.5	4.6	0.1	4.0	1.3	2.9	7.0	-2.1	-8.9	7.3	2.4	10.4	7.2
O/S Equities	13.8	-1.1	1.3	3.7	-0.2	3.0	2.6	3.9	8.2	-4.3	-7.3	8.8	4.5	10.6	7.3
	(53)	(73)	(63)	(70)	(82)	(18)	(48)	(46)	(63)	(15)	(72)	(32)	(65)	(67)	(64)
N. America	*19.2*	*2.8*	*1.0*	*8.6*	*0.8*	*2.3*	*5.1*	*8.9*	*7.1*	*-3.7*	*-3.1*	*10.8*	*10.6*	*20.6*	*14.3*
	(15)	*(37)*	*(16)*	*(12)*	*(85)*	*(58)*	*(76)*	*(18)*	*(35)*	*(8)*	*(28)*	*(7)*	*(26)*	*(20)*	*(27)*
Europe ex UK	*14.2*	*1.5*	*4.1*	*5.9*	*0.8*	*1.7*	*-2.0*	*0.9*	*10.1*	*-6.3*	*-2.1*	*6.7*	*7.8*	*11.8*	*8.9*
	(21)	*(20)*	*(84)*	*(32)*	*(91)*	*(14)*	*(42)*	*(34)*	*(78)*	*(91)*	*(18)*	*(46)*	*(46)*	*(41)*	*(27)*
Japan	*22.6*	*7.8*	*3.9*	*-4.0*	*-5.6*	*3.2*	*3.4*	*0.8*	*15.5*	*-3.6*	*-10.3*	*19.0*	*18.9*	*16.8*	*6.6*
MGJE	*19.5*	*4.4*	*0.3*	*0.0*	*-5.9*	*4.2*	*3.1*	*1.6*	*16.4*	*-2.3*	*-8.0*	*12.5 #*			
Pacific	*8.7*	*-9.0*	*0.3*	*-4.8*	*-2.7*	*2.6*	*4.8*	*2.4*	*12.3*	*-5.9*	*-13.3*	*14.1*	*4.5*	*1.9*	*1.7*
	(81)	*(48)*	*(68)*	*(92)*	*(90)*	*(45)*	*(9)*	*(51)*	*(13)*	*(30)*	*(66)*	*(29)*	*(7)*	*(58)*	*(59)*
Other Intl.	*5.7*	*-8.9*	*-1.2*	*-1.8*	*-0.8*	*5.3*	*1.7*	*-1.3*	*5.8*	*-3.3*	*-17.6*	*3.0*	*-13.1*	*-5.2*	*-4.9*
	(64)	*(84)*	*(63)*	*(85)*	*(54)*	*(13)*	*(61)*	*(81)*	*(76)*	*(15)*	*(91)*	*(92)*	*(92)*	*(94)*	*(94)*
Global Eq												-0.1 #			
Bonds + IL	*1.8*	*-2.8*	*2.5*	*0.4*	*2.8*	*2.3*	*2.6*	*4.2*	*3.4*	*-4.0*	*0.9*	*0.4*	*0.6*	*4.8*	*7.2*
	(76)	*(20)*	*(6)*	*(17)*	*(36)*	*(11)*	*(68)*	*(59)*	*(27)*	*(69)*	*(59)*	*(18)*	*(24)*	*(30)*	*(33)*
Total Bonds	1.8	-2.8	2.5	0.4	2.8	2.3	2.6	4.2	3.4	-4.0	0.9	0.4	0.6	4.8	7.2

	(46)	(25)	(11)	(16)	(30)	(17)	(66)	(60)	(32)	(52)	(60)	(40)	(48)	(24)	(38)
UK Bonds	*1.8*	*-2.8*	*2.5*	*0.4*	*2.8*	*2.3*	*2.6*	*4.2*	*3.4*	*-4.0*	*0.9*	*0.4*	*0.6*	*4.8*	*7.2*
	(27)	*(18)*	*(14)*	*(17)*	*(30)*	*(21)*	*(72)*	*(69)*	*(26)*	*(65)*	*(69)*	*(29)*	*(48)*	*(27)*	*(36)*
UK Corp Bond	*1.8*	*-2.8*	*2.5*	*0.4*	*2.8*	*2.3*	*2.6*	*4.2*	*3.4*	*-4.0*	*0.9*	*0.4*	*0.6*	*4.8*	*7.2*
	(38)	*(18)*	*(37)*	*(18)*	*(38)*	*(46)*	*(78)*	*(68)*	*(41)*	*(59)*	*(40)*	*(48)*	*(48)*	*(30)*	*(45)*
Multi Asset										0.0 #	-4.8	2.6			
											(84)	(4)			
Cash/ Alts	1.0	2.5	0.1	0.2	0.6	0.3	0.4	0.2	0.1	-0.2	-0.1	0.1	-0.2	1.7	1.1
	(71)	(19)	(27)	(56)	(55)	(52)	(69)	(71)	(74)	(60)	(76)	(70)	(87)	(64)	(68)
Cash	*1.0*	*2.5*	*0.1*	*0.2*	*0.6*	*0.3*	*0.4*	*0.2*	*0.1*	*-0.2*	*-0.1*	*0.1*	*-0.2*	*1.7*	*1.1*
	(27)	*(16)*	*(21)*	*(25)*	*(19)*	*(27)*	*(35)*	*(41)*	*(53)*	*(65)*	*(82)*	*(54)*	*(85)*	*(29)*	*(42)*
Curr Instr	n/a	n/a	n/a	n/a	n/a	n/a	n/a	364.4	n/a	n/a	n/a	n/a	n/a	n/a	n/a
	n/a	n/a	n/a	n/a	n/a	n/a	n/a	(17)	n/a	n/a	n/a	n/a	n/a	n/a	n/a
UK Property	0.7	1.8	1.7	3.2	2.6	3.9	3.5	3.1	2.5	4.1	2.1	2.5	11.6	10.9	8.6
	(64)	(44)	(78)	(80)	(78)	(63)	(76)	(87)	(77)	(4)	(89)	(72)	(76)	(86)	(69)
Gbl Property	5.2	5.3	-7.9	3.7	1.4	20.7	9.0	6.8	9.4	6.6	6.1	8.8	34.6	26.6	
FRANKLIN TEM															
FRANKLIN TEM															
FRANKLIN TEM	5.2	5.3	-7.9	3.7	1.4	20.7	9.0	6.8	9.4	6.6	6.7	10.2	37.1	27.3	
Property Uni												-100.0 #			
Total Assets	7.5	-0.7	3.4	3.5	0.9	2.9	1.1	2.4	4.6	-1.0	-3.5	3.4	3.3	8.3	7.1
	(89)	(43)	(14)	(57)	(55)	(4)	(90)	(79)	(81)	(4)	(51)	(86)	(56)	(78)	(66)

not invested in this area for the entire period

Allenbridge

REPORT PREPARED FOR

London Borough of Islington Pension Fund

17th March 2016

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1. Fund Manager Overview

Table 1 provides an overview of the external managers, in accordance with the Committee's terms of reference for monitoring managers.

Table 1

Manager	Leavers, joiners and departure of key individuals	Performance	Assets under management	Change in strategy/risk	Manager specific concerns
AllianzGI	Chief executive and co-head of Allianz Global Investors Elizabeth Corley is stepping down. Andreas Utermann will replace her.	Outperformed the Index for the quarter by +0.5% and by +0.8% p.a. over three years to end December. Behind the target of +3.0% p.a. over three years.	£290 billion AUM as at 31st December 2014 (more recent figures not available).		
Newton	No joiners and one leaver this quarter. Terry Coles (Islington's portfolio manager) is taking on am additional role as alternate manager on Newton's Global Income Fund.	Outperformed the Index by +1.3% in the quarter. Also outperforming over three years by +3.1% per annum, and by +6.0% over 12 months.	£47 billion as at 31st December 2015, down from £48.3 billion as at 30th June 2015.		

Manager	Leavers, joiners and departure of key individuals	Performance	Assets under management	Change in strategy/risk	Manager specific concerns
Standard Life	10 joiners (of whom two were in fixed income), and five leavers (none from fixed income) during the quarter.	Over three years the Fund has outperformed by +0.3% p.a., behind the performance target of +0.8% p.a.	Underlying fund fell in value by £54m in Q4. London Borough of Islington's holding is 6.1% of the value of the total pooled fund.	Holding 6.5% in high yield non-benchmark bonds.	
Aviva	49 leavers and 74 joiners. Eight joiners in the Real Estate team and four leavers.	Outperformed the gilt benchmark by +3.5% p.a. over three years and ahead of the performance target.	Fund was valued at £1.6 billion as at end Q4 2015. Firm-wide assets under management of £267 billion as at end June 2015.		Awarded "Long Income Property Manager of the Year" by Professional Pensions, in November 2015
Columbia Thread-needle	Six joiners and three leavers during the quarter, none of whom were in the real estate division.	Outperformed the benchmark by +1.2% per annum over three years – ahead of their performance target.	Combined assets of new firm £320 billion as at 31st December 2015. Pooled fund has assets of £1.68 billion of which Islington holds 4.3%.		
Legal and General	Not reported.	Regional funds are all tracking the indices.	Assets under management of £728 billion at end September.		

Manager	Leavers, joiners and departure of key individuals	Performance	Assets under management	Change in strategy/risk	Manager specific concerns
Franklin Templeton	No leavers or joiners during the quarter within the private real estate team, although Witsard Schaper left the firm just after the quarter end.	Outperforming their benchmark by +15.1% per annum over three years and by +22.4% over one year.			
Hearth-stone	No changes to the team of six in Q4 2015.	Behind the benchmark during the quarter by -0.2%. Outperformed over one year by +8.8%.	Fund was valued at £41.9 m at end Q4 2015. Islington's holding represents approximately 61% of the Fund.		
Schroders	55 leavers and 60 joiners within the UK business as a whole. No changes in the multi-asset team.	Fund returned +2.6% during the quarter, ahead of the benchmark return of +1.0%	Total AUM of £313.5 billion as at 31st December 2015, across both institutional and retail clients.		

Key to shading in Table 1:

Minor concern

Monitoring required

2. Individual Manager Reviews

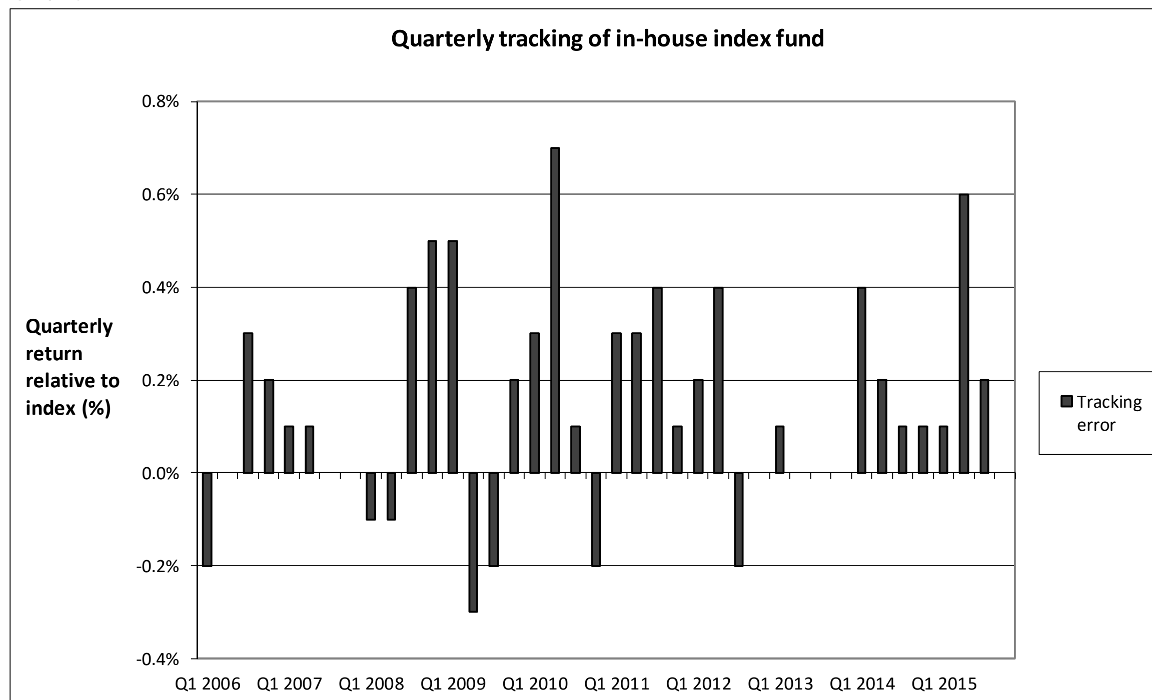
2.1. In-house – Passive UK Equities – FTSE All Share Index Fund

Headline comments: The portfolio continues to meet its objectives. The fund delivered a quarterly return very slightly behind the index benchmark (+3.9% versus +4.0%). Over three years the fund has outperformed the index by +0.7% p.a. and delivered a return of +8.0% per annum.

Mandate summary: A UK equity index fund designed to match the total return on the UK FTSE All Share Index. The in-house manager uses Barra software to create a sampled portfolio whose risk/return characteristics match those of the index.

Performance attribution: Chart 1 shows the tracking error of the in-house index fund against the FTSE All Share Index since Q1 2006. **There are no performance issues.** Over three years, the small quarterly positive relative returns (shown in Chart 1) have accumulated, and as a result the portfolio has outperformed its three-year benchmark by +0.7% per annum.

Chart 1



Source: Allenbridge based on WM figures

Portfolio risk: The tracking error on the portfolio at the end of December was 0.31% per annum. In terms of sector bets, relative to the Index, the largest underweight sector position relative to the index was Financials (-1.7%). The fund was most overweight in Utilities (+0.4%) and General Industries (+0.4%). This compares with sector bets of around 5-10% for the active managers.

Portfolio characteristics: The total number of holdings in the portfolio stood at 293 securities at the end of Q4 2015. Other than corporate actions and cash transfers into and out of the fund, the manager made £6.0 million of purchases and £0.9 million of sales in Q4.

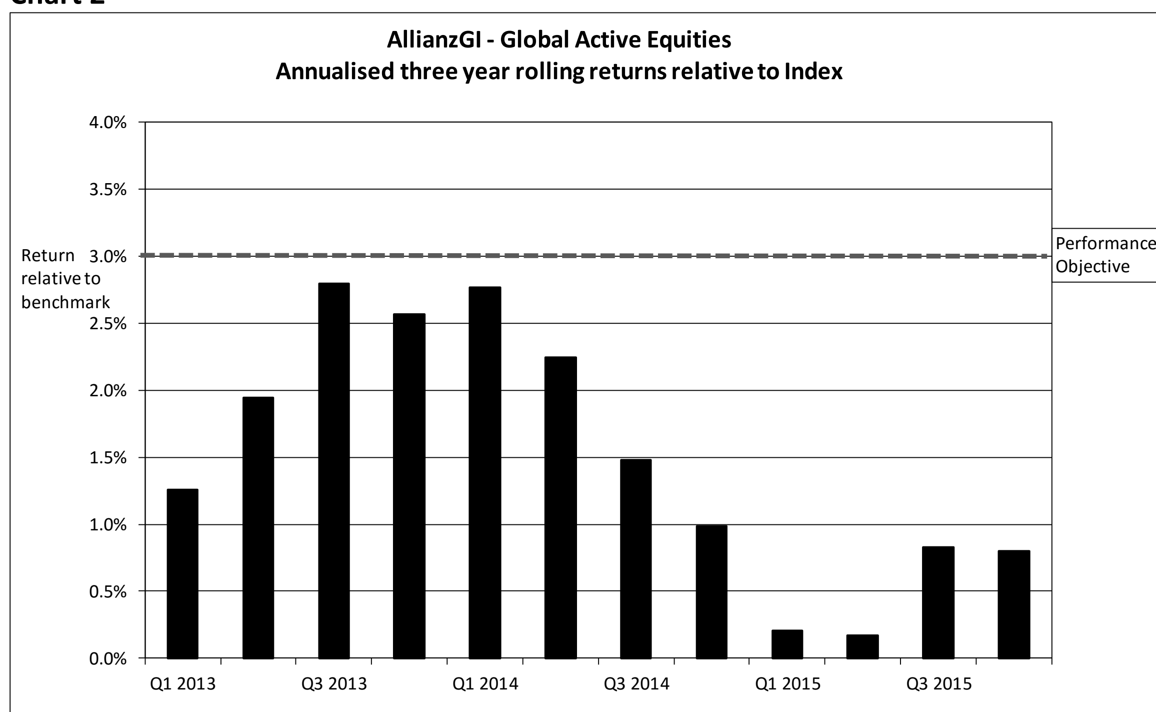
2.2. AllianzGI (RCM) – Global Active Equities

Headline comments: In terms of relative performance, the fund was ahead of the benchmark return of +8.1% for Q4 2015, delivering an absolute return of +8.6%. Over three years the fund is ahead of the benchmark by 0.8% per annum: however, this is behind the target of 3% per annum.

Mandate summary: An active global equity portfolio. AllianzGI operates a bottom-up global stock selection approach. They employ a team of research analysts to identify undervalued stocks in each geographical region (Europe, US, Asia Pacific). A global portfolio team is responsible for constructing the final portfolio. The objective of the fund is to outperform the FTSE All World Index by 3.0% per annum over rolling 3 year periods gross of fees.

Performance attribution: For the three years to December 2015, AllianzGI is ahead of its benchmark by +0.8% per annum, although **they are still trailing their performance target of 3% per annum**, shown by the dotted line in Chart 2.

Chart 2



Source: Allenbridge based on AllianzGI figures

Staff turnover: In October, the Chief Executive of AllianzGI, Elizabeth Corley, announced her intention to step down on 1st March 2016. She will remain on the Board as the non-executive Vice Chair. Global chief investment officer Andreas Utermann will assume the role of Chief Executive Officer from 1st March.

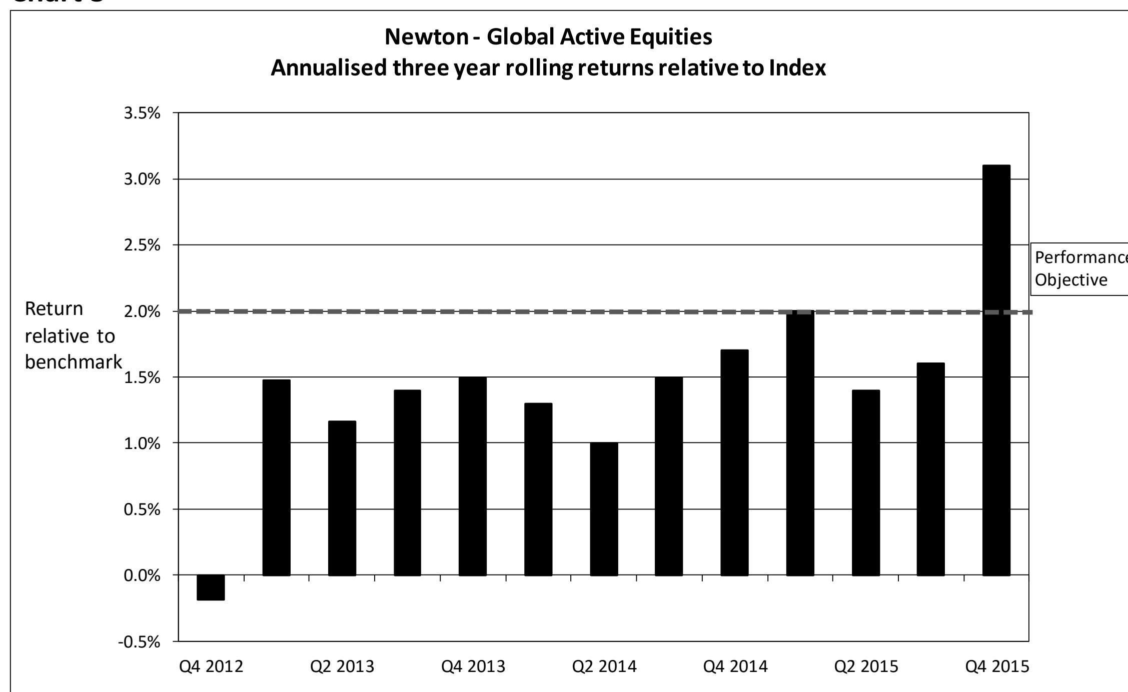
2.3. Newton – Global Active Equities

Headline comments: Newton were ahead by +1.3% during Q4 2015 bringing their one-year relative performance to +6.0%, an impressive level of outperformance. Over three years the portfolio outperformed by +3.1% per annum, well ahead of the target of 2% p.a. The outperformance of +3.1% per annum over three years can be attributed to both successful stock selection (+2.5%) and successful asset allocation (+0.9%).

Mandate summary: An active global equity portfolio. Newton operates a thematic approach based on 12 key themes that impact the economy and industry. Some are broad themes that apply over the longer term; others are cyclical. Stock selection is based on the industry analysts' thematic recommendations. The objective of the fund is to outperform the FTSE All World Index by 2.0% per annum over rolling 3 year periods, net of fees.

Performance attribution: Chart 3 shows the three year rolling returns of the portfolio relative to the Index (the black bars) and compares this with the performance target, shown by the dotted line.

Chart 3



Source: Allenbridge based on data from Newton and WM

Chart 3 shows the excellent progress being made by the manager, relative to the performance objective. For the three-year period to the end of 2015, the fund (shown by the right hand black bar) is +1.1% per annum ahead of the performance objective (shown by the dotted line). Note that this will mean the manager earns a performance fee in Q4 2015.

Over the three years to December 2015, Newton's return was +15.4% p.a. compared to the index return of +11.9% p.a., an outperformance of +3.1% p.a. Stock selection accounted for +2.5% of the outperformance with the balance from asset allocation.

Since the inception of Newton's portfolio in November 2008, the pension fund is better off than it would have been with a passive mandate. Newton's 'since inception' return is +13.4% per annum, compared to the benchmark return at 12.5% per annum, an outperformance of +0.9% p.a. *(source: Newton, gross of fees performance shown)*.

During the quarter the most successful sector was Technology (+0.75% contribution to relative performance) where Newton had successful stock positions and was overweight the sector, both of which helped performance. The least successful sector was Basic

Materials (-0.15% from relative performance). This was due to poorly performing companies in that sector.

Portfolio Risk: The largest overweight regional allocation was in European Equities (+2.6% overweight). This has been a long-standing position that has been in place since Q3 2011 although the current positioning is significantly lower than in Q3 2013 when the overweight position stood at 9.8%. This overweight position detracted slightly from relative performance in Q4. The most underweight allocation was Pacific ex Japan (-4.9%). This underweight allocation detracted slightly from performance although that was more than offset by good stock selection in this region.

In terms of sector bets, Newton remained overweight in Consumer Services (+9.6% relative to benchmark.) The most underweight sector remained in Financials (-10.4%). This underweight position has been in place since Q2 2009 although during that time the position has made a broadly neutral contribution to relative performance.

The level of active risk in the portfolio (i.e. the relative risk of the active bets being taken by Newton, or the tracking error) returned to its more typical level of 2.4%, as at end December 2015, having risen to 2.8% at the end of September. This is within Newton's normal range of 2% and 6%.

Portfolio characteristics: At the end of Q4 2015, the portfolio held 67 securities (69 as at the end of Q3 2015). There has been a steady drop in the number of stocks in the portfolio, which is worth noting. At the end of 2009, Newton held 138 stocks. Even three years ago, the number still stood at 99 holdings. Turnover over the past 12 months was 22%, at the low end of Newton's normal expected range of turnover to 30%-70%.

Investment process: At their annual conference, in November 2015, Newton announced that they were introducing two new themes to their thematic approach:

- Energy Economy: this theme is changing to "Abundance". The original theme was based around demand and supply in energy - supply has been increasing which has led to pricing pressure. Abundance goes beyond that to say that cheap money has resulted in an explosion of capacity in many sectors, with the result that pricing patterns are changing;
- Global realignment: this theme is changing to "Mind the gaps". Over the last few years the markets have been supported by central bank intervention. Now investors need to "mind the gap" between the winners and the losers, making selective stock selection increasingly important.

Newton holds the view that Healthcare will continue to do well, as a sector. The investment case is that between 2013 and 2050 the world population is expected to grow by 140% in the 60-80 age bracket and by 227% in the over 80's. This will lead to increasing demand for healthcare.

London CIV update: Newton has remained in discussion with the London Common Investment Vehicle (London CIV) and, whilst they were not in Phase 1 to transfer onto the CIV (with AllianzGI), they are hoping to transfer in Phase 2. They have proposed both an ad valorem fee and a performance fee. Newton have indicated that if the CIV adopts the performance fee (which is the arrangement currently in place for Islington), it should result in a small fee saving for the pension fund, assuming the manager outperforms by around 2%, in line with the performance target.

Staff turnover: during the quarter there were no new joiners and one leaver (James Harries). James was a portfolio manager within the Global Equity Income and Real Returns team. Nick Clay, another portfolio manager in the team, has taken over as lead manager of the Global Income Fund with Terry Coles as the alternate manager. This is worth noting because Terry is the lead portfolio manager for the London Borough of Islington. Newton have confirmed that there are no plans to switch Terry from the lead manager role on Islington's portfolio.

2.4. Standard Life – Fixed Income

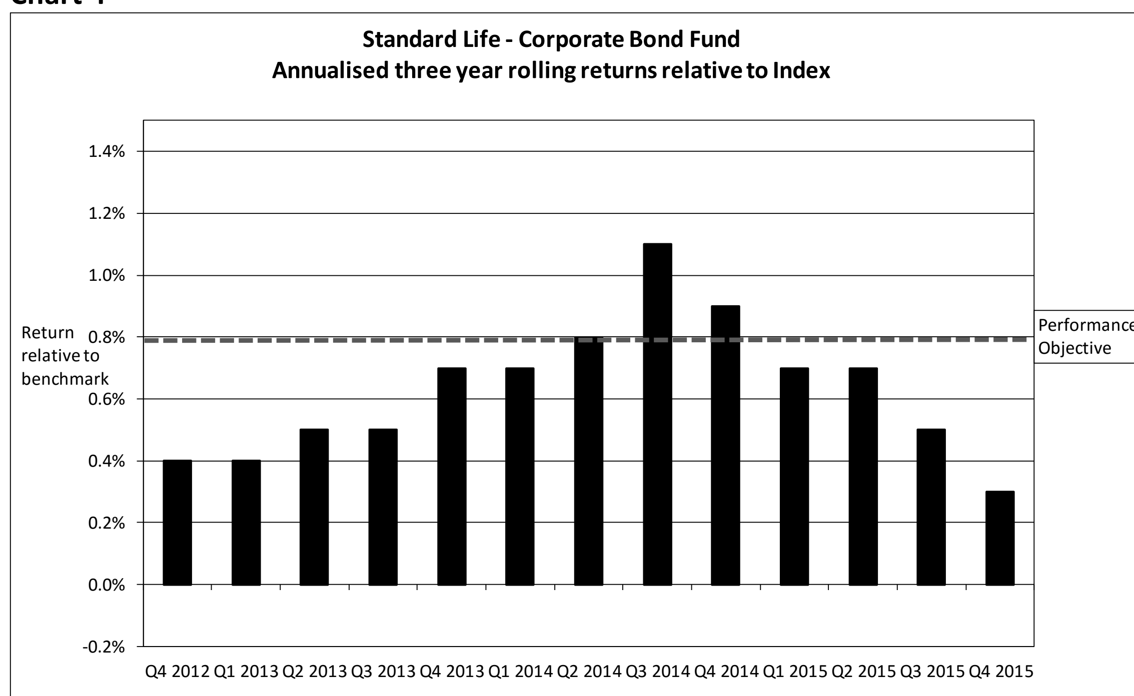
Headline comments: The portfolio was slightly behind the benchmark during the quarter with a return of +0.4% versus +0.5% for the Index. Over three years, Standard Life's outperformance was +0.3% per annum. This is slightly trailing their performance target of +0.8% per annum.

Mandate summary: An actively managed bond portfolio, invested in Standard Life's Corporate Bond Fund. The objective of the fund is to outperform the Merrill Lynch UK Non Gilt All Stocks Index by 0.8% per annum over rolling 3 year periods.

Performance attribution:

Chart 4 shows the performance the Corporate Bond Fund versus its benchmark and performance target.

Chart 4



Source: Allenbridge based on WM figures

Over three years, the portfolio has returned +4.8% p.a. compared to the benchmark return of +4.5% p.a., an outperformance of +0.3% p.a. The fund is behind its performance objective of outperforming the benchmark by +0.8% per annum.

Over the past three years, most of the outperformance has come from successful stock selection, followed by asset allocation. The outperformance has been partly offset by a negative contribution to performance from curve plays.

Portfolio Risk: The largest holding in the portfolio at quarter end was EIB 5.625% 2032 (1.3% of the portfolio). The largest overweight sector position remained Financials (+5.8%). The long-standing underweight position in sovereigns and sub-sovereigns remains (-17.1%).

The fund holds 6.5% of the portfolio in non-investment grade bonds (these do not form part of the benchmark).

Portfolio characteristics: The value of Standard Life's total pooled fund at end December 2015 was £3,549.6 million, £53.6 million lower than at the end of Q3 2015. London Borough of Islington's holding of £215.0 million is 6.1% of the total fund value. When Islington first invested, the percentage holding was 3.4%.

Staff turnover: there were ten joiners during the quarter, including two fixed income specialists, and five leavers, none of whom was from the fixed income division. Lara Kharratt joined the London credit team as an Assistant Portfolio Manager and Sefton Kincaid joined as a Credit Analyst in Boston.

2.5. Aviva Investors – Property – Lime Property Fund

Headline comments: In a reversal of Q3, gilts performed poorly and delivered a negative return. The Lime Fund outperformed the gilt benchmark by +3.5% during the quarter. Over three years, the Fund returned +7.9% compared to the gilt benchmark return of +4.2% per annum - well ahead of the performance target of +1.5% per annum outperformance.

Mandate summary: An actively managed UK pooled property portfolio, the Lime Fund invests in a range of property assets including healthcare, education, libraries, offices and retail. The objective of the fund is to outperform a UK gilt benchmark, constructed of an equally weighted combination of the FTSE 5-15 Years Gilt Index and the FTSE 15 Years+ Gilt Index, by +1.5% per annum, over three year rolling periods.

Performance attribution: The fund was ahead of the gilt benchmark this quarter by +3.5%, as bond markets fell. The fund rose +1.8% whilst the benchmark fell by -1.7%. The portfolio trailed the IPD Index in Q4 2015 by -1.9%.

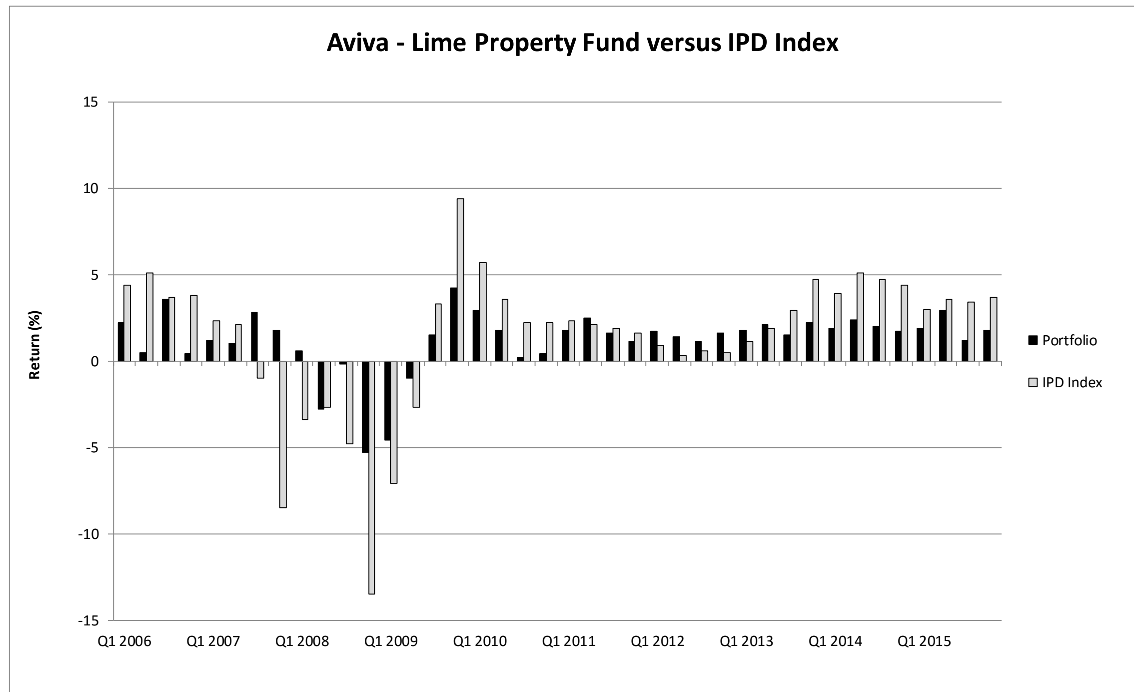
Over three years, the fund has returned +7.9% p.a. compared to the gilt benchmark of +4.2% p.a., an outperformance of +3.5% per annum. The **portfolio is ahead of its performance objective of +1.5% per annum outperformance over three years**. Of the +7.9% fund return over three years, 5.2% came from income, with the balance from capital gain.

Portfolio risk: There were several deals during the quarter including a purchase of Premier Inn in Portsmouth, a letting of an industrial asset to Royal Mail, in Northampton, and a restructuring of a lease to Compass, in Birmingham. The average unexpired lease term is 20.0 years, with 9.4% of the portfolio's lease exposure in properties in 30-35 year

leases, and 1.9% in over-35-year leases. The largest sector exposure remains offices at 28.2%. The cash allocation stood at 5.9% as at quarter end.

The Lime Fund is a low risk property portfolio and this is shown clearly in Chart 5 which shows the absolute performance of the Fund each quarter compared to the IPD Index. This shows the return stream of the portfolio (in black) following a more muted profile (in both up and down markets) than the IPD Index as a whole.

Chart 5



Source: Allenbridge based on WM figures

Portfolio characteristics: As at end December 2015 the Lime Fund was valued at £1.631 billion, an increase of £19 million from the previous quarter end. London Borough of Islington's holding represents approximately 3.4% of the total Fund's value.

Staff turnover/organisation: 49 leavers and 74 joiners in Q4 2015. Of these, eight joined the real estate team, whilst three left the team. Aviva were awarded "Long Income Property Manager of the Year" by Professional Pensions, in November 2015.

2.6. Columbia Threadneedle - Pooled Property Fund

Headline comments: The Fund's performance was ahead of its benchmark in Q4 2015 by +0.2% (source: Columbia Threadneedle). Over three years, the Fund has outperformed by +1.2% per annum, ahead of the performance target of 1% p.a. above benchmark over three years.

Mandate summary: An actively managed UK commercial property portfolio, the Columbia Threadneedle Pooled Property Fund invests in a diversified, multi-sector portfolio of UK property assets. Its performance objective is to outperform the AREF/IPD All Balanced – Weighted Average (PPFI) Index by at least 1% p.a., net of fees, on a rolling three year basis. The benchmark changed at the end of Q4 2013. Prior to this, the benchmark was the CAPS pooled property median fund.

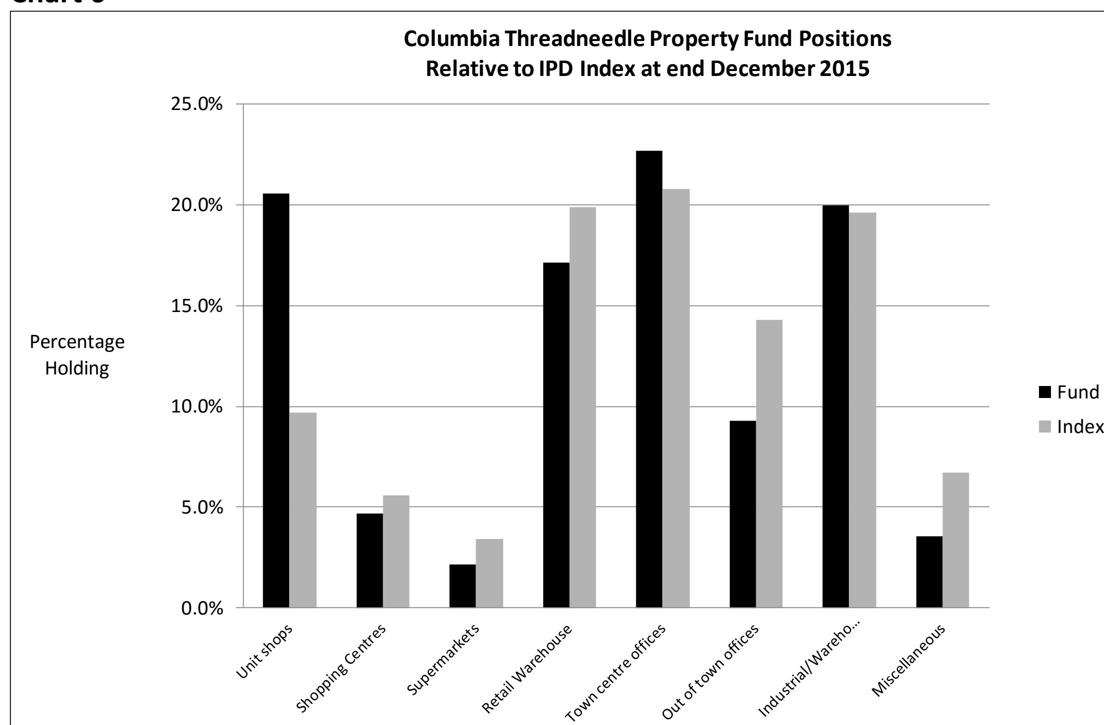
Performance attribution: The portfolio was ahead of the benchmark in Q4 2015, by +0.2% (source: Columbia Threadneedle), delivering a return of +3.1%. Of this, +1.7% was from capital growth and the balance from income. In terms of the three-year performance, **the Fund is ahead of its benchmark by +1.2% per annum so ahead of the performance target of +1% per annum.** The absolute return over three years remains strong. The portfolio returned +13.4% p.a. over three years compared to the benchmark return of +12.0% p.a.

Portfolio Risk: As at quarter end, the Fund held 260 properties with an average size of £5.8 million. This makes the portfolio highly diversified. The top ten tenants make up 20% of the portfolio. In contrast, in the IPD Index the top ten tenants account for 45%, so Threadneedle's portfolio is more diversified than many of their peers. Chart 6 shows the current breakdown of the portfolio relative to its benchmark.

Threadneedle's market view is that the economy has become quite strong in certain areas. Occupiers are in good corporate health so the office and industrial warehouse sectors are robust. There is more competition for space than two years ago so rental growth is growing. Threadneedle perceives that retail (high street) stores still have problems. The distribution sector is performing well but the high street is struggling.

Overall, Threadneedle's views are that property returns will begin to slow, but they are not intending to change the shape of their portfolio in light of these lower expectations. They continue to operate a "buy and hold" approach with an emphasis on income.

Chart 6



Source: Allenbridge based on Columbia Threadneedle data.

Portfolio characteristics: As at 31st December 2015, the Threadneedle Property Fund was valued at £1.68 billion, an increase of £228.5 million compared with September 2015. London Borough of Islington's holding represents 4.3% of the Fund. The Fund had been operating a queue for new investors. This has now all been fully invested within the fund so they are no longer operating a queue.

The net initial yield on the portfolio was 6.1% at the end of December compared to 5% for the IPD Index. The vacancy rate stands at 6.7% which is below the market average rate of 7.3%.

Staff turnover: There were six joiners and three leavers during the quarter; however, none of these were in the real estate division.

London CIV update: Columbia Threadneedle are hoping to transfer their property fund onto the London CIV and are currently exploring ways in which they might convert the existing fund into an ACS fund structure in a tax efficient manner. They are also bringing London Borough clients onto a common fee scale in anticipation of that, and this should result in a fee discount for London Borough of Islington.

2.7. Legal and General Investment Management (LGIM) – Overseas Equity Index Funds

Headline comments: All the index funds were within the expected tracking range when compared with their respective benchmarks and there are no issues. The fundamental FTSE-RAFI Emerging Markets index fund underperformed its market capitalisation-weighted counterpart in Q4 by -7.2%. For the 12 months to Q4 2015 the underperformance was -6.6%.

Mandate summary: Four regional overseas equity index funds, in Europe, Japan, Asia Pacific ex Japan, and emerging markets, designed to match the total return on the FTSE All World Regional Indices. One additional index fund is designed to match the total return on the FTSE-RAFI Emerging Markets Equity Index. The FTSE All World Indices are based on capitalisation weights whereas the FTSE-RAFI Index is based on fundamental factors.

Performance attribution: **The regional portfolios are all tracking their benchmarks**, as shown in Table 2.

Table 2

Q4 2015	Fund	Index	Tracking
Europe	6.3%	6.3%	0.0%
Japan	12.6%	12.5%	0.1%
Asia Pacific ex Japan	10.3%	10.3%	0.0%
FTSE emerging markets	3.1%	3.0%	0.1%
RAFI emerging markets	1.2%	1.2%	0.0%

Source: LGIM

Portfolio Risk: The percentage allocation to each regional fund is based on pre-agreed band widths, which also take into account the global equity managers' allocations. The largest deviation from the benchmark allocation is North America which is 4.8% overweight.

Organisation: Assets under management stood at £728 billion as at end December.

2.8. Franklin Templeton – Global Property Fund

Headline comments: This is a long term investment and as such a longer term assessment of performance is recommended. There are now two funds in which London Borough of Islington invests. The portfolio in aggregate delivered a return of +26.6% per annum over

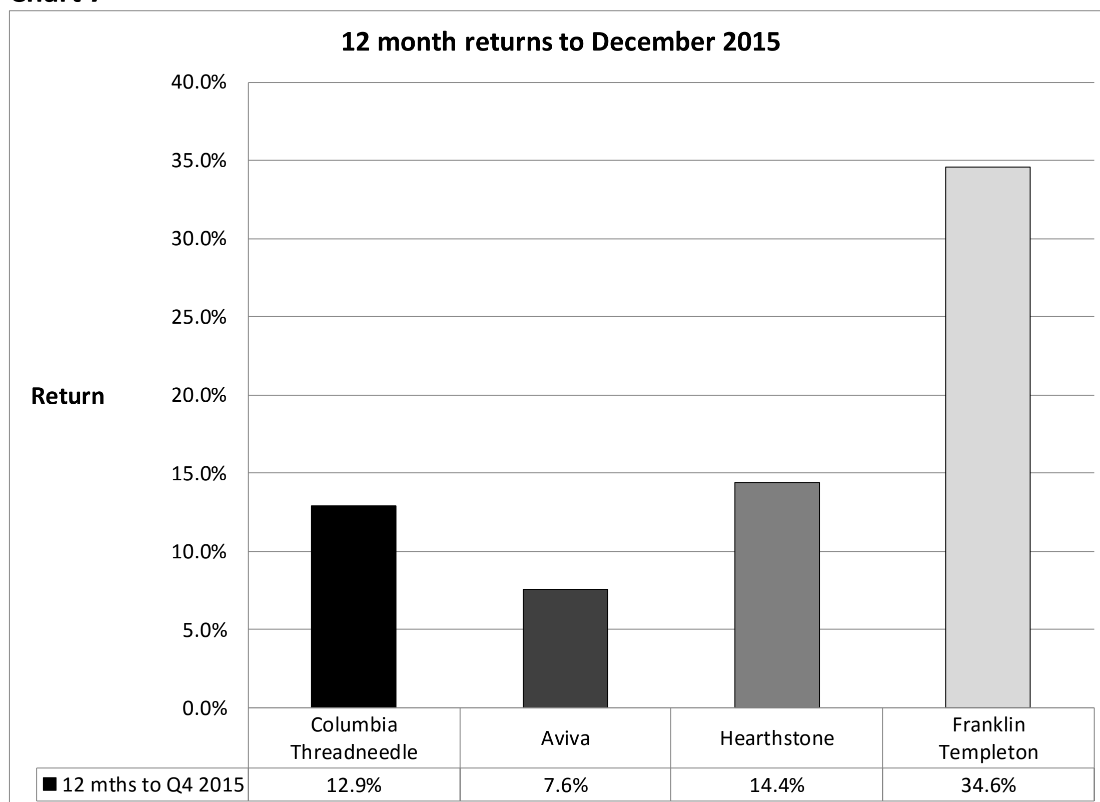
the three years to end December 2015, outperforming the absolute return benchmark by +15.1% per annum.

Mandate summary: Two global private real estate fund of funds investing in sub funds. The performance objective is an absolute return benchmark over the long term of 10% per annum.

Performance attribution: Over the past twelve months, **Franklin Templeton is the best performing fund across all four property managers**, by some way, as shown in Chart 7. Fund 1 is now fully committed and entering its distribution phase. Distributions in Q4 2015 amounted to 5.7% of the total equity commitments. Fund 2 received its first distribution from an underlying investment, in Q4. It also closed its third investment, an office building in Seattle, Washington, in the US.

The strong 12 month returns have fed through to the three year numbers and the Fund is now comfortably ahead of its target absolute return of 10% per annum, with the three years to December 2015 delivering a return of +26.6% per annum.

Chart 7



	Columbia Threadneedle	Aviva	Hearthstone	Franklin Templeton
■ 12 mths to Q4 2015	12.9%	7.6%	14.4%	34.6%

Portfolio risk: Leverage on Fund 1 was 53% as at end December, with three funds showing leverage of 70% as at end December (GreenOak Japan, Project Redfish and Valla Park Co-Investment 70%). Leverage on Fund 2 was 54% as at end December.

Of the 14 investments in Fund 1, three are on target (10%-15% projected net internal rate of return (IRR)), seven are above target (15-25% projected net IRR) and three are substantially above target (more than 25% projected net IRR). One fund is still too early to assess at this stage. The three funds which are substantially above target are: GreenOak, Project Redfish (a Toyko fund managed by Green Oak) and Secured Capital Japan V.

Of the three investments in Fund 2, one is on target and two are too early to assess.

Staff turnover: there were no joiners to or leavers from Franklin Templeton Real Asset Advisers during Q4 2015.

Just after the quarter end, however, Franklin Templeton announced that Witsard Schaper was leaving the firm in January. Witsard has presented to the Pensions Committee in the past. He has been offered a job with a Sovereign Wealth Fund.

In terms of a replacement for Witsard, Franklin Templeton plan to appoint a new senior member of the team, although this may take some time to find the right person. Raymond Jacobs in the US, Caroline Demol in Switzerland and David Germer in London remain heavily involved in the fund and all three cover Europe which was Witsard's specific area of expertise. Until a replacement is found, Raymond Jacobs will attend any meetings. Mark Weidner remains the lead fund manager for London Borough of Islington.`

2.9. Hearthstone – UK Residential Property Fund

Headline comments: The portfolio returned +1.6% compared to the benchmark return of +1.9% for the quarter ending December 2015. Over one year, the Fund delivered a return of +14.4%, compared to the benchmark return of +5.2%, an outperformance of +8.8%.

Mandate summary: The Fund invests in private rented sector housing across the UK and aims to outperform the LSL Acadametrics House Price Index (note that this excludes income), as well as providing an additional income return.

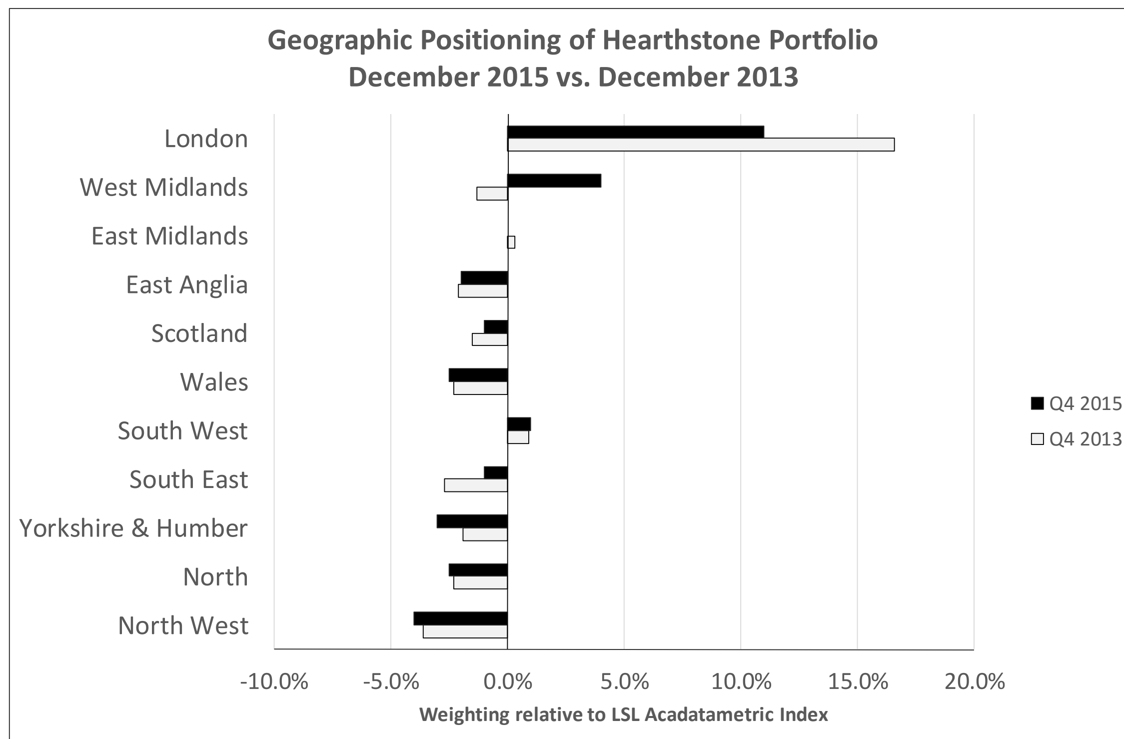
Performance attribution: The Fund returned +14.4% compared to the return on the index of +5.2% over the past 12 months, an outperformance of +8.8%. However, it is worth noting that the LSL Acadata House Price Index only takes price appreciation into account.

The gross yield on the portfolio was 5.4% at the end of December. This compares with LDL's average gross yield for properties in England and Wales (as calculated for their Buy to Let Index) of 5.0%.

Portfolio risk: The overweight position in London, primarily a result of the Wembley investment opportunity, is gradually decreasing as the Fund attracts new money which is being invested in other regions (in particular the North West, North and South East). Hearthstone's long term strategy is to maintain broadly neutral regional bets in the portfolio. At the end of 2013, the Fund was 16.6% overweight to London. At the end of 2015, that had dropped to an 11% overweight position.

Chart 7 compares the regional bets in the portfolio in Q4 2013 with the bets in Q4 2105. The reduced London overweight is shown by the top black bar (2015), compared with the top grey bar (2013).

Chart 7



Source: Allenbridge based on Hearthstone figures

Portfolio characteristics: The Fund has a 20% allocation to detached houses, 49% allocated to flats, 26% in terraced accommodation and 5% in semi-detached. The allocation to flats remains a significant overweight position relative to the Index (49% for the Fund compared to 17% for the Index). This is offset by an underweight position in semi-detached houses (5% for the Fund compared to 24% for the Index).

Organisation and staff turnover: There were no changes in personnel in Q4 2015. The firm still has just six employees and this remains a concern.

2.10. Schroder – Diversified Growth Fund (DGF)

Headline comments: The Diversified Growth Fund delivered a return of +2.6% in Q4 2015.This compared with their RPI plus 5% p.a. target return of +1.6% for Q4.

Mandate summary: The Fund invests in a broad mix of growth assets and uses dynamic asset allocation over the full market cycle, with underlying investments in active, passive and external investment, as appropriate. Schroders aim to outperform RPI plus 5% per annum over a full market cycle, with two-thirds the volatility of equities.

Performance attribution: In Q4 2015, Schroders' exposure to global equities made the largest contribution to the portfolio return (+1.0%), with smaller contributions from additional regional equity allocations (ranging from +0.1% to +0.3%). Alternative assets such as absolute return, infrastructure, property and private equity each contributed a further 0.1%. This was offset by negative contributions from government bonds (-0.2%), investment grade bonds (-0.1%), and currency (-0.1%).

Portfolio risk: The portfolio is expected to deliver equity-like returns with two-thirds the volatility of equities. However, this is over a full 3-5 year market cycle. Over the past 12

months, the volatility of the Fund was 8.2% compared to a 12-month volatility of 13.4% in equities.

Portfolio characteristics: The Fund had 9% in internally managed funds, 40% in bespoke solutions, 14% in externally managed funds, 31% in passive funds and 6% in cash, as at end December 2015. In terms of asset class exposure, 46% was in equities, 26% in alternatives and 22% in credit and government debt, with the balance in cash.

Alternative assets include absolute return funds, infrastructure, property, insurance-linked securities, private equity and commodities.

Organisation and staff turnover: there were no changes in staff within the Multi-Asset investment team (i.e. the team running the Diversified Growth Fund). Firm-wide, globally there were 101 leavers and 106 joiners. Of these 55 leavers and 60 joiners were for the UK business. After the quarter end, Schroders announced that Michael Dobson will step down as chief executive after 14 years in the role, to become non-executive chairman. He will be replaced by Peter Harrison, the head of investment.

Karen Shackleton
Senior Adviser, Allenbridge
17th March 2016

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MARCH, 2016

LGPS CURRENT ISSUES

NEWS IN BRIEF

IN THIS ISSUE

- News in Brief
- State Pension Reform
- Dates to Remember
- Contacts

PENSION INCREASES / REVALUATION OF CARE BENEFITS

Given that UK inflation, as measured by the Consumer Prices Index (CPI), fell by -0.1% in the period September 2014 to September 2015, those members in the LGPS who have retired/left service, will receive no increase to their benefits with effect from April 2016.

With regard to members in service, on 1 February 2016, a draft of The Public Service Pensions Revaluation (Prices) Order 2016 was published, which specified that a decrease of -0.1% should come into effect from 1 April 2016. Therefore, whilst this has yet to be laid, it is looking likely that HM Treasury will choose to use their powers under the legislation and apply a reduction to post 2014 CARE benefits.

The very low CPI figure will also have an effect on the 2016/17 Annual Allowance calculations.

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EQUITABLE LIFE DEVELOPMENTS

There have been a number of recent developments at Equitable Life with regard to the various investment Funds available to members. A number of changes have already taken place.

In short, Equitable Life is increasing the annual management charges it applies to various funds, and also halving its overall fund range, with assets being disinvested and reinvested in one or more of the remaining funds. Whilst we would expect that the majority of LGPS members with Equitable Life policies to not be affected (given they will be invested in With-Profits funds which are not subject to any of the changes announced), LGPS Funds, which have members with Equitable Life Policies, still need to consider what action they should take.

In particular, administering authorities need to be aware that any automatic reinvestment performed by Equitable Life, could be deemed to be an investment decision by the administering authority on behalf of members.

We will be producing a separate note on the options available and what steps should be taken.

SINGLE FRAUD INVESTIGATION SERVICE BULK TRANSFERS

The Single Fraud Investigation Service (SFIS) involves the transfer of a handful of local authority staff from each LGPS Fund to the PCSPS.

We understand that members are currently being provided with the details of their options on joining the PCSPS and in some cases the transfers will be paid shortly. For other funds, once members have made their decisions we will be in touch with Funds to agree the amounts of any transfers to be paid.

EUROPEAN UNION REFERENDUM

The Prime Minster has announced that the European Union (EU) Referendum will be held on 23 June 2016.

The most important immediate impact that the EU Referendum will have on pension schemes will be the impact on the financial markets (e.g. potential volatile equity prices and bond yields) both before the Referendum, depending on how close the vote is predicted to be, and afterwards, should the vote be to leave the EU. Markets are currently expecting the UK to stay in the EU, so if there is an exit, it is difficult to predict the outcome.

Such volatility and uncertainty in the markets will have a knock-on effect on funding positions and for LGPS Funds in England and Wales, this may need to be considered carefully as the outcome of the referendum will be announced right in the middle of the 2016 valuation process.

In addition to market volatility, given that UK pension law has been brought into line with various EU directives e.g. gender/age discrimination etc, in theory a vote to leave the EU could pave the way for the UK to change its legislation in certain areas, although whether any major changes will be brought in is perhaps doubtful.

2016 ACTUARIAL VALUATION (ENGLAND AND WALES)

We are now less than a month away to 31 March 2016, the effective date of the next round of actuarial valuations for English and Welsh Funds. There will be a number of challenges facing Funds, Employers (and advisors!) in relation to this exercise, in particular given it will be the first valuation in the Post 2014 environment, and also with regard to the greater level of scrutiny that the LGPS is now under.

Preparatory work is already underway on a number of fronts and we will be producing a separate note to consider some of these in more detail.

INFRASTRUCTURE AND INVESTMENT POOLING IN THE LGPS

The Chancellor made a statement back in October that referred explicitly to infrastructure investment and investment pooling in the LGPS. The statement provided the clearest sign yet of the scale of ambition that the LGPS has been tasked to achieve.

Alongside the deadline for responses to the Consultation on the Investment Regulations (as referred to below), LGPS Funds had to submit by 19 February 2016 details of what progress they had made to date in terms of pooling with other authorities. As we understand, there are now 7 pools in the process of being established.

The next deadline for Funds to consider is 15 July 2016. By this date, Funds will have had to make a final submission to the government describing the proposed structure and governance of any pooling arrangement, what costs (and importantly savings) are expected, and also how this will be implemented e.g. transition profile for the assets involved. Unlike the initial submissions (which could have been submitted jointly by Funds), final submissions need to be on an individual basis.

If done in the right way, pooling could have significant investment and governance benefits to the LGPS and wider society. However, we should not lose sight of the LGPS's ultimate objective of providing pensions in a cost effective manner, which requires a holistic approach encompassing credible and transparent funding plans, effective cost management, best in class governance, return generation and risk management. There is no silver bullet therefore and continuous effort on all these fronts is needed.

INVESTMENT REGULATIONS' CONSULTATION

The deadline for responses to the Government's consultation on revoking and replacing the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 ended on 19 February 2016 and responses are now being considered.

In summary the main changes proposed centred around:

- Pooling of assets to increase scale and reduce costs possibly through more internal management e.g. the Common Investment Vehicle being implemented by the London Boroughs.
- Improving governance by ensuring strategies are adhering to regulation and guidance
- Increasing flexibility for Administering Authorities to determine an appropriate risk based investment strategy
- Allowing the Secretary of State to intervene where Funds are not taking advantage of pooling and/or not delivering appropriate risk based investment strategies

Mercer has responded to the consultation, please contact your usual Mercer contact if would like a copy.

UPDATE ON IMPLICATIONS OF THE STATE PENSION REFORM

Time is potentially running out to prepare for state pension reform, and actions need to be taken before 6 April 2016.

There are a number of implications for LGPS funds and employers as a result of the reform and we have considered this in more detail later in this edition.

MARCH 2016 BUDGET AND RESULT OF PENSION TAX CONSULTATION

The current pensions tax system is under review and the government issued a consultation on pension tax relief in July 2015. Mercer understands that the four structures most likely to be seriously considered by HM Treasury are: the current system; an amended version of the current system; an ISA-style structure with additional incentive to make long term saving; and a flat rate of tax relief.

The result of the consultation is likely to be announced in the March 2016 Budget and there are many issues that this could potentially create including further upheaval for employers and Funds who have already had to address issues caused by auto-enrolment, the new pensions freedoms and the end of contracting-out in April 2016.

All the time of writing , Press reports strongly support that Chancellor will make no changes to the current system, but we cannot be certain until after the Budget and even then it may only be a deferment of the decision.

PUBLIC SECTOR EXIT PAYMENTS

As trailed in the Chancellor's Spending Review and Autumn Statement, the government has issued a consultation on further reforms to public sector exit payments. This is the third in a series of reviews in this area, the other two being:

- the "Recovery Regulations" (whereby higher earners have to repay part or all of their exit payment if they rejoin the public sector within a year), effective from April 2016.
- the proposed overall limit on exit payments of £95,000, which is expected to become effective in Autumn this year (date not yet confirmed)

The latest consultation is aimed at reducing the overall cost of exit payments and achieving greater consistency with the private sector. Once again, the costs of any pension enhancements awarded are within the government's sights. In brief, the proposals are to:

- Set a maximum tariff (three weeks' pay per year of service) for calculating exit payments.
- Cap the maximum number of months' salary that can be used when calculating redundancy payments to 15 months. Some minor variations on this general policy might be allowable.
- Set a maximum salary (possibly £80,000) on which an exit payment can be based.
- Taper the amount of compensation as an individual gets closer to their pension retirement age.
- Require employer-funded early access to pension to be limited or ended. The consultation puts forward a number of options, including meeting any cost out of the remainder of the exit package, limiting the ages at which employer-funded early access might be made available, or even abolishing the practice completely and allowing the cost of any top-up to be met entirely by the individual.

At the same time, HMT has written to all government departments setting out new guidance on the rules they must follow on pay and terms for public sector workers.

In practice, this seems to be little more than a consolidation of existing guidance, including the requirement for approval of the Chief Secretary to the Treasury for civil service appointments with a remuneration package is above £142,500 and for bonus arrangements worth over £17,500. For local government appointing staff on salaries of £100,000 or more should be subject to a vote of full council.

Clearly the government still has the overall area of public sector pay and exit packages well in its sights, and more can be expected (e.g. the promised review of sickness absence has yet to emerge). For the LGPS it could well mean the removal of access to unreduced pensions for all on exit from the sector.

We will be responding to the latest consultation, and will update you with any further developments.

CODE OF PRACTICE ON INCENTIVE EXERCISES

The Incentive Exercises Monitoring Board has published Version 2 of the Incentive Exercises for Pensions code of good practice. The code applies to all new incentive exercises made available to members on or after 1 February 2016. Exercises made available to members prior to this date will continue to fall under Version 1.

Version 2 introduces a proportionality threshold under which there is no requirement to provide advice or for a member to take guidance. The threshold is £10,000 for transfers and full commutation exercises, and £500 p.a. of pension affected by a pension increase exchange.

This proportionality threshold is a useful mechanism for Funds and employers wishing to conduct bulk trivial commutation exercises to reduce liabilities and administration costs, as it potentially removes the requirement to pay for financial advice for the member, where the member's pension is trivial, which significantly increases the appeal of such exercises.

The 2016 valuations mark an ideal time for Funds which have not yet previously considered such exercises to assess the liabilities that can be extinguished through trivial commutation and we are able to incorporate such analysis in our valuation calculations.

STATE PENSION REFORM, THE DETAILS AND THE ACTION REQUIRED

As a result of the reforms to state pensions, there are a number of actions required by LGPS Funds and Employers and we have summarised these in the table, with further details provided below:

ACTION	FUND/ EMPLOYER?	DEADLINE
Ensure payroll function notified of national insurance and any other contribution changes.	Employer	5 April 2016
Notify members: Of any change in contractual terms (because of change in contracting-out status) by 6 May 2016. Consider notifying employees of impact on take home pay from 6 April 2016.	Employer	6 May 2016
Update booklets and communications to reflect changes to state benefits.	Fund / Employer	n/a
Commence GMP reconciliation exercise before April 2016.	Fund	5 April 2016
Notify active members of the end of contracting-out by 6 July 2016.	Fund	6 July 2016
Respond to government consultation on solutions to indexation for public service pension schemes and their members	Fund / Employer	Expected later in 2016

GMP RECONCILIATION EXERCISE

The National Insurance Contributions and Earnings Office (NIC&EO) of HMRC has issued its latest update on the abolition of contracting-out for DB schemes, which will come into effect in April 2016.

HMRC key messages remain:

- The cut-off date for expressions of interest (EOI) for the Scheme Reconciliation Service SRS is 5 April 2016
- No action by Trustees / Funds, who have received SRS data, will result in an assumption that the data held by HMRC is accurate
- Failure to reconcile this with the Fund's records could result in Funds being assigned pensions that they were not previously aware about, or had previously been extinguished but not notified to HMRC.
- All funds therefore need to register an EOI by 5 April 2016 to avoid this potential liability

LGPS TO PICK UP THE COST OF FULLY INDEXING GMPS

On 1 March, Government issued a Press Notice, announcing that public service schemes would be required to pick up the cost of fully indexing GMPs in respect of members who reach State Pension Age from 6th April 2016 to 5th December 2018.

For members reaching State Pension Age from 6th December 2018, HM Treasury intends to consult later this year on a solution to the indexation issue and GMP equalisation for the public service schemes and their members.

What is the financial impact?

If full indexation had been implemented for all members who reached State Pension Age from 6 April 2016, we had estimated that the burden for the LGPS would have been additional liabilities of around £1 billion which equated to around 0.5% of the Scheme's total liabilities. Based on this initial shorter window of pensioners, we estimate that the current impact on the LGPS will now be additional liabilities of the order of £225 million, which will have to be reflected in the forthcoming 2016 valuation: The impact will vary for individual employers, depending on their membership profile, and again this is something to be costed in the valuation.

Practical impact?

From an administration/pensioner payroll perspective there will be a need to identify affected members and set up processes for them in order to apply the correct increases going forward when they reach State Pension Age with potentially different treatment again from 2018.

It remains to be seen how this will play out in the longer term. We are aware that private sector companies who operate public sector style "mirror" schemes have been lobbying government to prevent the full requirement from being imposed on public service schemes and therefore their own as well. We anticipate that they will respond strongly to the consultation on this.

We will be touch again once the consultation details are published and will remain in close contact with HM Treasury in the meantime.

COMMUNICATION WITH EMPLOYEES

Funds and employers will need to notify members about the change to their contracting out status. Further information and example communications can be found here: http://lgpsregs.org/images/Bulletins/Bulletin140.pdf

STATE PENSION REVIEW BEGINS

In addition to the above reforms, a review of the State Pension Age has begun that may mean people joining the workforce today having to wait until their mid-70s before they can retire.

The review will make its recommendations by May 2017.

Whilst directly affecting members' state pensions, this could also have implications for LGPS benefits as the Scheme's Normal Retirement Age is linked to State Pension Age.

DATES TO REMEMBER

DATE	ISSUE	SUMMARY
31 March 2016	Actuarial valuation	Effective date of the 2016 actuarial valuation exercise for English and Welsh LGPS funds
1 April 2016	Pension increases	Effective date of the annual pension increase for the LGPS / application of care revaluation rate
6 April 2016	Lifetime allowance	The lifetime allowance will reduce to £1 million, subject to legislation. Fixed and individual protection will be made available to impacted inviduals.
6 April 2016	Annual allowance	The annual allowance will be reduced from 2016/17 for high earners, tapered down to £10,000 for the highest earners. All pension input periods will be aligned with the tax year.
6 April 2016	State pensions	The government will introduce a single-tier state pension. Contacting out for defined benefit schemes will be abolished.
6 May 2016	Abolition of contracting out	This is the deadline for employers to have notified employees of change in contractual terms (as a result of the abolition of contracting-out)
23 June 2016	European Referendum	The referendum on whether the uk will opt out of the EU will take place on this date.
5 July 2016	Abolition of contracting out	This is the deadline for administering authorities to have notified active members of their change in contracted-out status.
15 July 2016	Investment pooling	Deadline for funds to have formally submitted their proposals to the government for investment pooling with other funds.
30 September 2016	Actuarial valuation	Deadline for membership data to have been submitted to GAD as part for the LGPS cost management analysis.
31 March 2017	Actuarial valuation	Deadline for the 2016 actuarial valuation exercises to have been formally signed off by the fund actuary.

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REPORT PREPARED FOR

London Borough of Islington Pension Fund

17th March 2016

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1. Fund Manager Overview

Table 1 provides an overview of the external managers, in accordance with the Committee's terms of reference for monitoring managers.

Table 1

Manager	Leavers, joiners and departure of key individuals	Performance	Assets under management	Change in strategy/risk	Manager specific concerns
AllianzGI	Chief executive and co-head of Allianz Global Investors Elizabeth Corley is stepping down. Andreas Utermann will replace her.	Outperformed the Index for the quarter by +0.5% and by +0.8% p.a. over three years to end December. Behind the target of +3.0% p.a. over three years.	£290 billion AUM as at 31st December 2014 (more recent figures not available).		
Newton	No joiners and one leaver this quarter. Terry Coles (Islington's portfolio manager) is taking on am additional role as alternate manager on Newton's Global Income Fund.	Outperformed the Index by +1.3% in the quarter. Also outperforming over three years by +3.1% per annum, and by +6.0% over 12 months.	£47 billion as at 31st December 2015, down from £48.3 billion as at 30th June 2015.		

Manager	Leavers, joiners and departure of key individuals	Performance	Assets under management	Change in strategy/risk	Manager specific concerns
Standard Life	10 joiners (of whom two were in fixed income), and five leavers (none from fixed income) during the quarter.	Over three years the Fund has outperformed by +0.3% p.a., behind the performance target of +0.8% p.a.	Underlying fund fell in value by £54m in Q4. London Borough of Islington's holding is 6.1% of the value of the total pooled fund.	Holding 6.5% in high yield non-benchmark bonds.	
Aviva	49 leavers and 74 joiners. Eight joiners in the Real Estate team and four leavers.	Outperformed the gilt benchmark by +3.5% p.a. over three years and ahead of the performance target.	Fund was valued at £1.6 billion as at end Q4 2015. Firm-wide assets under management of £267 billion as at end June 2015.		Awarded "Long Income Property Manager of the Year" by Professional Pensions, in November 2015
Columbia Thread-needle	Six joiners and three leavers during the quarter, none of whom were in the real estate division.	Outperformed the benchmark by +1.2% per annum over three years – ahead of their performance target.	Combined assets of new firm £320 billion as at 31st December 2015. Pooled fund has assets of £1.68 billion of which Islington holds 4.3%.		
Legal and General	Not reported.	Regional funds are all tracking the indices.	Assets under management of £728 billion at end September.		

Manager	Leavers, joiners and departure of key individuals	Performance	Assets under management	Change in strategy/risk	Manager specific concerns
Franklin Templeton	No leavers or joiners during the quarter within the private real estate team, although Witsard Schaper left the firm just after the quarter end.	Outperforming their benchmark by +15.1% per annum over three years and by +22.4% over one year.			
Hearth-stone	No changes to the team of six in Q4 2015.	Behind the benchmark during the quarter by -0.2%. Outperformed over one year by +8.8%.	Fund was valued at £41.9 m at end Q4 2015. Islington's holding represents approximately 61% of the Fund.		
Schroders	55 leavers and 60 joiners within the UK business as a whole. No changes in the multi-asset team.	Fund returned +2.6% during the quarter, ahead of the benchmark return of +1.0%	Total AUM of £313.5 billion as at 31st December 2015, across both institutional and retail clients.		

Key to shading in Table 1:

Minor concern

Monitoring required

2. Individual Manager Reviews

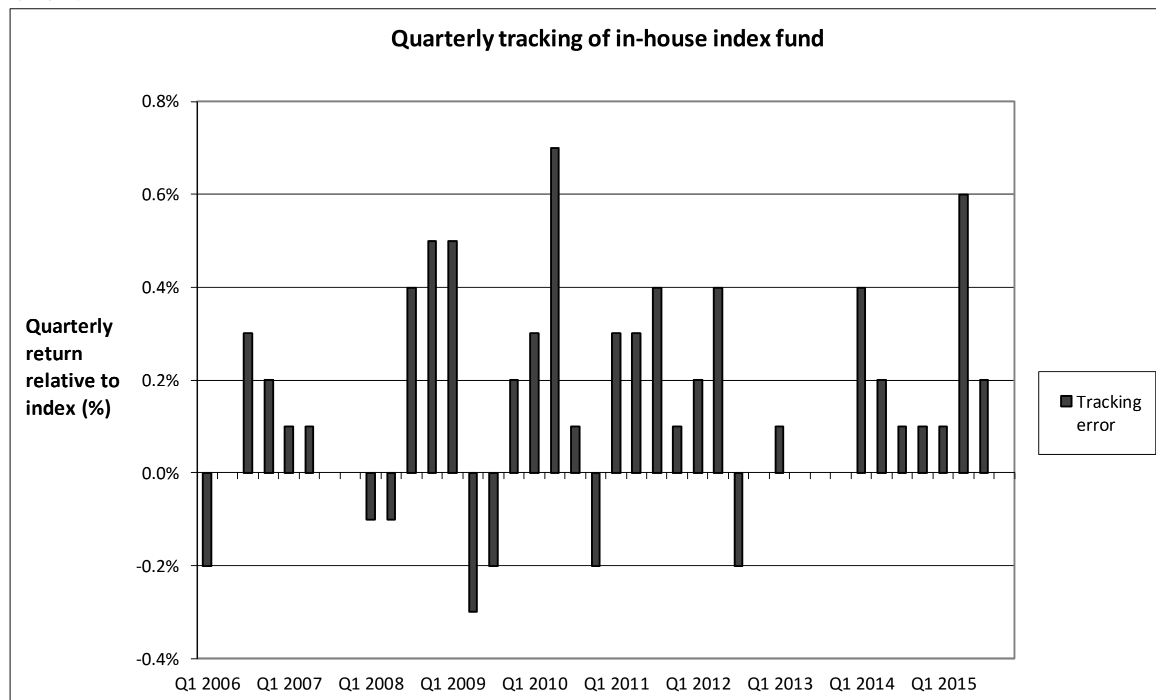
2.1. In-house – Passive UK Equities – FTSE All Share Index Fund

Headline comments: The portfolio continues to meet its objectives. The fund delivered a quarterly return very slightly behind the index benchmark (+3.9% versus +4.0%). Over three years the fund has outperformed the index by +0.7% p.a. and delivered a return of +8.0% per annum.

Mandate summary: A UK equity index fund designed to match the total return on the UK FTSE All Share Index. The in-house manager uses Barra software to create a sampled portfolio whose risk/return characteristics match those of the index.

Performance attribution: Chart 1 shows the tracking error of the in-house index fund against the FTSE All Share Index since Q1 2006. **There are no performance issues.** Over three years, the small quarterly positive relative returns (shown in Chart 1) have accumulated, and as a result the portfolio has outperformed its three-year benchmark by +0.7% per annum.

Chart 1



Source: Allenbridge based on WM figures

Portfolio risk: The tracking error on the portfolio at the end of December was 0.31% per annum. In terms of sector bets, relative to the Index, the largest underweight sector position relative to the index was Financials (-1.7%). The fund was most overweight in Utilities (+0.4%) and General Industries (+0.4%). This compares with sector bets of around 5-10% for the active managers.

Portfolio characteristics: The total number of holdings in the portfolio stood at 293 securities at the end of Q4 2015. Other than corporate actions and cash transfers into and out of the fund, the manager made £6.0 million of purchases and £0.9 million of sales in Q4.

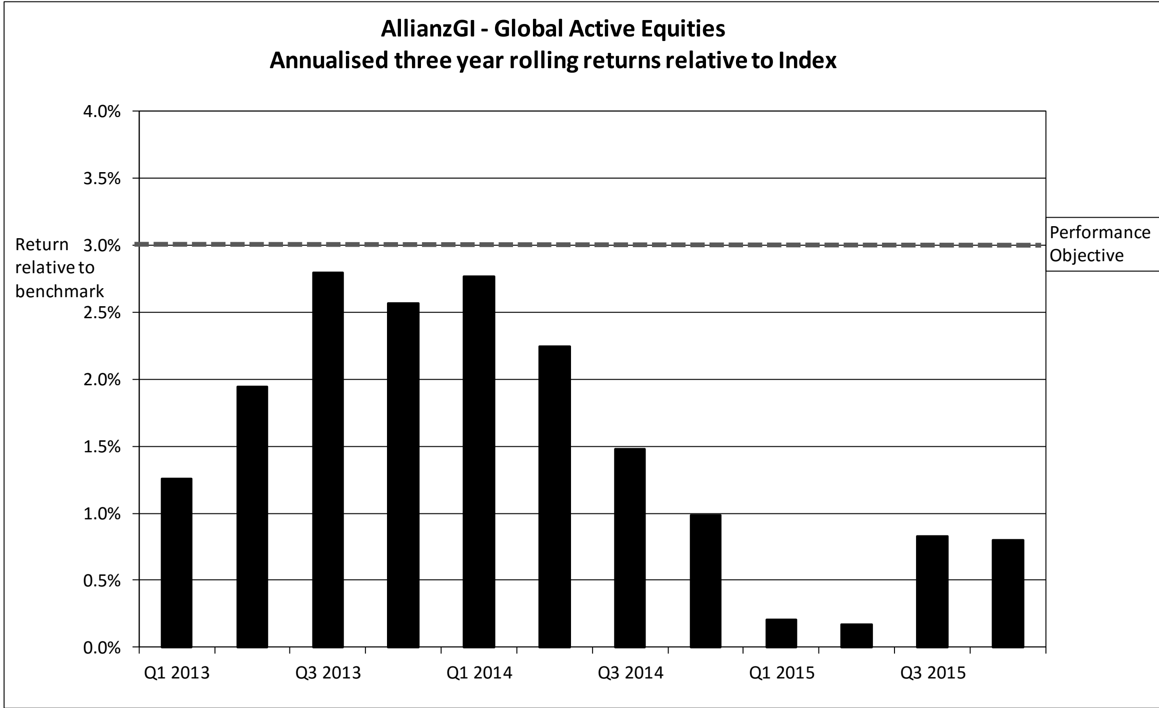
2.2. AllianzGI (RCM) – Global Active Equities

Headline comments: In terms of relative performance, the fund was ahead of the benchmark return of +8.1% for Q4 2015, delivering an absolute return of +8.6%. Over three years the fund is ahead of the benchmark by 0.8% per annum: however, this is behind the target of 3% per annum.

Mandate summary: An active global equity portfolio. AllianzGI operates a bottom-up global stock selection approach. They employ a team of research analysts to identify undervalued stocks in each geographical region (Europe, US, Asia Pacific). A global portfolio team is responsible for constructing the final portfolio. The objective of the fund is to outperform the FTSE All World Index by 3.0% per annum over rolling 3 year periods gross of fees.

Performance attribution: For the three years to December 2015, AllianzGI is ahead of its benchmark by +0.8% per annum, although **they are still trailing their performance target of 3% per annum**, shown by the dotted line in Chart 2.

Chart 2



Source: Allenbridge based on AllianzGI figures

Staff turnover: In October, the Chief Executive of AllianzGI, Elizabeth Corley, announced her intention to step down on 1st March 2016. She will remain on the Board as the non-executive Vice Chair. Global chief investment officer Andreas Utermann will assume the role of Chief Executive Officer from 1st March.

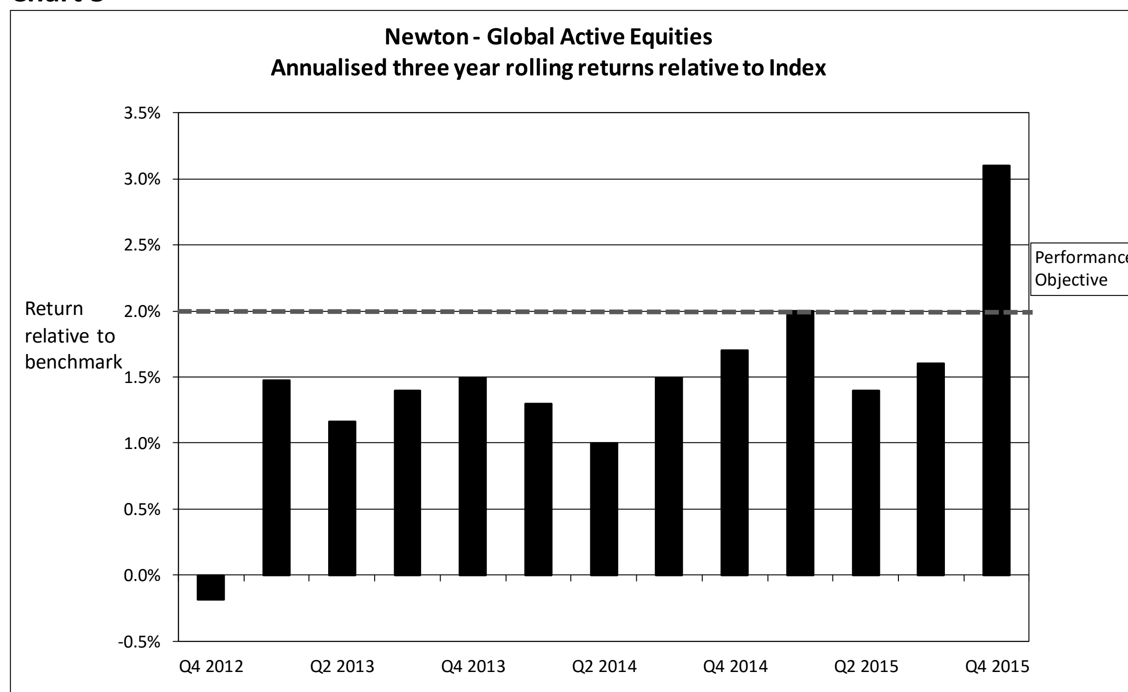
2.3. Newton – Global Active Equities

Headline comments: Newton were ahead by +1.3% during Q4 2015 bringing their one-year relative performance to +6.0%, an impressive level of outperformance. Over three years the portfolio outperformed by +3.1% per annum, well ahead of the target of 2% p.a. The outperformance of +3.1% per annum over three years can be attributed to both successful stock selection (+2.5%) and successful asset allocation (+0.9%).

Mandate summary: An active global equity portfolio. Newton operates a thematic approach based on 12 key themes that impact the economy and industry. Some are broad themes that apply over the longer term; others are cyclical. Stock selection is based on the industry analysts' thematic recommendations. The objective of the fund is to outperform the FTSE All World Index by 2.0% per annum over rolling 3 year periods, net of fees.

Performance attribution: Chart 3 shows the three year rolling returns of the portfolio relative to the Index (the black bars) and compares this with the performance target, shown by the dotted line.

Chart 3



Source: Allenbridge based on data from Newton and WM

Chart 3 shows the excellent progress being made by the manager, relative to the performance objective. For the three-year period to the end of 2015, the fund (shown by the right hand black bar) is +1.1% per annum ahead of the performance objective (shown by the dotted line). Note that this will mean the manager earns a performance fee in Q4 2015.

Over the three years to December 2015, Newton's return was +15.4% p.a. compared to the index return of +11.9% p.a., an outperformance of +3.1% p.a. Stock selection accounted for +2.5% of the outperformance with the balance from asset allocation.

Since the inception of Newton's portfolio in November 2008, the pension fund is better off than it would have been with a passive mandate. Newton's 'since inception' return is +13.4% per annum, compared to the benchmark return at 12.5% per annum, an outperformance of +0.9% p.a. *(source: Newton, gross of fees performance shown)*.

During the quarter the most successful sector was Technology (+0.75% contribution to relative performance) where Newton had successful stock positions and was overweight the sector, both of which helped performance. The least successful sector was Basic

Materials (-0.15% from relative performance). This was due to poorly performing companies in that sector.

Portfolio Risk: The largest overweight regional allocation was in European Equities (+2.6% overweight). This has been a long-standing position that has been in place since Q3 2011 although the current positioning is significantly lower than in Q3 2013 when the overweight position stood at 9.8%. This overweight position detracted slightly from relative performance in Q4. The most underweight allocation was Pacific ex Japan (-4.9%). This underweight allocation detracted slightly from performance although that was more than offset by good stock selection in this region.

In terms of sector bets, Newton remained overweight in Consumer Services (+9.6% relative to benchmark.) The most underweight sector remained in Financials (-10.4%). This underweight position has been in place since Q2 2009 although during that time the position has made a broadly neutral contribution to relative performance.

The level of active risk in the portfolio (i.e. the relative risk of the active bets being taken by Newton, or the tracking error) returned to its more typical level of 2.4%, as at end December 2015, having risen to 2.8% at the end of September. This is within Newton's normal range of 2% and 6%.

Portfolio characteristics: At the end of Q4 2015, the portfolio held 67 securities (69 as at the end of Q3 2015). There has been a steady drop in the number of stocks in the portfolio, which is worth noting. At the end of 2009, Newton held 138 stocks. Even three years ago, the number still stood at 99 holdings. Turnover over the past 12 months was 22%, at the low end of Newton's normal expected range of turnover to 30%-70%.

Investment process: At their annual conference, in November 2015, Newton announced that they were introducing two new themes to their thematic approach:

- Energy Economy: this theme is changing to "Abundance". The original theme was based around demand and supply in energy - supply has been increasing which has led to pricing pressure. Abundance goes beyond that to say that cheap money has resulted in an explosion of capacity in many sectors, with the result that pricing patterns are changing;
- Global realignment: this theme is changing to "Mind the gaps". Over the last few years the markets have been supported by central bank intervention. Now investors need to "mind the gap" between the winners and the losers, making selective stock selection increasingly important.

Newton holds the view that Healthcare will continue to do well, as a sector. The investment case is that between 2013 and 2050 the world population is expected to grow by 140% in the 60-80 age bracket and by 227% in the over 80's. This will lead to increasing demand for healthcare.

London CIV update: Newton has remained in discussion with the London Common Investment Vehicle (London CIV) and, whilst they were not in Phase 1 to transfer onto the CIV (with AllianzGI), they are hoping to transfer in Phase 2. They have proposed both an ad valorem fee and a performance fee. Newton have indicated that if the CIV adopts the performance fee (which is the arrangement currently in place for Islington), it should result in a small fee saving for the pension fund, assuming the manager outperforms by around 2%, in line with the performance target.

Staff turnover: during the quarter there were no new joiners and one leaver (James Harries). James was a portfolio manager within the Global Equity Income and Real Returns team. Nick Clay, another portfolio manager in the team, has taken over as lead manager of the Global Income Fund with Terry Coles as the alternate manager. This is worth noting because Terry is the lead portfolio manager for the London Borough of Islington. Newton have confirmed that there are no plans to switch Terry from the lead manager role on Islington's portfolio.

2.4. Standard Life – Fixed Income

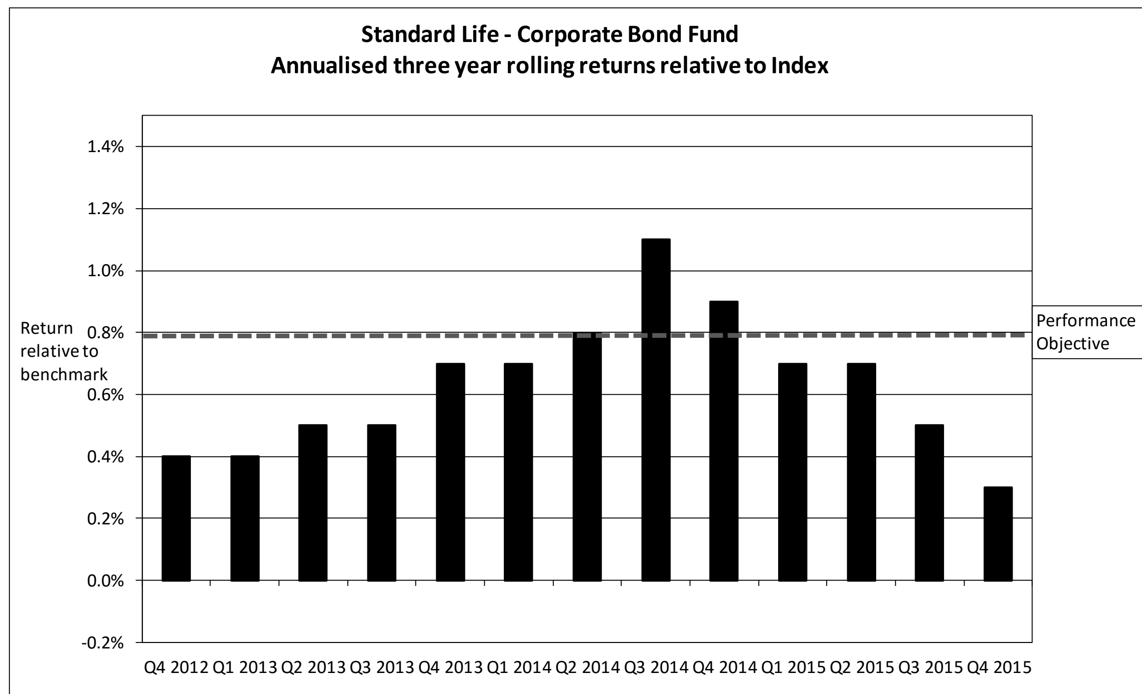
Headline comments: The portfolio was slightly behind the benchmark during the quarter with a return of +0.4% versus +0.5% for the Index. Over three years, Standard Life's outperformance was +0.3% per annum. This is slightly trailing their performance target of +0.8% per annum.

Mandate summary: An actively managed bond portfolio, invested in Standard Life's Corporate Bond Fund. The objective of the fund is to outperform the Merrill Lynch UK Non Gilt All Stocks Index by 0.8% per annum over rolling 3 year periods.

Performance attribution:

Chart 4 shows the performance the Corporate Bond Fund versus its benchmark and performance target.

Chart 4



Source: Allenbridge based on WM figures

Over three years, the portfolio has returned +4.8% p.a. compared to the benchmark return of +4.5% p.a., an outperformance of +0.3% p.a. The fund is behind its performance objective of outperforming the benchmark by +0.8% per annum.

Over the past three years, most of the outperformance has come from successful stock selection, followed by asset allocation. The outperformance has been partly offset by a negative contribution to performance from curve plays.

Portfolio Risk: The largest holding in the portfolio at quarter end was EIB 5.625% 2032 (1.3% of the portfolio). The largest overweight sector position remained Financials (+5.8%). The long-standing underweight position in sovereigns and sub-sovereigns remains (-17.1%).

The fund holds 6.5% of the portfolio in non-investment grade bonds (these do not form part of the benchmark).

Portfolio characteristics: The value of Standard Life's total pooled fund at end December 2015 was £3,549.6 million, £53.6 million lower than at the end of Q3 2015. London Borough of Islington's holding of £215.0 million is 6.1% of the total fund value. When Islington first invested, the percentage holding was 3.4%.

Staff turnover: there were ten joiners during the quarter, including two fixed income specialists, and five leavers, none of whom was from the fixed income division. Lara Kharratt joined the London credit team as an Assistant Portfolio Manager and Sefton Kincaid joined as a Credit Analyst in Boston.

2.5. Aviva Investors – Property – Lime Property Fund

Headline comments: In a reversal of Q3, gilts performed poorly and delivered a negative return. The Lime Fund outperformed the gilt benchmark by +3.5% during the quarter. Over three years, the Fund returned +7.9% compared to the gilt benchmark return of +4.2% per annum - well ahead of the performance target of +1.5% per annum outperformance.

Mandate summary: An actively managed UK pooled property portfolio, the Lime Fund invests in a range of property assets including healthcare, education, libraries, offices and retail. The objective of the fund is to outperform a UK gilt benchmark, constructed of an equally weighted combination of the FTSE 5-15 Years Gilt Index and the FTSE 15 Years+ Gilt Index, by +1.5% per annum, over three year rolling periods.

Performance attribution: The fund was ahead of the gilt benchmark this quarter by +3.5%, as bond markets fell. The fund rose +1.8% whilst the benchmark fell by -1.7%. The portfolio trailed the IPD Index in Q4 2015 by -1.9%.

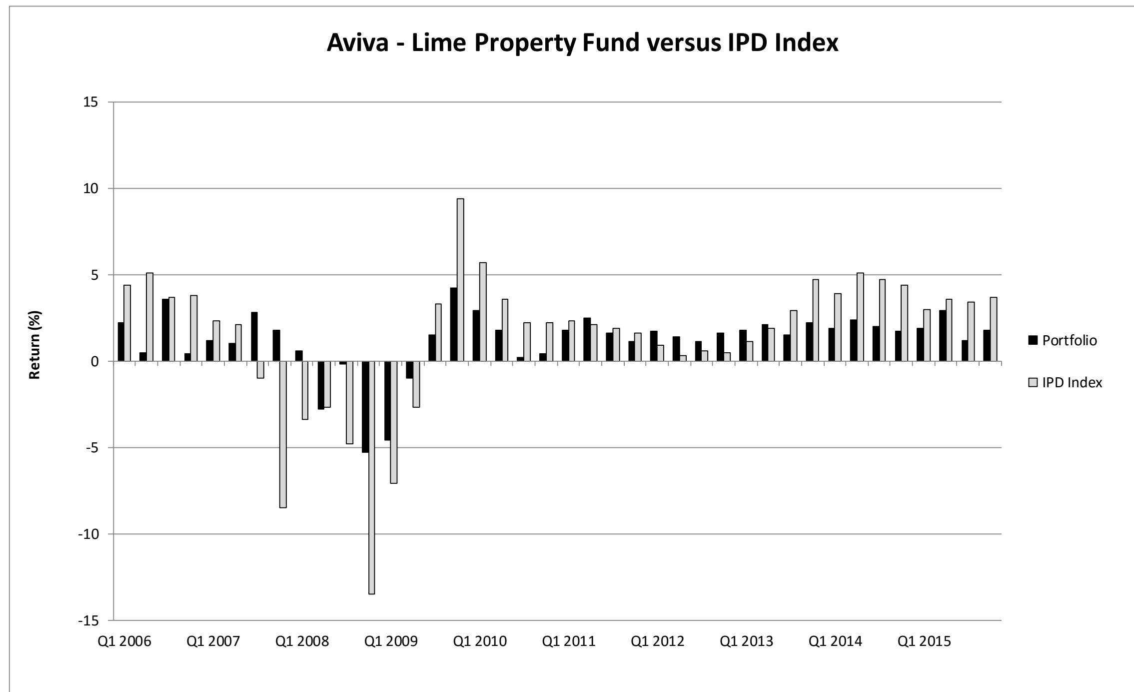
Over three years, the fund has returned +7.9% p.a. compared to the gilt benchmark of +4.2% p.a., an outperformance of +3.5% per annum. The **portfolio is ahead of its performance objective of +1.5% per annum outperformance over three years**. Of the +7.9% fund return over three years, 5.2% came from income, with the balance from capital gain.

Portfolio risk: There were several deals during the quarter including a purchase of Premier Inn in Portsmouth, a letting of an industrial asset to Royal Mail, in Northampton, and a restructuring of a lease to Compass, in Birmingham. The average unexpired lease term is 20.0 years, with 9.4% of the portfolio's lease exposure in properties in 30-35 year

leases, and 1.9% in over-35-year leases. The largest sector exposure remains offices at 28.2%. The cash allocation stood at 5.9% as at quarter end.

The Lime Fund is a low risk property portfolio and this is shown clearly in Chart 5 which shows the absolute performance of the Fund each quarter compared to the IPD Index. This shows the return stream of the portfolio (in black) following a more muted profile (in both up and down markets) than the IPD Index as a whole.

Chart 5



Source: Allenbridge based on WM figures

Portfolio characteristics: As at end December 2015 the Lime Fund was valued at £1.631 billion, an increase of £19 million from the previous quarter end. London Borough of Islington's holding represents approximately 3.4% of the total Fund's value.

Staff turnover/organisation: 49 leavers and 74 joiners in Q4 2015. Of these, eight joined the real estate team, whilst three left the team. Aviva were awarded "Long Income Property Manager of the Year" by Professional Pensions, in November 2015.

2.6. Columbia Threadneedle - Pooled Property Fund

Headline comments: The Fund's performance was ahead of its benchmark in Q4 2015 by +0.2% (source: Columbia Threadneedle). Over three years, the Fund has outperformed by +1.2% per annum, ahead of the performance target of 1% p.a. above benchmark over three years.

Mandate summary: An actively managed UK commercial property portfolio, the Columbia Threadneedle Pooled Property Fund invests in a diversified, multi-sector portfolio of UK property assets. Its performance objective is to outperform the AREF/IPD All Balanced – Weighted Average (PPFI) Index by at least 1% p.a., net of fees, on a rolling three year basis. The benchmark changed at the end of Q4 2013. Prior to this, the benchmark was the CAPS pooled property median fund.

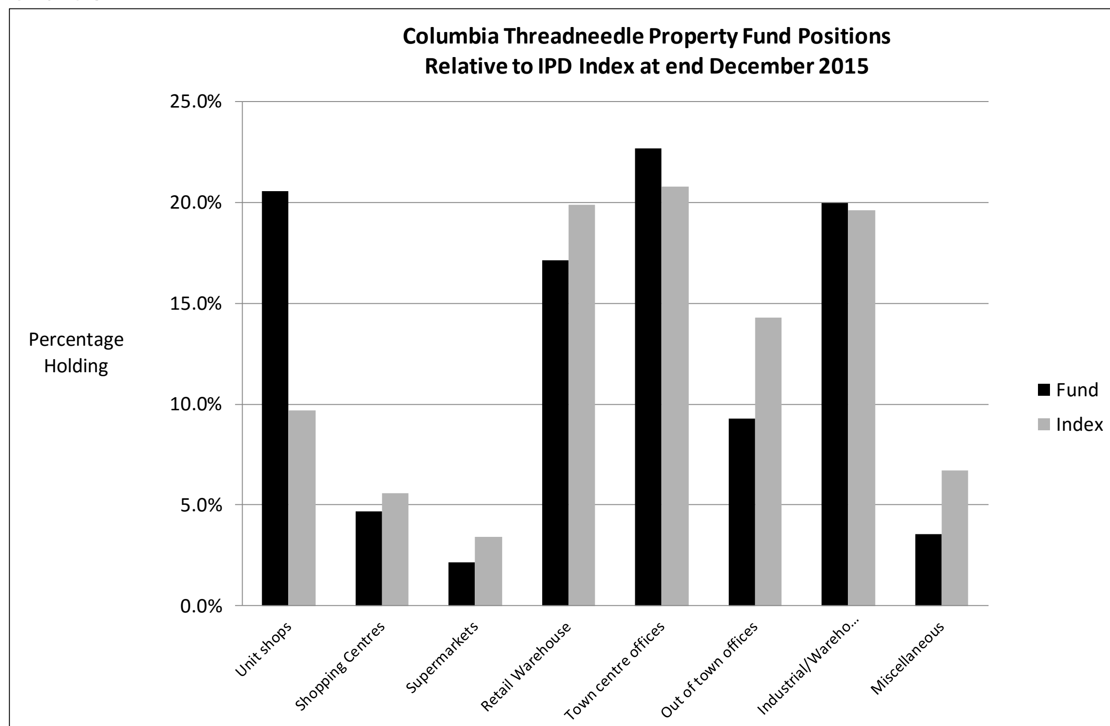
Performance attribution: The portfolio was ahead of the benchmark in Q4 2015, by +0.2% (source: Columbia Threadneedle), delivering a return of +3.1%. Of this, +1.7% was from capital growth and the balance from income. In terms of the three-year performance, **the Fund is ahead of its benchmark by +1.2% per annum so ahead of the performance target of +1% per annum.** The absolute return over three years remains strong. The portfolio returned +13.4% p.a. over three years compared to the benchmark return of +12.0% p.a.

Portfolio Risk: As at quarter end, the Fund held 260 properties with an average size of £5.8 million. This makes the portfolio highly diversified. The top ten tenants make up 20% of the portfolio. In contrast, in the IPD Index the top ten tenants account for 45%, so Threadneedle's portfolio is more diversified than many of their peers. Chart 6 shows the current breakdown of the portfolio relative to its benchmark.

Threadneedle's market view is that the economy has become quite strong in certain areas. Occupiers are in good corporate health so the office and industrial warehouse sectors are robust. There is more competition for space than two years ago so rental growth is growing. Threadneedle perceives that retail (high street) stores still have problems. The distribution sector is performing well but the high street is struggling.

Overall, Threadneedle's views are that property returns will begin to slow, but they are not intending to change the shape of their portfolio in light of these lower expectations. They continue to operate a "buy and hold" approach with an emphasis on income.

Chart 6



Source: Allenbridge based on Columbia Threadneedle data.

Portfolio characteristics: As at 31st December 2015, the Threadneedle Property Fund was valued at £1.68 billion, an increase of £228.5 million compared with September 2015. London Borough of Islington's holding represents 4.3% of the Fund. The Fund had been operating a queue for new investors. This has now all been fully invested within the fund so they are no longer operating a queue.

The net initial yield on the portfolio was 6.1% at the end of December compared to 5% for the IPD Index. The vacancy rate stands at 6.7% which is below the market average rate of 7.3%.

Staff turnover: There were six joiners and three leavers during the quarter; however, none of these were in the real estate division.

London CIV update: Columbia Threadneedle are hoping to transfer their property fund onto the London CIV and are currently exploring ways in which they might convert the existing fund into an ACS fund structure in a tax efficient manner. They are also bringing London Borough clients onto a common fee scale in anticipation of that, and this should result in a fee discount for London Borough of Islington.

2.7. Legal and General Investment Management (LGIM) – Overseas Equity Index Funds

Headline comments: All the index funds were within the expected tracking range when compared with their respective benchmarks and there are no issues. The fundamental FTSE-RAFI Emerging Markets index fund underperformed its market capitalisation-weighted counterpart in Q4 by -7.2%. For the 12 months to Q4 2015 the underperformance was -6.6%.

Mandate summary: Four regional overseas equity index funds, in Europe, Japan, Asia Pacific ex Japan, and emerging markets, designed to match the total return on the FTSE All World Regional Indices. One additional index fund is designed to match the total return on the FTSE-RAFI Emerging Markets Equity Index. The FTSE All World Indices are based on capitalisation weights whereas the FTSE-RAFI Index is based on fundamental factors.

Performance attribution: **The regional portfolios are all tracking their benchmarks**, as shown in Table 2.

Table 2

Q4 2015	Fund	Index	Tracking
Europe	6.3%	6.3%	0.0%
Japan	12.6%	12.5%	0.1%
Asia Pacific ex Japan	10.3%	10.3%	0.0%
FTSE emerging markets	3.1%	3.0%	0.1%
RAFI emerging markets	1.2%	1.2%	0.0%

Source: LGIM

Portfolio Risk: The percentage allocation to each regional fund is based on pre-agreed band widths, which also take into account the global equity managers' allocations. The largest deviation from the benchmark allocation is North America which is 4.8% overweight.

Organisation: Assets under management stood at £728 billion as at end December.

2.8. Franklin Templeton – Global Property Fund

Headline comments: This is a long term investment and as such a longer term assessment of performance is recommended. There are now two funds in which London Borough of Islington invests. The portfolio in aggregate delivered a return of +26.6% per annum over

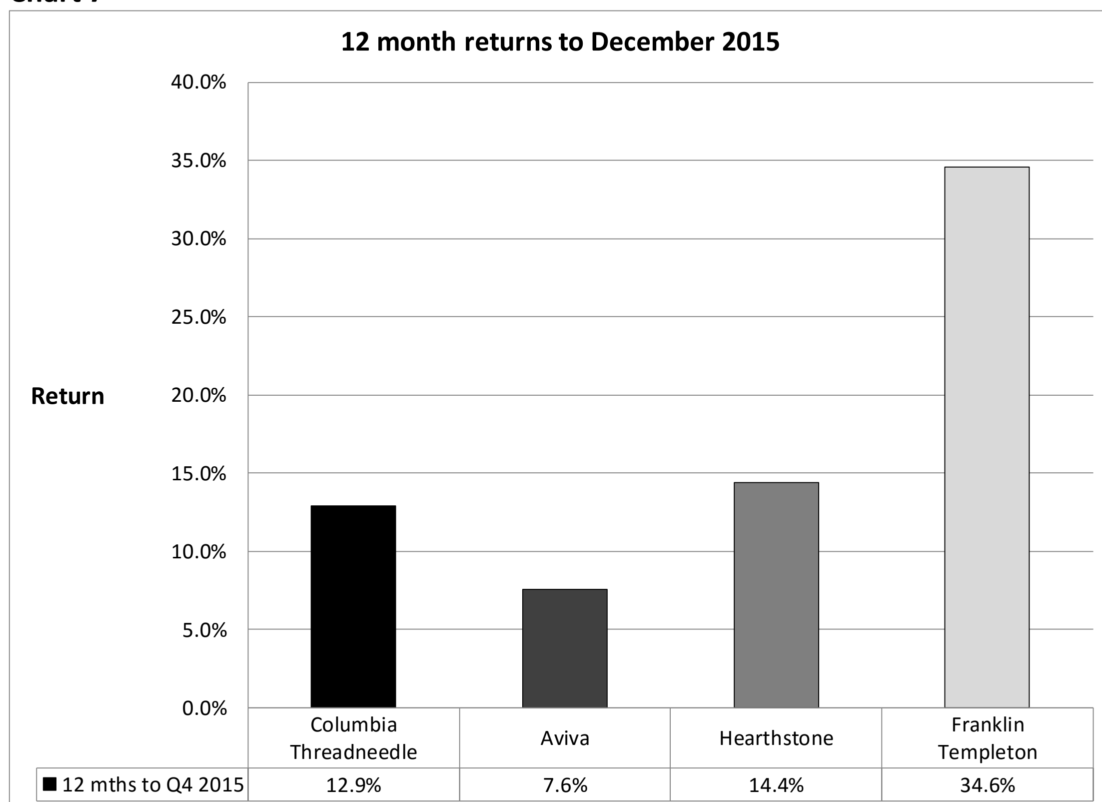
the three years to end December 2015, outperforming the absolute return benchmark by +15.1% per annum.

Mandate summary: Two global private real estate fund of funds investing in sub funds. The performance objective is an absolute return benchmark over the long term of 10% per annum.

Performance attribution: Over the past twelve months, **Franklin Templeton is the best performing fund across all four property managers**, by some way, as shown in Chart 7. Fund 1 is now fully committed and entering its distribution phase. Distributions in Q4 2015 amounted to 5.7% of the total equity commitments. Fund 2 received its first distribution from an underlying investment, in Q4. It also closed its third investment, an office building in Seattle, Washington, in the US.

The strong 12 month returns have fed through to the three year numbers and the Fund is now comfortably ahead of its target absolute return of 10% per annum, with the three years to December 2015 delivering a return of +26.6% per annum.

Chart 7



	Columbia Threadneedle	Aviva	Hearthstone	Franklin Templeton
■ 12 mths to Q4 2015	12.9%	7.6%	14.4%	34.6%

Portfolio risk: Leverage on Fund 1 was 53% as at end December, with three funds showing leverage of 70% as at end December (GreenOak Japan, Project Redfish and Valla Park Co-Investment 70%). Leverage on Fund 2 was 54% as at end December.

Of the 14 investments in Fund 1, three are on target (10%-15% projected net internal rate of return (IRR)), seven are above target (15-25% projected net IRR) and three are substantially above target (more than 25% projected net IRR). One fund is still too early to assess at this stage. The three funds which are substantially above target are: GreenOak, Project Redfish (a Toyko fund managed by Green Oak) and Secured Capital Japan V.

Of the three investments in Fund 2, one is on target and two are too early to assess.

Staff turnover: there were no joiners to or leavers from Franklin Templeton Real Asset Advisers during Q4 2015.

Just after the quarter end, however, Franklin Templeton announced that Witsard Schaper was leaving the firm in January. Witsard has presented to the Pensions Committee in the past. He has been offered a job with a Sovereign Wealth Fund.

In terms of a replacement for Witsard, Franklin Templeton plan to appoint a new senior member of the team, although this may take some time to find the right person. Raymond Jacobs in the US, Caroline Demol in Switzerland and David Germer in London remain heavily involved in the fund and all three cover Europe which was Witsard's specific area of expertise. Until a replacement is found, Raymond Jacobs will attend any meetings. Mark Weidner remains the lead fund manager for London Borough of Islington.`

2.9. Hearthstone – UK Residential Property Fund

Headline comments: The portfolio returned +1.6% compared to the benchmark return of +1.9% for the quarter ending December 2015. Over one year, the Fund delivered a return of +14.4%, compared to the benchmark return of +5.2%, an outperformance of +8.8%.

Mandate summary: The Fund invests in private rented sector housing across the UK and aims to outperform the LSL Acadametrics House Price Index (note that this excludes income), as well as providing an additional income return.

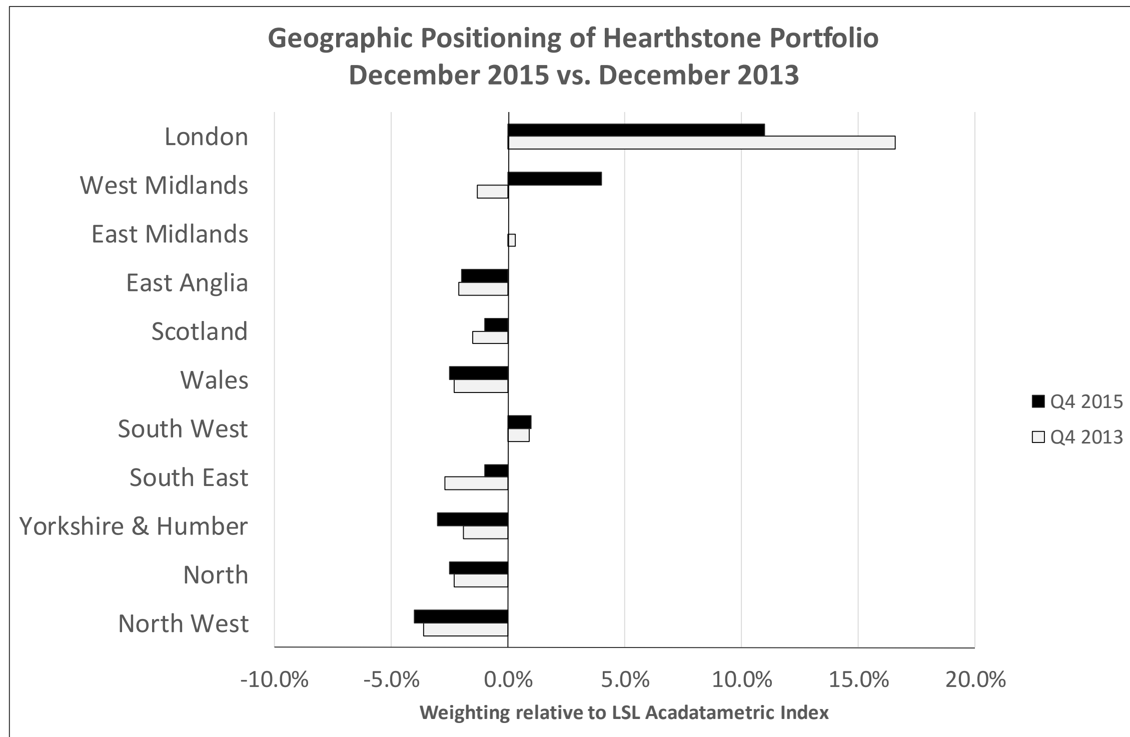
Performance attribution: The Fund returned +14.4% compared to the return on the index of +5.2% over the past 12 months, an outperformance of +8.8%. However, it is worth noting that the LSL Acadata House Price Index only takes price appreciation into account.

The gross yield on the portfolio was 5.4% at the end of December. This compares with LDL's average gross yield for properties in England and Wales (as calculated for their Buy to Let Index) of 5.0%.

Portfolio risk: The overweight position in London, primarily a result of the Wembley investment opportunity, is gradually decreasing as the Fund attracts new money which is being invested in other regions (in particular the North West, North and South East). Hearthstone's long term strategy is to maintain broadly neutral regional bets in the portfolio. At the end of 2013, the Fund was 16.6% overweight to London. At the end of 2015, that had dropped to an 11% overweight position.

Chart 7 compares the regional bets in the portfolio in Q4 2013 with the bets in Q4 2105. The reduced London overweight is shown by the top black bar (2015), compared with the top grey bar (2013).

Chart 7



Source: Allenbridge based on Hearthstone figures

Portfolio characteristics: The Fund has a 20% allocation to detached houses, 49% allocated to flats, 26% in terraced accommodation and 5% in semi-detached. The allocation to flats remains a significant overweight position relative to the Index (49% for the Fund compared to 17% for the Index). This is offset by an underweight position in semi-detached houses (5% for the Fund compared to 24% for the Index).

Organisation and staff turnover: There were no changes in personnel in Q4 2015. The firm still has just six employees and this remains a concern.

2.10. Schroder – Diversified Growth Fund (DGF)

Headline comments: The Diversified Growth Fund delivered a return of +2.6% in Q4 2015.This compared with their RPI plus 5% p.a. target return of +1.6% for Q4.

Mandate summary: The Fund invests in a broad mix of growth assets and uses dynamic asset allocation over the full market cycle, with underlying investments in active, passive and external investment, as appropriate. Schroders aim to outperform RPI plus 5% per annum over a full market cycle, with two-thirds the volatility of equities.

Performance attribution: In Q4 2015, Schroders' exposure to global equities made the largest contribution to the portfolio return (+1.0%), with smaller contributions from additional regional equity allocations (ranging from +0.1% to +0.3%). Alternative assets such as absolute return, infrastructure, property and private equity each contributed a further 0.1%. This was offset by negative contributions from government bonds (-0.2%), investment grade bonds (-0.1%), and currency (-0.1%).

Portfolio risk: The portfolio is expected to deliver equity-like returns with two-thirds the volatility of equities. However, this is over a full 3-5 year market cycle. Over the past 12

months, the volatility of the Fund was 8.2% compared to a 12-month volatility of 13.4% in equities.

Portfolio characteristics: The Fund had 9% in internally managed funds, 40% in bespoke solutions, 14% in externally managed funds, 31% in passive funds and 6% in cash, as at end December 2015. In terms of asset class exposure, 46% was in equities, 26% in alternatives and 22% in credit and government debt, with the balance in cash.

Alternative assets include absolute return funds, infrastructure, property, insurance-linked securities, private equity and commodities.

Organisation and staff turnover: there were no changes in staff within the Multi-Asset investment team (i.e. the team running the Diversified Growth Fund). Firm-wide, globally there were 101 leavers and 106 joiners. Of these 55 leavers and 60 joiners were for the UK business. After the quarter end, Schroders announced that Michael Dobson will step down as chief executive after 14 years in the role, to become non-executive chairman. He will be replaced by Peter Harrison, the head of investment.

Karen Shackleton
Senior Adviser, Allenbridge
17th March 2016

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Agenda Item 2

ISLINGTON

Finance Department
7 Newington Barrow Way
London N7 7EP

Report of: **Corporate Director of Finance and Resources**

Meeting of:	**Date**	**Agenda item**	**Ward(s)**
Pensions Sub-Committee	11 April 2016		

Delete as appropriate	Exempt	~~Non-exempt~~

Appendix 1 to this report is exempt and not for publication as it contains the following category of exempt information as specified in Paragraph 3 of Schedule 12A of the Local Government Act 1972 namely: "Information relating to the financial or business affairs of any particular person (including the authority holding that information)"

SUBJECT: The London CIV Update

1. Synopsis

1.1 This is a report informing the committee of the progress made at the London CIV in launching funds and running of portfolios over the period from November 2015 to March 2016

2. Recommendations

2.1 To note the progress made to March 2016
2.2 To note the report on proprosals to fund further resources amd budget projection to 2020 attached as Appendix1 (private and confidential)

3. Background

3.1 **Setting up of the London CIV Fund**
Islington is one of 32 London local authorities who have become active participants in the CIV programme and have each contributed £50,000 to the designated fund with a further £25,000 for the 2015-16 financial year to be invoiced shortly. The CIV has been constructed as a FCA regulated UK Authorised Contractual Scheme (ACS). The ACS is composed of two parts: the Operator and the Fund.

3.1.1 **Progress to Date**
A limited liability company (London LGPS CIV Ltd) has been established, with each participating borough holding a nominal £1 share. The company is based in London Councils' building in Southwark Street. A branding exercise has taken place and the decision was taken to brand the company as 'London CIV.'

3.1.2 The interim board of the company, which has been in place since the autumn of 2014, is shortly to be replaced by a full time board made up of three Non-Executive Directors and the three Executive Directors of the company which include the Chief Executive (CEO), the Chief Operating Officer (COO) and the Investment Oversight Director (IOD). Hugh Grover (previously Programme Director of the CIV for London Councils) was appointed CEO before the summer and the positions of COO and IOD were both filled during the last month.

3.1.3 The company has procured a number of specialist advisors to help not only with the establishment of the ACS (both Operator and Fund) but also with the day to day running of the company for its first few years of trading. Northern Trust were appointed as the Asset Servicer to the ACS (fulfilling custody, depositary and transfer agency roles) in December 2014. Eversheds and Deloitte were both appointed in the Spring of 2014 to help establish the vehicle from both a legal and tax perspective.

3.1.4 As an FCA authorised entity, both the Operator and the Fund are required to go through the FCA authorisation process. The Operator application for authorisation went to the FCA in July and the Fund application is planned to be submitted in September. The London CIV received its ACS authorisation in November.

3.2 **Launching of the CIV**

It was noted that a pragmatic starting point was to analyse which Investment Managers (IM) boroughs were currently invested through, to look for commonality (i.e. more than one borough invested with the same IM in a largely similar mandate), and to discuss with boroughs and IMs which of these 'common' mandates would be most appropriate to transition to the ACS fund for launch. Each mandate would become a separate, ring-fenced, sub-fund within the overall ACS fund. Boroughs would be able to move from one sub-fund to another relatively easily, but ring-fencing would prevent cross contamination between sub-funds.

3.2.1 Further discussions have been held with managers, focussing specifically on what would be achievable for launch, taking into account timing and transition complexities. Four managers have now been identified as offering potential opportunities for the launch of the CIV. These managers would provide the CIV with 9 sub-funds, covering just over £6bn of Borough assets and providing early opportunity to 20 boroughs. The sub-funds will consist of 6 'passive' equity sub-funds covering £4.2bn of assets, 2 Active Global Equity mandates covering £1.6bn and 1 Diversified Growth (or multi-asset) Fund covering just over £300m. Those boroughs that do not have an exact match across for launch are able to invest in these sub-funds from the outset at the reduced AMC rate that the CIV has negotiated with managers.

3.2.2

The Sub Fund identified are

Manager	LGIM	LGIM	LGIM	Blackrock	Blackrock	Blackrock	Baillie Gifford	Baillie Gifford	Allianz	Total
Sub Fund(s)	World Devel. ex UK	UK Equity Index	World Emerging Markets Eq Index	World Devel. ex UK	UK Equity Index	World Emerging Markets Eq Index	Global Alpha Fund	Diversified Growth Fund	Global Equity High Alpha	9
AUM	£1,372,958,854	£1,024,597,553	£168,189,926	£937,417,764	£571,324,102	£155,341,753	£1,113,921,440	£319,823,905	£525,004,960	**£6,188,580,257**

The Phase 1 launch was with Allianz our global equity manager and Ealing and Wandsworth are the 2 other boroughs who hold a similar mandate. The benefits of transfer include a reduction in basic fees and possible tax benefits because of the vehicle used. Members agreed to transfer our Allianz portfolio in Phase 1 launch that went ahead on 2 December at a transfer cost of £7,241.

3.3 A report providing proposals and rationale from London CIV's Board concerning the need for an accelerated recruitment process and two additional staff, and budget proposals to cover the forecast costs involved is attached as Appendix1 (private and confidential)

4. Implications

4.1 **Financial implications:**

4.1.1 Fund management and administration fees are charged directly to the pension fund.

4.2 **Legal Implications:**

4.2.1 The Council, as the administering authority for the pension fund may appoint investment managers to manage and invest an equity portfolio on its behalf (Regulation 8(1) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended).

4.2.2 The Council is able to invest fund money in a London CIV fund asset without undertaking a competitive procurement exercise because of the exemption for public contracts between entities in the public sector (regulation 12 of the Public Contracts Regulations 2015). The conditions for the application of this exemption are satisfied as the London authorities exercise control over the CIV similar to that exercised over their own departments and CIV carries out the essential part of its activities (over 80%) with the controlling London boroughs.
.

4.3 **Environmental Implications:**

4.3.1 None specific to this report

4.4 **Resident Impact Assessment:**

4.4.1 An equalities impact assessment has not been conducted because this report is updating members on the implementation of a fund structure by external managers. There are therefore no specific equality implications arising from this report.

5. Conclusion and reasons for recommendations

5.1 The Council is a shareholder of the London CIV and has agreed in principle to pool assets when it is in line with its Fund strategy and will be beneficial to fund members and council tax payers. This is a report to allow Members to review progress at the London CIV.

Appendices: 1 (private and confidential)

Background papers:

Final report clearance:

Signed by:

Corporate Director for Finance and Resources Date

Received by:

Head of Democratic Services Date

Report Author: Joana Marfoh
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Agenda Item 3

ISLINGTON

Finance Department
7 Newington Barrow Way
London N7 7EP

Report of: **Corporate Director of Finance and Resources**

Meeting of:	Date	Agenda item	Ward(s)
Pensions Sub-Committee	11 April 2016		n/a

Delete as appropriate		Non-exempt

SUBJECT: CARBON RISK MANAGEMENT

1. Synopsis

1.1 The Appendix 1 to this report is a paper prepared by our investment advisor, Mercer on approaches and factors to consider on low carbon and fossil free passive equity.

2. Recommendation

2.1 To consider and discuss the paper prepared by Mercer and attached.as Appendix 1

2.2 To consider further work on identifying how our current passive equity fund compares to a low carbon and fossil free index for discussion at a future meeting

3. Background

3.1 Regulation 12(2)(f) of the Management and Investment of Funds Regulations requires that the Statement of Investment Principles (SIP) must be a statement of the principles governing the authority's decisions about the investment of fund money, which covers the extent to which social, ethical or environmental (SEE) considerations are taken into account in the selection, retention and realisation of investments.
Our current SIP paragraphs, on social and ethical considerations were updated in November 2014 to reflect the Pension Sub committees' policy.

3.2 The Council is the administering authority for the London Borough of Islington Pension Fund, within the Local Government Pension Scheme (LGPS). It is managed within the legal framework set down in the Local Government Pension Scheme Regulations 2007/8 as amended. The body responsible for decision making in relation to the Pension Fund is the Pensions Sub-Committee of the Audit Committee.

3.3 The Pensions Sub-Committee, as the administering authority, is aware of its fiduciary responsibility to obtain the best possible financial return on investments over appropriate investment periods, within acceptable levels of risk and will apply this principle when making investment decisions on behalf of the Islington pension fund.

3.4 Members agreed to consider a further paper on engagement to develop and enhance their current policies. Mercer has prepared a high level paper on drivers and approaches of responsible investment and next steps implementation for Members' consideration.

4. Implications

4.1 Financial implications

There are no financial implications arising from this report.

4.2 Legal Implications

Regulation 12(2)(f) of the Management and Investment of Funds Regulations requires that the Statement of Investment Principles (SIP) must be a statement of the principles governing the authority's decisions about the investment of fund money, which covers the extent to which social, ethical or environmental (SEE) considerations are taken into account in the selection, retention and realisation of investments.

4.3 Environmental Implications

Environmental considerations can lawfully be taken into account in investment decisions.

4.4 Equality Impact Assessment

4.4.1 The Council must, in carrying out its functions, have due regard to the need to eliminate unlawful discrimination and harassment and to promote equality of opportunity in relation to disability, race and gender and the need to take steps to take account of disabilities, even where that involves treating the disabled more favourably than others (section 49A Disability Discrimination Act 1995; section 71 Race Relations Act 1976; section 76A Sex Discrimination Act 1975."

4.4.2 An equalities impact assessment has not been conducted because this report is not considering any policy changes. All employers have been consulted on changes to assumptions and there are no equalities issues arising.

5. Conclusion and reasons for recommendation

5.1 To consider Mercer's paper Appendix 1 on low carbon and fossil free passive equity and agree further work and consideration to a future meeting.

Background papers:
Islington Council Statement of Investment Principle (November 2014)

Final report clearance:

Signed by:

	Corporate Director of Finance & Resources	Date
Received by:		
	Head of Democratic Services	Date

Report Author: Joana Marfoh
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MERCER
MAKE TOMORROW, TODAY

AN INTRODUCTION TO LOW CARBON AND FOSSIL FREE PASSIVE EQUITY

MARCH 2016

Appendix 1

MARSH & McLENNAN COMPANIES

BACKGROUND – WHY HAVE LOW CARBON AND FOSSIL FREE INDICES EMERGED NOW?

Mercer's recent study, '*Investing in a Time of Climate Change*'[1], highlighted that investors should consider the risks posed by climate change; in particular policy risks. Following the positive outcomes from the recent meeting of global leaders in Paris, where a new global agreement to manage carbon emissions and tackle climate change was reached[2], it is anticipated that the policy response to managing climate change will become more urgent in the coming years.

Some of the key financial risks associated with climate change are rising carbon prices and the potential for "stranded assets" i.e. the possibility that a proportion of existing fossil fuel reserves will never be utilised due to changes in regulation, demand and technology.

Accordingly, investors are increasingly considering how to hedge their portfolios against the risks posed by climate change as well as seeking positive investment opportunities aligned with anticipated shifts in energy use and technology.

In a world where the cost of carbon is likely to rise, managing exposure to high carbon companies is an intuitive step to take.

One approach investors can take is to reduce the carbon intensity of their portfolios over time, also known as "portfolio decarbonisation". The benefits of this approach include:

- A portfolio that is less susceptible to increasing carbon pricing, stranded assets and/ or related regulation.
- Supports the flow of capital to a resilient low-carbon economy and may help to address the market mispricing of carbon.
- Produces a market signal that incentivises companies to develop and invest in low carbon and clean technologies, influences policymakers and also helps to catalyse a new standard for other institutional investors.

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[1] Available at: http://www.mercer.com/insights/focus/invest-in-climate-change-study-2015.html

[2] Available at: http://www.mercer.com/content/dam/mercer/attachments/global/investments/investing-in-a-time-of-climate-change-dispatch-from-cop21-mercer-2016.pdf

WHAT ARE LOW CARBON AND FOSSIL FREE INDICES?

Low carbon indices are designed to track broad market indices but with lower carbon footprints, in some cases significantly lower.

The primary benefit of a low carbon index is that it can be an important first step for investors to take to reduce the carbon intensity of their portfolios.

Additional benefits include that they are relatively low cost (albeit typically a little more expensive than broad market indices), relatively simple to understand (i.e. asset owners can point to a clear carbon reduction) and relatively easy to implement.

In a world where the cost of carbon is likely to rise, managing exposure to high carbon companies is an intuitive step to take. However investors need to consider carefully the methodologies and outcomes of these specialist indices:

- The indices are focussed on risk management and do not capture the opportunity side of the equation (i.e. by shifting from high carbon to lower carbon companies, investors may not necessarily gain exposure to companies leading on the development or provision of products/services best positioned to succeed in a lower carbon environment).
- To date, the indices are typically based on a market-capitalisation weighted methodology, and therefore bring with them the same issues that core market cap benchmarks have in this context (e.g. that investors end up with more exposure to overvalued companies as price fluctuates).
- Investors should be aware that whilst low carbon indexes are designed to track parent indices, the different construction approaches can lead to varying degrees of tracking error. During periods of extreme stress or market dislocation the performance of low carbon or fossil free indices could deviate significantly from the mainstream benchmark.
- Low carbon indices remain subject to concerns around data availability and transparency. The reporting of carbon emissions remains relatively inconsistent (particularly in emerging markets) and hence data is subject to assumptions and sometimes opaque standardisation methodologies.

OVERVIEW OF INDEX APPROACHES

Low carbon indices and fossil free investment solutions are a hot topic right now: multiple, competing indices have emerged over the last two years, with various investment vehicles launched. In our view, there are three broad categories of low carbon indices: Broad Market Optimised; Best-in-class and Fossil Free. We have set out in the table below a summary of the likely investor suitability and appeal of the different approaches.

Approach	Example Indices	Likely to be suitable for a client that….
Broad Market Optimised	• MSCI Low Carbon Target • FTSE UK Carbon Optimised	**… does not have an exclusion policy in place.** – By starting with the full universe, the construction methodology is consistent with the way an investor with a focus on ESG integration applies its responsible investment approach more generally across its investments. **… is seeking reduction in the exposure to carbon emissions and to carbon reserves.** **… is seeking to reduce exposure to fossil fuel related carbon emissions.**
Best-in-Class	• MSCI Low Carbon Leaders • S&P 500 Carbon Efficient Index	**… is able to accommodate negative exclusions.** – Typically such indices exclude the worst performers (in terms of carbon emissions/ reserves) from each sector and re-weight across the sector. **… wants an approach that considers carbon efficiency across all sectors (rather than focus on the sectors with the highest carbon emissions).** **… wants to send a clear signal to stakeholders that the largest carbon emitters are not present in the portfolio.**
Fossil Free	• MSCI ex Fossil Fuel • MSCI ex Coal • FTSE ex Fossil Fuel • FTSE ex Coal	**… is able to accommodate negative exclusions.** – Typically more applicable to foundation/ endowment clients. **… wants simple and transparent methology.** **… is committed to fossil fuel divestment based on a full review of their investment beliefs.** – These indices may be appropriate as a benchmark for active management.

SUMMARISING MERCER'S VIEW

- The use of low carbon or fossil free indices is only one of the many tools available for tackling climate change risks. Low carbon and fossil free index strategies do not typically offer exposure to investment opportunities aligned with a shift to a low-carbon economy.
- These indices may not necessarily bring an outperformance premium in the traditional sense. The "premium" is reduced carbon exposure rather than performance. This reduced exposure may be rewarded in financial terms, all else equal, as policy measures develop to reward lower carbon activities.
- Investors need to be fully aware of the underlying construction methodology – in particular, fossil free does not have one consistent definition across asset owners, index providers or investment managers.
- The use of such indices should not be seen as equivalent to, or as a substitute for, actively managed equities with a high level of ESG integration. Many actively managed strategies with strong ESG integration do not have exposure to high carbon sectors as a result of their idea generation and portfolio construction process and are also able to capitalise on investment opportunities that specifically address climate change and low carbon.
- **Low carbon indices** are expected to track (subject to tracking error limits) broad market indices with the potential for outperformance if policy measures develop to reward lower carbon activities. We consider low carbon indices to provide a scalable hedge against climate change risk for passive investors, without necessarily forfeiting returns in the interim.
- **Fossil free indices** are expected to show significant deviation from broad market indices. These indices may be appropriate for asset owners committed to divesting from fossil fuels and these indices may also be suitable as a benchmark for active management. Given their exclusionary nature, fossil free indices have performed well in the recent environment of falling oil prices but would be expected to underperform if there was a reversal to the current trend.

  Both low carbon and fossil free indices can serve to meet external commitments to align with a decarbonising economy and help to send a strong signal to stakeholders that they are proactively managing climate risk.

There are several questions for investors in determining the most appropriate approach, including:

- What risks do low carbon/ fossil free indices protect against?
- Are there any unexpected consequences of the construction methodology?
- Could an investor be taking unexpected biases as a result?

Mercer has reviewed the indices provided by the leading index providers and has assessed the current investment strategies available. Please contact us if you would like further information.

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MARSH & McLENNAN
COMPANIES

Agenda Item 4

ISLINGTON

Finance Department
7 Newington Barrow Way
London N7 7EP

Report of: **Corporate Director of Finance and Resources**

Meeting of:	**Date**	**Agenda item**	**Ward(s)**
Pensions Sub-Committee	11 April 2016		n/a

Delete as appropriate		Non-exempt

SUBJECT: PENSIONS SUB-COMMITTEE 2016/17– FORWARD PLAN

1. Synopsis

1.1 The Appendix to this report provides information for Members of the Sub-Committee on agenda items for forthcoming meetings and training topics.

2. Recommendation

2.1 To consider and note Appendix A attached.

2.2 To note the update on the process to procure and appoint an Emerging/frontier market manager

3. Background

3.1 **Update on Emerging/Frontier Market Manager Appointment**
Mercer our investment advisors are assisting officers to draw up request for proposal (RFP) tendering document to be published in the European journal. Unfortunately due to the tight deadline set for the transfer of our Allianz assets to the London CIV and staffing resource the timetable has slipped to the second quarter.

3.2 The Forward Plan will be updated as necessary at each meeting, to accord with Members' wishes.

3.3 Details of agenda items for forthcoming meetings will be reported to each meeting of the Sub-Committee for members' consideration in the form of a Forward Plan. There will be a standing item to each meeting on performance.

4. Implications

4.1 Financial implications

None applicable to this report. Financial implications will be included in each report to the Pensions Sub-Committee as necessary.

4.2 Legal Implications

None applicable to this report. Legal implications will be included in each report to the Pensions Sub-Committee as necessary.

4.3 Environmental Implications

None applicable to this report. Environmental implications will be included in each report to the Pensions Sub-Committee as necessary.

4.4 Equality Impact Assessment

None applicable to this report. The council must, in the exercise of its functions, have due regard to the need to eliminate discrimination, harassment and victimisation, and to advance equality of opportunity, and foster good relations, between those who share a relevant protected characteristic and those who do not share it (section 149 Equality Act 2010). The council has a duty to have due regard to the need to remove or minimise disadvantages, take steps to meet needs, in particular steps to take account of disabled persons' disabilities, and encourage people to participate in public life. The council must have due regard to the need to tackle prejudice and promote understanding

.

5. Conclusion and reasons for recommendation

5.1 To advise Members of forthcoming items of business to the Sub-Committee and training topics

Background papers:
None

Final report clearance:

Signed by:

Corporate Director of Finance & Resources Date

Received by:

Head of Democratic Services Date

Report Author: Joana Marfoh
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APPENDIX A

Pensions Sub-Committee Forward Plan for June 2016– April 2017

Date of meeting	Reports
	Please note: there will be a standing item to each meeting on: • Performance report- quarterly performance and managers' update • CIV update report I
13 June 2016	WM presentation 3 year Business plan review Pooling proposal document-draft Appointment of emerging and frontier market manager(s)
6 September 2016	Actuarial valuation funding assumptions and training Introduction of Investment strategy statement –ISS (DCLG requirement)
17 October 2016	Annual pension meeting
15 November 2016	Strategy review Funding strategy statement (FSS) draft for consultation Initial results from actuarial review
13 March 2017	FSS and consultation results

Proposed training for Members before committee meetings-

Date	**Training**
16 September 2014	Investment in Sub Saharan Africa - 6.20-.6.50pm Infrastructure - 6.55- 7.25pm
25 November 2014	Multi asset credit- 6.15-6.45pm Real estate including social housing- 6.50-7.20pm
9 March 2015	Frontier Market public equity- 6.15 -6.45pm Emerging market debt- 6.50- 7.20 pm
11 June 2015	Impact investing
14 September 2015- 4.45pm pm	Social bonds
13 June 2016	Actuarial review and assumptions training
6 September 2016	Actuarial review and assumptions

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