



Report of: Corporate Director of Finance and Resources

Meeting of:	Date	Agenda item	Ward(s)
Pensions Sub-Committee	15 July 2014	B2	n/a

Delete as appropriate	Exempt	Non-exempt
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Appendix 3 is exempt and not for publication as it contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: Information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: PENSION FUND PERFORMANCE 1 JANUARY to 31 MARCH 2014

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 January to 31 March 2013
- 2.2 To note the quarterly WM Company report on the overall performance updated market value and asset allocation of the fund as at 31 March 2014 at Annex A.
- 2.3 To receive the presentation by Allenbridge EPIC Investment Advisers, our independent investment advisers, on our fund managers' quarterly performance attached as Appendix 2.
- 2.4 To note the briefing paper on Wonga from Pantheon Ventures (Appendix 3 private and confidential).

2.5 Members are asked to consider the Franklin Templeton cashflow projection and agree to re-invest the return of capital to a Franklin Templeton Private Real Estate Fund 2.

2.6 If recommendation 2.5 is agreed, then to delegate powers to the Corporate Director of Finance and Resources and the Assistant Chief Executive – Governance and Human Resources to undertake due diligence and agree terms.

3. Fund Managers Performance for January to March 2014

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 (Jan-March14) Net of fees		12 Months to March'14 Performance Gross of fees	
			Portfolio	Benchmark	Portfolio	Benchmark
LBI-In House	33%	UK equities	-0.2%	-0.6%	9.4%	8.8%
AllianzGI (RCM)	9%	Global equities	-0.6%	0.5%	6.6%	6.8%
Newton	13%	Global equities	0.4%	0.5%	7.2%	6.8%
Legal & General	7%	Global equities	-1.1%	-0.9%	-6.1%	-5.6%
Standard Life	20%	Corporate bonds	2.8%	2.5%	2.8%	1.6%
Aviva (1)	5%	UK property	1.9%	3.0% 3.9%	8.0%	-3.4% 14.0%
Threadneedle Investments (TPEN)	6%	UK commercial property	3.2%	3.3%		9.9%
Hearthstone	2%	UK residential property	1.8%	4.0%	6.3	9.9

(1) -3.0% and -3.4% = original Gilts benchmark; 3.9% and 14.0% 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 March 2014 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 March 2014 is shown in the table below. The Fund's quarterly underperformance of -0.2% was attributable to asset allocation.

Combined Fund Performance	Latest Quarter Performance Net of fees		12 Months to March' 2014 Performance Net of fees	
	Portfolio %	Benchmark %	Portfolio %	Benchmark %
LB of Islington Fund	0.9%	1.1%	7.3%	6.5%

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 March 2014 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	7.3%	8.0%	12.7%
LBI customised benchmark	6.5%	8.1%	13.6%
Percentile ranking in the peer group	34	38	53

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 In the March quarter the fund underperformed net of fees by returning -0.6% against a benchmark of 0.5%. Since inception in December 2008, portfolio has returned 13.0 % against a benchmark of 14.6% net of fees. Relative return over three years is 2.4% per annum.

3.6.3 The portfolio underperformed the benchmark during the quarter. Stock selection detracted in consumer goods and health care sectors, as well as underweight positions in utilities. Stock selection in technology and basic materials was positive to performance.

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.. The fund under performed slightly by returning 0.4% net of fees against a benchmark of 0.5% for the March quarter. Since inception the fund has delivered a relative underperformance of 0.18%. Relative return over three years is 1.4% per annum

3.7.2 The performance this quarter was mainly driven by stock selection in Health sector, while consumer stocks detracted returns.

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 5.5% against a benchmark of 5.5% for the March quarter.

3.8.2 There were sales and purchases during the quarter of £1.8m, and there was a net out flow of £0.6m from rights issue and private equity distributions less cash withdrawals of £1m to the pension fund bank account to cover expenditure.

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 March quarter, the fund returned 2.8% against a benchmark of 2.5% and a 3 year relative return of 0.7% per annum.

3.9.2 The main driver behind the strong absolute returns achieved during the quarter was the robust performance of the underlying gilt market. Relative outperformance was largely due to good stock selection and our overweight exposure to the financial sector.

3.9.3 The strategy remains to hold overweight positions in subordinated financial debt, collateralised bonds and an off-benchmark exposure to high yield. These positions come at the expense of an underweight holding in supra nationals.

3.10 **Aviva**

3.10.1 Aviva manages the fund's UK long lease to value commercial 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 Long Lease to Value Property managed under the Lime Property Unit Trust Fund.

3.10.2 The fund for this quarter delivered a return of 1.9% against a gilt market of 3.0%. The All Property IPD benchmark returned 3.9% for this quarter. Since inception the fund has delivered an absolute return of 6.31% net of fees.

3.10.3 Quarter I, saw the completion of acquisitions and developments as reported last quarter to continue the fund's strategy of risk mitigation via structural improvements. As a result the fund has maintained an unexpired term of 21 years and increased diversification specifically in relation to tenant exposure that now stands at 6.17%. Lime is well positioned to deliver attractive returns over the medium term.

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

3.11.1 This is the fund's UK commercial pooled property portfolio that was fully funded on 14 July 2010 with an initial investment of £45 million. The net asset value at the end of March was £53.2million.

3.11.2 The agreed mandate guidelines are as listed below:

- Benchmark: CAPS UK Pooled Property Index
- 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 3.2% against its benchmark of 3.3% for the March quarter and a rental income yield of 6.8%. The marginal under performance was due to higher than average acquisition cost and lower than average capital growth. There is a strong asset diversification at portfolio level with a total of 244 properties. There were strong investor inflows of £78m increasing un-invested cash to 9.5%. The Fund has a significant acquisition pipeline of £70m which will serve to reduce the cash level to 6% by 30 April. As a result of new letting activity and fixed rental value increases the fund's property portfolio rent roll is set to increase by £5.65million

by 30 March 2016

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 March quarter, the hedged overseas equities returned 0.1% compared to the unhedged combined return of -0.2%.

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. 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 There was a capital call and distribution in June to bring total drawdown to \$19million and return of funds of \$6.4m. The projected net internal rate of return is 17.26%

A cash flow projection for future years is shown in the table below:

year	2011	2012	2013	2014E	2015E	2016E
Cumulative capital call \$m	6	14	23	30	36	38
Cumulative distribution \$m	0	2	4	7	20	35
Net \$m	6	12	19	23	16	3

3.13.3 From the table above if the cash flow is met we will be at our peak investment by the end of 2014 at \$23m out of the initial investment of \$40m. In order to maintain our investment level it will be necessary to commit to another fund to recycle the distributions received. Officers have had initial talks with the manager and there is a Franklin Templeton Private Real Estate Fund 2 being marketed for first close by September.

3.13.4 Members are asked to agree to reinvest the distributions by committing to Fund 2 and delegate to Director of Finance and Director of Legal to undertake due diligence and agree terms.

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 -1.1% net of fees against a benchmark of -0.9% for the quarter with a 12 months relative return -0.2%.

3.14.2 Following a review meeting, our current fee structure has been reduced. This will equate to a saving of £25,000 per annum.

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 Academics House Price Index

3.15.2 For the March quarter the value of the fund investment was £20.8m and total funds under management is £24.6million. Performance net of fees was 1.8% compared to the benchmark of 4.0%, and 12month relative return -3.3%. The income yield after cost was 5.4%. The portfolio had 125 properties, 76 were let on licence and leaseback agreement to house builders and 34 properties let on assured short term agreements. 15 properties are vacant because they were acquired on 28 March.

4. **Implications**

4.1 **Financial implications:**

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

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 March 2014 as part of the regular monitoring of fund performance.

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:

Received by: Corporate Director for Finance Date

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 March
 2014
 Pound Sterling

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

Return %	----- 2011 -----			----- 2012 -----				----- 2013 -----				2014	1yr	3yrs % pa	5yrs % pa
	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
Total Equity	0.9 (67)	- (8)	7.3 (38)	8.1 (64)	-3.1 (18)	5.2 (10)	2.4 (90)	10.9 (97)	-0.6 (67)	4.3 (19)	4.6 (75)	0.1 (56)	8.6 (52)	8.5 (49)	14.7 (87)
Private Eq	2.9	2.4	-4.5	0.1	1.2	-1.1	-0.3	3.7	6.9	0.6	-1.6	2.6	8.8	4.2	3.0
UK Equities	2.3 (25)	- (43)	8.8 (24)	6.2 (58)	-2.1 (14)	4.5 (77)	3.9 (44)	10.8 (39)	-1.7 (75)	5.5 (74)	5.5 (56)	-0.3 (28)	9.2 (56)	9.6 (50)	17.0 (50)
O/S EQ Hedge	-1.1	- 15.8	7.9	12.3	-5.0	7.3	1.0	12.3	-0.4	3.5	4.6	0.1	7.9	7.9	13.9
O/S Equities	0.7 (41)	- (46)	7.1 (22)	10.7 (20)	-3.4 (12)	5.1 (16)	1.9 (93)	13.8 (53)	-1.1 (73)	1.3 (63)	3.7 (70)	-0.2 (82)	3.7 (77)	7.0 (59)	12.6 (93)
N. America	-0.8 (71)	- (65)	11.4 (49)	11.4 (16)	-0.6 (16)	4.8 (14)	-2.3 (96)	19.2 (15)	2.8 (37)	1.0 (16)	8.6 (12)	0.8 (85)	13.6 (23)	13.6 (24)	17.6 (29)
Europe ex UK	3.1 (36)	- (12)	6.7 (6)	9.4 (68)	-3.0 (6)	7.6 (19)	5.4 (86)	14.2 (21)	1.5 (20)	4.1 (84)	5.9 (32)	0.8 (91)	12.9 (70)	11.1 (10)	14.7 (62)
Japan	-1.9	-5.8	-3.2	9.4	-3.2	-1.6	1.4	22.6	7.8	3.9	-4.0	-5.6	1.5	5.6	5.8
MGJE	6.1 #	-3.1	-3.6	8.0	-5.5	-3.5	5.0	19.5	4.4	0.3	0.0	-5.9	-1.4		
Pacific	1.4 (22)	- (8)	3.2 (85)	11.0 (26)	-5.5 (75)	6.1 (80)	3.7 (80)	8.7 (81)	-9.0 (48)	0.3 (68)	-4.8 (92)	-2.7 (90)	-15.5 (95)	-1.8 (91)	6.7 (98)
Other Intl.	-2.2 (66)	- (72)	4.8 (50)	10.8 (52)	-7.6 (63)	5.3 (36)	5.3 (33)	5.7 (64)	-8.9 (84)	-1.2 (63)	-1.8 (85)	-0.8 (54)	-12.3 (82)	-5.1 (81)	12.6 (44)
Bonds + IL	1.7 (85)	0.6 (97)	2.8 (89)	3.4 (2)	2.1 (47)	6.2 (2)	2.7 (38)	1.8 (76)	-2.8 (20)	2.5 (6)	0.4 (17)	2.8 (36)	2.8 (3)	8.2 (29)	9.5 (36)
Total Bonds	1.7 (70)	0.6 (91)	2.8 (76)	3.4 (5)	2.1 (66)	6.2 (8)	2.7 (16)	1.8 (46)	-2.8 (25)	2.5 (11)	0.4 (16)	2.8 (30)	2.8 (6)	8.2 (25)	9.9 (30)
UK Bonds	1.7 (60)	0.6 (93)	2.8 (82)	3.4 (2)	2.1 (69)	6.2 (10)	2.7 (13)	1.8 (27)	-2.8 (18)	2.5 (14)	0.4 (17)	2.8 (30)	2.8 (12)	8.2 (29)	10.9 (19)
UK Corp Bond	1.7 (46)	0.6 (67)	2.8 (55)	3.4 (21)	2.1 (52)	6.2 (32)	2.7 (25)	1.8 (38)	-2.8 (18)	2.5 (37)	0.4 (18)	2.8 (38)	2.8 (18)	8.2 (44)	12.4 (35)
Cash/ Alts	-0.2 (83)	1.0 (22)	-0.0 (44)	-1.1 (92)	0.6 (32)	0.2 (53)	0.1 (69)	1.0 (71)	2.5 (19)	0.1 (27)	0.2 (56)	0.6 (55)	3.4 (34)	1.6 (59)	5.3 (26)

Cash	-0.2 (79)	1.0 (17)	-0.0 (51)	-1.1 (95)	0.6 (22)	0.2 (34)	0.1 (39)	1.0 (27)	2.5 (16)	0.1 (21)	0.2 (25)	0.6 (19)	3.4 (15)	1.6 (26)	0.6 (46)
Curr Instr	-10.6 (26)	13.1 (37)	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
UK Property	2.3 (24)	1.6 (33)	1.5 (28)	1.1 (19)	0.6 (25)	0.5 (28)	1.3 (18)	0.7 (64)	1.8 (44)	1.7 (78)	3.2 (80)	2.6 (78)	9.5 (86)	6.4 (48)	7.4 (54)
Gbl Property	-6.8 #	2.3	0.2	-7.0	6.5	-11.5	-0.8	5.2	5.3	-7.9	3.7	1.4	1.9		
FRANKLIN TEM	-25.7 #	1.0	0.2	-4.7	3.8	-8.1	0.0 #								
FRANKLIN TEM	3.7 #	2.5	0.2	-7.4	6.9	-12.1	0.0 #								
FRANKLIN TEM							-0.8 #	5.2	5.3	-7.9	3.7	1.4	1.9		
Total Assets	1.1 (75)	-8.6 (33)	5.5 (57)	6.1 (22)	-1.5 (30)	4.7 (4)	2.3 (72)	7.5 (89)	-0.7 (43)	3.4 (14)	3.5 (57)	0.9 (55)	7.3 (34)	8.0 (38)	12.7 (53)

not invested in this area for the entire period