ISLINGTON

Finance Department
7 Newington Barrow Way
London N7 7EP

Report of: Corporate Director of Resources

Meeting of:	**Date**	**Agenda item**	**Ward(s)**
Pensions Sub-Committee	26 June 2018		

Delete as appropriate	~~Exempt~~	Non-exempt

Subject: PENSION FUND PERFORMANCE 1 JANUARY TO 31 MARCH 2018

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 2018 as per BNY Mellon interactive performance report

2.2 To receive the presentation by MJ Hudsons Allenbridge, our independent investment advisers, on our fund managers' quarterly performance attached as Appendix 1.

2.3 To note the LGPS Current Issues- May 2018 Appendix 2.

2.4 To receive the Annual Fund performance compared to the LA Universe from PIRC Performance Services

3. Fund Managers Performance for 1 January to March 2018

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

Mercer's ESG ratings provide an assessment of the integration of ESG issues into the investment process and provides an overall rating – ESG 1 is the highest possible rating and ESG 4 is the lowest possible rating. As such, Mercer has provided the ESG ratings for the Fund's 9 strategies across equities, fixed income, DGFs, property and private equity.

Fund Managers	Asset Allocation	Mandate	*Mercer ESG Rating	Latest Quarter Performance (Jan-Mar'18) Gross of fees		12 Months to March 20 Performance Gross of fees
				Portfolio	Benchmark	Portfolio
LBI-In House	13%	UK equities	N	-6.06%	-6.87%	1.05%
London CIV Allianz	8%	Global equities	2	-2.88%	-4.68%	9.01%
LCIV -Newton	15%	Global equities	2	-4.45%	-4.38%	1.60%
Legal & General	11.3%	Global equities	1	-3.66	-3.52%	2.12%
Standard Life	19%	Corporate bonds	3	-1.31%	-1.15%	1.58%
Aviva (1)	5%	UK property	2	1.82%	0.25% 2.30%	8.06%
Columbia Threadneedle Investments (TPEN)	7%	UK commercial property	2	1.98%	1.90%	10.3%
Hearthstone	2%	UK residential property	N	0.43%	2.30%	4.16%
Schroders	10%	Diversified Growth Fund	4	-0.82%	1.27%	5.25%
BMO Investments-LGM	5.7%	Emerging/ Frontier equities	2	-3.37%	2.15%	n/a

0.25% & 0.69% = original Gilts benchmark; 2.30% and 11.26% are the IPD All property index; for information

3.2 BNY Mellon our new performance monitoring service provider now provides our quarterly interactive performance report. Performance attributions can be generated via their portal if required.

3.3 The combined fund performance and benchmark for the last quarter ending March 2018 is shown in the table below.

	Latest Quarter Performance **Gross** of fees		12 Months to March 2018 Performance Gross of fees	
Combined Fund Performance ex-hedge	Portfolio %	Benchmark %	Portfolio %	Benchmark %
	-2.56	-2.87	4.14	2.82

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

3.5 **Total Fund Position**

The Islington combined fund absolute performance with the hedge over the 1, 3 and 5 years' period to March 2018 is shown in the table below.

Period	1 year per annum	3 years per annum	5 years per annum
Combined LBI fund performance hedged	4.10%	6.50%	7.61%
Customised benchmark	2.82%	5.92%	7.32%

3.5.1 **<u>The PIRC LA Pension Fund Universe 2017/18 Results</u>**

The PIRC Local Authority Universe comprised of 61 funds as at the end of March 2018 with a value of £177 billion. The Funds ranking and league table has now been finalised and the comparative data is shown in the table.

	2017/18	3yrs (% PA)	5yrs(%PA)	10yrs(%PA)	20 yrs(%PA)
average	4.5	8.3	8.8	7.7	6.5
median	4.0	7.7	8.5	7.5	6.1
Islington Fund performance	4.1	6.5	7.61	6.5	5.6
Ranking in percentile	40th	83rd	78th	87th	90th

Members are asked to note the results above. A representative from PIRC will be presenting our Fund's individual manager performance over the long term and the Universe trends.

3.6 **AllianzGI (RCM)**

3.6.1 AllianzGI (formerly known as RCM) is the fund's global equity manager and was originally appointed in December 2008. There have been amendments to the mandate, the last being a transfer to the CIV platform.

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' net of fees.

3.6.3 This quarter the fund returned -2.9% against a benchmark of -4.8%. Since inception with the London CIV in December 2015, there is a relative over performance of 2.4% whiles since January 2009 the original inception date, relative outperformance is 0.3% per annum. The main drivers were stock selection in an increased volatile market. The portfolio holds 48 stocks.

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. There have been amendments to the mandate the latest being a transfer to the London CIV platform.

3.7.2 The inception date for the LCIV NW Global Equity Fund was 22 May 2017. The new benchmark is the MSCI All Country World Index Total return. The outperformance target is MSCI All Country Index +1.5% per annum net of fees over rolling three- year periods.

3.7.3 The fund underperformed by returning -4.45% gross of fees against a benchmark of -4.38% for the March quarter. Since inception the fund has delivered an absolute return of 11.72% but relative under performance of -0.5% gross of fees per annum

3.7.4

The under performance this quarter was driven mainly by overweight positions in Consumer Staples and underweight position in Financial and Material sectors as well as regional positions in Emerging Markets and US.

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. After a review of the fund's equities, carbon footprint Members agreed to now track the FTSE UK All Share Carbon Optimised Index and this became effective in September 2017.

3.8.2 The fund returned -6.06% against FTSE All Share Index benchmark of -6.87 % for the March quarter and a relative over performance of 0.34% over the five- year period. The portfolio is now mirroring the low carbon index.

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 -1.3% against a benchmark of -1.2% and an absolute return of 7.2% per annum since inception.

3.9.2 The main driver behind the under- performance in this quarter was due to asset allocation with overweight positions in financials and underweight exposure to supra nationals

3.9.3 The forward strategy is to reduce exposure to gilts and shorter maturity corporate bonds.

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 benchmark of 0.25%. The All Property IPD benchmark returned 2.3% for this quarter. Since inception, the fund has delivered an absolute return of 6.14% net of fees.

3.10.3 This March quarter the fund's unexpired average lease term is now 19.6years. During the quarter a value add asset management was completed enabling the lease to be extended by 19years.

3.10.4 The fund also has £622m of investor cash of which £286m is committed to developments and close to completion. The current queue period to invest is around 18months.

3.10.5 As agreed, our fund has now committed £50m to the Lime Fund. An opportunity arose in May when an existing investor was selling their units and we were able to purchase £24m of these units. This has therefore halved our existing commitment in the queue to £26m. Our purchase was funded from Standard life corporate bond portfolio.

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 March was £79.9million.

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 a relative outperformance return against its benchmark 0.1% for the March quarter and a 0.3% three - year relative return. The cash balance now stands at 4.7% compared to 5.4% last quarter and with post Brexit uncertainties, will continue to adopt a conservative cash management strategy. During the quarter there were two acquisitions totalling £29.6m and four secondary high street retail assets disposals. There is a strong asset diversification at portfolio level with a total of 276 properties.

3.11.4 The medium to long term prospects of commercial property post referendum are likely to be a catalyst for moderate capital value declines but the fund is cushioned by its high relative income return and maximum diversification at both portfolio and client level.

3.12 **Passive Hedge**

3.12.1 The fund currently targets to hedge 50% of its overseas equities to the major currencies dollar, euro and yen. The passive hedge is run by BNY Mellon our custodian. At the end of the March quarter, the hedged overseas equities were valued at £6.8m.

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 is now fully committed and drawn down, though $7.1m can be recalled 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

The total distribution received to the end of the March quarter is $48m.

3.13.3 Fund II has made 5 investments to date in Europe, USA and Asia, in the retail and office sector and the projected geographic exposure is 42% Asia, US 26% and 32% Europe. The Admission period to accept new commitments from investors has been extended with our consent through to March 2017. The total capital call to the quarter end was $17.4.m and a distribution of $3.0m.

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 were managed passively against regional indices to formulate a total FTSE All World Index series. Member agreed restructuring in 2016 in now complete and the funding of BMO (our emerging market manager and restructuring of the fund to the MSCI World Low Carbon was completed on 3rd July.

3.14.2 The components of the new mandate as at the end of June inception was £138m benchmarked against MSCI World Low Carbon Index and £28m benchmarked against RAFI emerging markets.

For the March quarter, the fund totalled £146m with a performance of -3.6%% and relative return of -0.14%. the decrease from last quarter was because £25m was used to fund our equity protection premium.

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 March, quarter the value of the fund investment was £27.6m and total funds under management is £56million. Performance net of fees was 0.43% compared to the LSL benchmark of 0.3%.
The income yield after cost was 3.2%. The portfolio has 192 properties and 1set of parking spaces. 6 are let on licence and leaseback agreement to house builders and 172 properties let on assured short term agreements.

3.15.3 There are 14vacant properties, 1 of which is being sold, 13 being marketed for rent all of which are re-lets.

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 eleventh quarter since funding and the value of the portfolio is now £128m including an additional cash injection of £15m**.** The aim is to participate in equity market rallies, while outperforming in falling equity markets. The March quarter performance before fees was -0.82% against the benchmark of 1.27% (inflation+5%). The one -year performance is 5.25% against benchmark of 8.3% before fees.

3.16.3 The underperformance was attributed to market falls in traditional asset classes detracting from returns. However, losses were cushioned by gains in selected alternative strategies and currency positions.

3.17 **BMO Global Assets Mgt**

This is the new emerging and frontier equity manager seeded in July 2017 with a total £74.4m withdrawn from LGIM. The mandate details as follows:

- A blended portfolio with 85% invested in emerging market and 15% in frontier markets
- Target performance MSCI Emerging Markets Index +3.0% (for the global emerging markets strategy)
- Expected target tracking error 4-8% p.a
- The strategy is likely to have a persistent bias towards profitability, and invests in high quality companies that pay dividend

3.17.1 The March quarter saw a combined performance of -3.37% against a benchmark of -2.15% before fees. The detraction is mainly due to market volatility and stock selection.

The strategy remains to continue to research new companies that we suspect might be worthy of your hard earned capital and continue to have a close communication with our existing investments to push them to higher business and governance standards which we believe will ultimately enhance your long term return.

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 **Resident Impact Assessment:**
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".

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 2018 as part of the regular monitoring of fund performance and receive the Annual Fund performance presentation. Members are also asked to note for information LGPS News update to May.

Background papers:
1. Quarterly management reports from the Fund Managers to the Pension Fund.
2. Quarterly performance monitoring statistics for the Pension Fund – BNY Mellon

Final report clearance:

Signed by:

Corporate Director of Resources Date

Received by:

Head of Democratic Services Date

Report Author: Joana Marfoh
Tel: 0207-527-2382
Fax: 0207-527 -2056
Email: joana.marfoh@islington.gov.uk