ISLINGTON

Finance Department
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Report of: Corporate Director of Resources

Meeting of:	Date	Agenda item	Ward(s)
Pensions Sub-Committee	15 September 2020		

Delete as appropriate	~~Exempt~~	Non-exempt

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Subject: PENSION FUND PERFORMANCE 1 APRIL TO 30 JUNE 2020

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 April to 30 June 2020 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.
3.	**Fund Managers Performance for 1 April to June 2020**
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 latest 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 (Apr-June'20) Gross of fees		12 Months to June' 2020-Performance Gross of fees	
				Portfolio	Benchmark	Portfolio	Bench Mark
LBI-In House	12.4%	UK equities	N	10.13%	10.17%	-12.3%	-12.9%
London Sustainable EQ- RBC	9.1%	Global equities	N	22.9%	19.8%	n/a	n/a
LCIV -Newton	16.5%	Global equities	2	18.5%	19.8%	8.2%	5.7%
Legal & General	11.7%	Global equities	1	18.7%	18.8%	3.0%	3.4%
Standard Life	10.9%	Corporate bonds	2	7.2	6.95%	7.5%	6.4%
Aviva (1)	8.2%	UK property	3	0.68%	2.8% -2.26%	5.14%	12.9% -2.7%
Columbia Threadneedle Investments (TPEN)	5.3%	UK commercial property	2	-2.0%	-1.97%	-2.56%	6.4%
Hearthstone	2.1%	UK residential property	4	-0.27%	-2.26%	0.83%	-2.8%
Schroders	7.7%	Diversified Growth Fund	4	10.1%	1.29%	1.4%	6.1%
BMO Investments-LGM	4.6%	Emerging/ Frontier equities	2	16.7%	18.6%	-21.4%	-13.1%

2.8% & 12.9% = original Gilts benchmark; -2.26% and -2.8% 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 June 2020 is shown in the table below.

	Latest Quarter Performance **Gross** of fees		12 Months to June 2020 Performance Gross of fees	
Combined Fund Performance hedge	Portfolio %	Benchmark %	Portfolio %	Benchmark %
	9.5	9.4	4.2	3.7

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 2019 is shown in the table below.

Period	1 year per annum	3 years per annum	5 years per annum
Combined LBI fund performance hedged	4.2%	5.7%	7.1%
Customised benchmark	3.7%	5.3%	6.9%

3.6 **LCIV RBC Sustainability Fund**

3.6.1 RBC is the fund's global sustainable equity manager on the LCIV platform and was originally appointed in November 2018 to replace our Allianz mandate also on the LCIV platform.

3.6.2 LCIV RBC Sustainability was fully funded on 5 August 2019. Mandate guidelines include the following;

- The sub fund manager will invest only where they find all four forces of competitive dynamics (business model, market share opportunity, end market growth & management and ESG
- Target performance is MSCI World Index +2%p.a. net of fees over a three-year period.
- Target tracking error range over three years 2% p.a – 8.0%.
- Number of stocks 30 to 70
- Active share is 85% to 95%

3.6.3 The fund outperformed its quarterly benchmark to June by 3.19%. As the portfolio inception is August 2019, a 12- month performance is not applicable. The outperformance was mainly due to stock selections in the healthcare and financial sectors.

3.7 **Newton Investment Management**

3.7.1 Newton is the Fund's other global equity manager with an inception date of 1 March 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 returned 18.5% against a benchmark of 19.7% for the June quarter. Since inception the fund has delivered an absolute return of 11.9% but relative under performance of 0.07% net of fees per annum

3.7.4	The performance this quarter was attributed to defensive stocks and sector positions in information technology and underweight in financials as well as geographical exposure to Emerging markets and Japan.
3.8 3.8.1 3.8.2	**In House Tracker** 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 March 2008. After a review of the fund's equities, carbon footprint Members agreed to track the FTSE UK All Share Carbon Optimised Index and this became effective in September 2017. The fund returned 10.13% against FTSE All Share Index benchmark of 10.17% for the June quarter and a relative over performance of 0.30% since inception in 1992. Our internal fund manager has decided to retire at the end of September after 43 years of service and 28 years of managing the fund.
3.9 3.9.1 3.9.2 3.9.3	**Standard Life** 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 June quarter, the fund returned 7.2% against a benchmark of 7.0 % and an absolute return of 6.9% per annum since inception. The drivers behind the out performance were due to verweight exposure to the banking sector and utilities both made positive contributions. Banks recouped some of the underperformance from the first quarter, while utilities benefited from a strong demand for higher-rated noncyclical longer dated bonds. The biggest contributor, however, was the Fund's underweight to supranationals. The agreed infrastructure mandates are being funded from this portfolio and to date 5% has been drawn down.
3.10 3.10.1 3.10.2 3.10.3	**Aviva** 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. The fund for this quarter delivered a return of 0.68% against a gilt benchmark of 2.83%. The All Property IPD benchmark returned -2.26% for this quarter. Since inception, the fund has delivered an absolute return of 6.7% net of fees. This June quarter the fund's unexpired average lease term is now 20.2 years. The Fund holds 85 assets with 53 tenants. During the quarter there was a sale of supermarket with a 9.5year unexpired lease and a purchase of a distribution facility with a 26year unexpired lease. The fund has £310m of investible capital.

3.10.4	The Fund's portfolio is also well diversified across assets, tenants and sectors with the majority of its exposure to public sector tenants and limited exposure to leisure and discretionary spend retail. It believes it is well positioned to be able to weather the outcome with minimal disruption.
3.11 3.11.1 3.11.2	**Columbia Threadneedle Property Pension Limited (TPEN)** This is the fund's UK commercial pooled property portfolio that was fully funded on 14 January 2010 with an initial investment of £45 million. The net asset value at the end of June was £81 million. The agreed mandate guidelines are as listed below: • Benchmark: AREF/IPD All Balanced Property Fund Index (Weighted Average) since I April 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	To protect the interests of investors in the Fund, Columbia Threadneedle Investments temporarily suspended dealing in the Threadneedle Pensions (TPEN) Property Fund ("the Fund") from the 12 noon valuation point on 20 March 2020. This means policyholders are temporarily unable to buy or sell shares in the Fund. This decision has been taken by the TPEN Board due to the fact that the Fund's independent property valuer, CBRE, has deployed a 'market uncertainty clause', which means that they are unable to provide an accurate valuation of the Fund's assets in the current exceptional market environment.
3.11.4 3.11.5	The fund returned a performance of -2.01% against its benchmark -2.01% for the June quarter mainly due to higher income return, overweight positions to industrials and underweight exposure to retail. Above average capital expenditure on assets in the South East was a drag on performance. The cash balance now stands at 11% compared to 10% last quarter. During the quarter, there were no acquisitions and disposals. There is a strong asset diversification at portfolio level with a total of 273 properties and 1656 tenancies and a vacancy rate of 9.3% . Rent collection 67% the end of June and tenants are being dealt with on a case by case to enable their viability on the short to medium term.
3.11.6	The UK commercial real estate market is forecast to experience significant turbulence until the economy returns to some form of normality following the debilitating effects of a prolonged lockdown' period. In times of such material uncertainty, defensively positioned Property Funds with high relative income yields and significant levels of portfolio diversification are considered

	to be best positioned to deliver relative out-performance. Here are some of TPEN features that cushions its prospects: • Maximum diversification at both portfolio (273 properties, 1,344 tenancies) and • at client levels (65 Pension Fund clients) • Highly liquid average lot size of c.£6.4 million • Strategic portfolio positioning, with a focus on the strongest underlying subsectors (c.42%* of direct property exposure to the buoyant industrial market, with a 'last mile' focus) • Significant unrealised potential to add value through pro-active asset management across the portfolio • Defensive Fund positioning with ZERO property-level debt, no exposure to property company shares and no speculative property development • Proven track record of delivering relative out-performance in periods of significant macroeconomic volatility.
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.
3.12.2	Members agreed to reinstate the full 50% to the current global portfolios in their last meeting and the legal and fund documentation is being completed to implement the hedge.
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 June quarter is $60.1m.

3.13.3	The Fund is in the harvesting phase of its life cycle and continues to benefit from the realization of investments. The COVID-19 pandemic has interrupted progress on real estate business plans across the globe. Our expectation is that the primary effect upon the Fund will be a delay in execution of asset sales.
3.13.4	Fund II is fully invested and the completed portfolio of 10 holdings consist of a diverse mix of property sectors including office, retail and industrial uses and the invested geographic exposure is 6% Asia, US 26% and 68% Europe. The Admission period to accept new commitments from investors had been extended with our consent through to June 2017. The total capital call to the quarter end was \$36m and a distribution of \$33.9m. There was one calls and distribution during the quarter. Members should note that with both Fund I & II fully drawn down, if members are to maintain our asset allocation there is an opportunity to commit to Fund III.
3.14. 3.14.1	**Legal and General** 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, 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 2017.
3.14.2	The components of the new mandate as at the end of June inception was £138m and benchmarked against MSCI World Low Carbon Index and £34m benchmarked against RAFI emerging markets. For the quarter, the fund totalled £178m with a performance of 18.7%. The equity protection strategy was settled at 12 June with a total cash value of £74.6m now invested in a money market fund.
3.15 3.15.1	**Hearthstone** This is the fund's residential UK property manager. The fund inception date was 23 April 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 June quarter the value of the fund investment was £28.9m and total funds under management is £61.2m. Performance net of fees was -0.27% compared to the LSL benchmark of 1.1% The portfolio has 203 properties. Average annual occupancy 94.6%. Officers continue to monitor the fund on a quarterly basis with discussions with management. On 1 July as agreed, we have switched from our current accumulation share class to an income share class that will enable annual cash dividend distribution at around 800k.
3.15.3	As with most property funds, Covid-19 uncertainty led to the suspension of the fund but has now been lifted. Income from residential rents has been more sustainable than many other sources of income, 97% of rent demanded was collected in July. They are working closely with their tenants to help them through this period and they in turn have been amazing in engaging with them.

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	Schroders-
	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 3.16.3	The value of the portfolio is now £117m**.** The aim is to participate in equity market rallies, while outperforming in falling equity markets. The June quarter performance before fees was -10.1% against the benchmark of 1.29% (inflation+5%). The one -year performance is 1.43% against benchmark of 6.1% before fees. Equity positions, credit and government debt, and alternatives were the largest contributors to performance. The focus is on defence and quality before taking advantage of any opportunities that arise from the Covid-19 crisis.
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 3.17.2	The June quarter saw a combined performance of 16.7% against a benchmark of 18.6% before fees. Position in China and Russia, and off index investment in Eastern European airline added most value to performance. Positions in Mexico and South Africa were detractors to performance. 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. A further meeting was held with the fund manager following management changes .
3.18	**Quinbrook Infrastructure** This one of the infrastructure managers appointed in November 2018. The total fund allocation infrastructure was 10% circa £130m. 40% of the allocation equivalent to $67m was allocated to low carbon strategy. Merits of Quinbrook include: • Low carbon strategy, in line with LB Islington's stated agenda • Very strong wider ESG credentials • 100% drawn in 12-18 months • Minimal blind pool risk • Estimated returns 7%cash yield and 5% capital growth **Risks:** Key Man risk Drawdown to June 2020 is $59.7m **Pantheon Access-** is the other infrastructure manager also appointed in November 2018. Total allocation was $100m and merits of allocation included: • 25% invested with drawdown on day 1 • Expect fully drawn within 2-3 years • Good vintage diversification between secondary's and co-investments • Exposure to 150 investments • Estimated return 5% cash yield and 6% capital growth **Risks:** No primary fund exposure. Drawdown to June 2020 is $28.15m and distribution of $2.05m
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 and contribution to achieving a net zero carbon Islington by 2030:** Environmental implications will be included in each report to the Pensions-sub committee as necessary. The current agreed investment strategy statement for pensions outlines the policies and targets set to April 2022 to reduce the current and future carbon exposure by 50% and 75% respectively compared to when it was measured in 2016 and also invest 15% of t fund in green opportunities. The link to the full document is https://www.islington.gov.uk/~/media/sharepoint-lists/public-records/finance/financialmanagement/adviceandinformation/20192020/20190910londonborougho ngtonpensionfundinvestmentstrategystatement.pdf

5. Conclusion and reasons for recommendations

5.1 Members are asked to note the performance of the fund for the quarter ending March 2020 as part of the regular monitoring of fund performance and Appendix 1- MJ Hudson commentary on managers.

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

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