ISLINGTON

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Report of: Corporate Director of Resources

Meeting of:	**Date**	**Agenda item**	**Ward(s)**
Pensions Sub-Committee	23rd March 2021		

Delete as appropriate	Exempt	Non-exempt

. **Appendix 2 is** exempt and not for publication as it contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: Information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 OCTOBER TO DECEMBER 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 October to 31 December 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.

2.3 To note the update on BMO (emerging and frontier manager) attached as Exempt Appendix 2

2.4 To note January 2021 LGPS Current Issues attached as Appendix B

3. Fund Managers Performance for 1 October to 31 December 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 (Oct-Dec'20) Gross of fees		12 Months to Dec' 2020-Performance Gross of fees	
				Portfolio	Benchmark	Portfolio	Benchmark
LBI-In House	10.2%	UK equities	N	10.5%	12.6%	-9.8%	-9.8%
LCIV Sustainable EQ- RBC	10.1%	Global equities	1	11.9%	7.8%	24.6%	12.3%
LCIV -Newton	17.2%	Global equities	2	7.40%	8.6%	15.4%	13.2%
Legal & General	12.2%	Global equities	1	9.2%	9.1%	9.9%	10.4%
Standard Life	10.6%	Corporate bonds	2	3.3%	3.1%	8.6%	7.8%
Aviva (1)	7.8%	UK property	3	1.8%	0.75% 2.0%	5.2%	9.8% -1.0%
ColumbiaThreadneedle Investments (TPEN)	5.0%	UK commercial property	2	1.26%	2.1%	-1.7%	-1.1%
Hearthstone	1.8%	UK residential property	N	0.73%	2.0%	1.2%	-1.0%
Schroders	8.0%	Diversified Growth Fund	2	7.5%	1.6%	8.4%	6.2%
BMO Investments-LGM	5.1%	Emerging/ Frontier equities	2	11.6%	13.3%	7.3%	15.0%

0.75% & 9.8% = original Gilts benchmark; 2.0% and -1.0% 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 December 2020 is shown in the table below.

	Latest Quarter Performance **Gross** of fees		12 Months to Dec' 2020 Performance Gross of fees		
Combined Fund Performance	Portfolio %	Benchmark %	Portfolio %	Benchmark %	
	6.9	6.0	12.8	7.0	

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 December 2020 is shown in the table below.

Period	1 year per annum	3 years per annum	5 years per annum
Combined LBI fund performance hedged	12.8%	7.1%	9.0%
Customised benchmark	7.0%	6.1%	8.4%

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 out performed its quarterly benchmark to December by 4.13% and a twelve-month out performance of 12.4%. The outperformance was mainly due to stock selections in sectors financials, industrials and utilities sectors, while the healthcare sector detracted over the quarter.

3.7 LCIV 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 7.5% against a benchmark of 8.6% for the December quarter. Since inception the fund has delivered an absolute return of 11.4% but relative under performance of 0.55% net of fees per annum. The underperformance this quarter was attributed to defensive stocks and sector positions in particular to consumer discretionary stocks.

3.8 LBI- In House

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 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.

3.8.2 The fund returned 10.5% against FTSE All Share Index benchmark of 12.6% for the December quarter and a relative over performance of 0.26% since inception in 1992.

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 3.3% against a benchmark of 3.1% and an absolute return of 7.0% per annum since inception.

3.9.2 The drivers behind the performance were due to overweight exposure to the banking sector and utilities that made positive contributions. The biggest contributor, however, was the Fund's underweight to supranationals (government related entities such as KFW, UKRAIL and European Investment Bank).

3.9.3 The agreed infrastructure mandates are being funded from this portfolio and to date 5% has been drawn down.

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 0.75%. The All Property IPD benchmark returned 2.0% for this quarter. Since inception, the fund has delivered an absolute return of 5.9%

3.10.3 This December quarter the fund's unexpired average lease term is now 20.6 years. The Fund holds 89 assets with 53 tenants. During the quarter, two sales to de- risk the portfolio were completed whilst the three purchases of a distribution facility, university sport science facility and finally an office facility went towards improving percentage of income linked to inflation, distribution yield and unexpired lease length. Rent collection for the period was at 84%.

3.10.4 One of Aviva's objectives in its transition strategy to net zero by 2040 is to reduce real estate carbon intensity by 30% and energy intensity by 10%. The Fund's diverse portfolio of high-quality properties let to secure tenants on long-term leases with 95% subject to inflation or fixed uplifts is well placed to weather the current uncertainties.

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 January 2010 with an initial investment of £45 million. The net asset value at the end of December was £82.2 million.

3.11.2 The agreed mandate guidelines are as listed below:

- Benchmark: AREF/IPD All Balanced Property Fund Index (Weighted Average) since 1 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 The fund returned a performance of 1.3% against its benchmark 2.1% for the December quarter mainly due to higher income return, overweight positions to industrials and underweight exposure to retail.

3.11.4 The cash balance now stands at 8.9% compared to 9.6% last quarter. During the quarter, there were no acquisitions and 5 disposals. There is a strong asset diversification at portfolio level with a total of 273 properties and 1343 tenancies. Rent collection is improving and tenants are being dealt with on a case by case to enable their viability on the short to medium term.

3.11.5 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 (267 properties, 1,306 tenancies) and
- at client levels (65 Pension Fund clients)
- Highly liquid average lot size of c.£6.6million
- Strategic portfolio positioning, with a focus on the strongest underlying subsectors
  (c.44%* 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 September quarter, the hedged overseas equities had a cash value of £6.9m.

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 has now been completed. The hedge is now in place effective from 25 November for quarterly hedge rolls.

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 December 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 was extended with our consent through to June 2017 when it finally closed. The total capital call to the quarter end was $36m and a distribution of $33.9m. There was no call or distribution during this quarter and the NAV is $20m.

3.13.5 Members agreed to commit $50m to Fund III at the December meeting and the documentation was finalised in December to meet the final close date.

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, 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 £199m with a performance of 9.2%.

3.14.3 The equity protection strategy was settled on 12 June with a total cash value of £74.6m now invested in a money market fund but earmarked to fund the new Multi Asset Credit mandate.

3.15 **Hearthstone**

3.15.1 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 December, quarter the value of the fund investment was £28.8m and total funds under management is £60m. Performance net of fees was 0.74% compared to the IPD UK All Property benchmark of 2.0%.

Officers continue to monitor the fund on a quarterly basis with discussions with management. On 1 July as agreed, we switched from our current accumulation share class to an income share class that will enable annual cash dividend distribution at around 650k.

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, and rent collection is comparably high. They are working closely with their tenants to help them through this period. Cash balance stands at 14.0% with 204 properties.

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 The value of the portfolio is now £130m**.** The aim is to participate in equity market rallies, while outperforming in falling equity markets. The December quarter performance before fees was 7.5% against the benchmark of 1.6% (inflation+5%). The one -year performance is 8.4% against benchmark of 6.2% before fees.

3.16.3 Contributions to return over the quarter were achieved across return-seeking assets, driven by global and US equities. Gains in credit and emerging market debt supplemented these returns. Alternative assets also contributed, driven by absolute return strategies, while hedging positions in government bonds detracted from returns.

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 dividends.

3.17.1 The December quarter saw a combined performance of 11.6% against a benchmark of 13.3% before fees. The biggest contributor to performance was not owning Alibaba. Lack of exposure to the strong Korean market as well as having less than benchmark exposure to China detracted performance.

3.17.2 The strategy remains to continue to research new companies that appear worthy of capital and continue to have a close communication with our existing investments to push them to higher business and governance standards which are believed to ultimately enhance long term return.

3.17.3 Officers and our independent advisor met the fund portfolio manager in February 2021 to discuss the portfolio and details of the discussion is attached as an Exempt Appendix 2.

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 December 2020 is $65.2m

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 December 2020 is $39.85 and distribution of $3.75m

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 the fund in green opportunities. The link to the full document is:
https://www.islington.gov.uk/~/media/sharepoint-lists/public-records/finance/financialmanagement/adviceandinformation/20192020/20190910londonboroughofislingtonpensionfundinvestmentstrategystatement.pdf

5. Conclusion and reasons for recommendations

5.1 Members are asked to note the performance of the fund for the quarter ending December 2020 as part of the regular monitoring of fund performance and Appendix 1- MJ Hudson commentary on managers. To note January2021 LGPS Current Issues attached as Appendix B
Members are also asked to note meeting briefing with BMO in February 2021 attached as Exempt Appendix 2.

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 19 March 2021

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