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	14th March 2022		

Delete as appropriate	~~Exempt~~	Non-exempt

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Subject: PENSION FUND PERFORMANCE 1 OCTOBER TO 31 DECEMBER 2021

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 2021 as per BNY Mellon interactive performance report
2.2	To receive the presentation by MJ Hudsons, our independent investment advisers, on our fund managers' quarterly performance attached as Appendix 1.
2.3	To note the LGPS Current Issue - February'22 for information, attached as Appendix 2.
3.	**Fund Managers Performance for 1 October to 31 December 2021**

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

3.1 Fund Managers	Asset Allocation	Mandate	*Mercer ESG Rating	Latest Quarter Performance (Oct-Dec'21) Gross of fees		12 Months to December 2021-Performance Gross of fees	
				Portfolio	Benchmark	Portfolio	Benchmark
LBI-In House	9.7%	UK equities	N	3.5%	4.2%	17.6%	18.3%
LCIV Sustainable EQ- RBC	10.8%	Global equities	1	6.6%	7.3%	19.4%	22.9%
LCIV -Newton	18.4%	Global equities	2	6.5%	6.3%	20.2%	20.1%
Legal & General	13.1%	Global equities	1	6.2%	6.1%	21.2%	21.2%
Standard Life	7.8%	Corporate bonds	2	0.4%	0.3%	-3.4%	-3.1%
Aviva (1)	7.9%	UK property	3	3.6%	3.4% 7.9%	12.6%	-5.9% 19.9%
ColumbiaThreadneedle Investments (TPEN)	5.5%	UK commercial property	2	9.3%	7.5%	21.8%	19.1%
Hearthstone	1.6%	UK residential property	N	2.2%	7.9%	3.4%	19.9%
Schroders	7.8%	Diversified Growth Fund	2	1.5%	4.1%	8.1%	12.5%
M&G Alpha Opportunities	4.3%	Multi Asset Credit	N	0.04%	0.9	n/a	n/a
BMO Investments-LGM	4.3%	Emerging equities	2	0.3%	-1.7%	2.7%	-1.3%

3.4% & -5.9 = original Gilts benchmark; 7.9% and 19.9% 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 2021 is shown in the table below.

	Latest Quarter Performance **Gross** of fees		12 Months to Dec'2021 Performance Gross of fees	
Combined Fund Performance	Portfolio %	Benchmark %	Portfolio %	Benchmark %
	4.1	4.3	13.3	11.8

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 year periods to December 2021 is shown in the table below.

Period	1 year per annum	3 years per annum	5 years per annum
Combined LBI fund performance hedged	13.3%	11.4%	9.1%
Customised benchmark	11.8%	11.0%	7.9%

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 underperformed its quarterly benchmark to December by -0.7% and a twelve-month under performance of -3.5%. This was driven in equal parts by holdings that did not deliver and notably by what is not held in the portfolio. One of those areas is Energy

	where the traditional extraction and major oil industries drove returns. The manager has maintained its style away from value factors, investing in quality companies with low debt.
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 6.5% against a benchmark of 6.3% for the December quarter. Since inception, the fund has delivered an absolute return of 13%. The performance this quarter was attributed to a blend of companies which are expected to grow their profits at a relatively steady pace, more cyclical non-financial companies and banks and insurers which are linked to the interest rate cycle.
3.7.4	Newton have reduced exposure to highly valued growth stocks in favour of companies which can capitalise on strong market positions to benefit from reflation and higher interest rates.
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 3.5% against FTSE All Share Index benchmark of 4.2% for the December quarter and an absolute performance of 8.3% since inception in 1992. The In-House fund will be part of the indices review of Paris Aligned new generation indices.
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 0.34% and an absolute return of 6.1% per annum since inception.
3.9.2	Asset allocation was a small positive. Overweight exposure to telecoms and utilities benefitted performance, offset by exposure to property and banking.
3.9.3	The agreed infrastructure mandates are being funded from this portfolio and to date £80m 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 3.6% against a gilt benchmark of 3.2%. The All Property IPD benchmark returned 7.9% for this quarter. Since inception, the fund has delivered an absolute return of 6.27%
3.10.3	As at the end of this December quarter the fund's unexpired average lease term is 21.3 years. The Fund holds 89 assets with 53 tenants. During the quarter, there were sales of two car showrooms and a purchase of student accommodation in Bath.
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%. In 2021, the energy intensity across the portfolio reached 226kWh/m2. To further this progress and achieve the 2025 target of 213kWh/m2, asset managers allocated £29 million towards Environmental, Social, and Governance (ESG) improvements across the portfolio. The most significant savings will be made through: - LED lighting (expected reduction of 7kWh/m2) - Smart buildings – Electricity and Gas (expected reduction of 8kWh/m2) - Solar panels (expected reduction of 10kWh/m2)
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 £100million.
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 9.2% against its benchmark 7.5% for the December quarter mainly due to higher income return, overweight positions to industrials, and retail warehousing and underweight exposure to in-town retail and offices.
3.11.4	The cash balance now stands at 10.3% compared to 6.7% last quarter. During the quarter, there were three strategic acquisitions and seven disposal. There is a strong asset diversification at portfolio level with a total of 265 properties and 1267 tenancies.

	Rent collection is improving and tenants are being dealt with on a case by case basis to enable their viability on the short to medium term.
3.11.5	The Fund has set net zero target to neutralise carbon emissions within portfolios by 2050. An income distribution share class, will be available from quarter 1 in 2022, for investors who want to draw down income.
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 June quarter, the hedged overseas equities had a cash value of £4m.
3.12.2	The hedge has now been in place since 25 November 2020 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 drawndown. $3.5m remains undrawn. 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 $61.8m. The NAV is $0.8m
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.

Table within 3.13.2:

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

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 is $40m and total distribution of $33.8m. The NAV is $19m.
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. Fund III made its final close on 30th December with total equity commitment of $218m. Current portfolio consist of 5 holdings over a geographic exposure of 77% in Europe and 23% in USA with a 95% vintage in 2019 and 5% in 2021.
3.13.6	As at the quarter end $7.8m has been drawdown and a distribution of $4.0m has been received.
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 £241.4m with a performance of 6.1%. (Rafi -£37m) The Rafi emerging markets fund has now be reconstituted to RAFI Fundamental EM (ex Korea) Reduced Carbon Pathway - the number of holding has increased from 472 to 1000 and hence the energy holdings has decreased from 18% to 14% as at December.
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 December quarter, the value of the fund investment was £28.6million and total funds under management is £72m. Performance net of fees was 2.25% compared to the IPD UK All Property benchmark of 7.9%. 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. A total of £1million has been drawn down over the last financial year and discussions are ongoing to draw down some more cash in 2022.
3.15.3	As with most property funds, Covid-19 uncertainty led to the suspension of the fund far part of year in 2020. Income from residential rents has been more sustainable than many other sources of income, and rent collection is comparably high up to 99% at the end of September. They are working closely with their tenants to help them through this period. Cash balance at the end of the December quarter was £15.5m.

3.16
 	
3.16.1
	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	The value of the portfolio is now £140.6m**.** The aim is to participate in equity market rallies, while outperforming in falling equity markets. The December quarter performance before fees was 1.5% against the benchmark of 4.7% (inflation+5%). The performance since inception is 5.2% against benchmark of 8.2% before fees.

3.16.3 3.16.4	Contributions to return over the quarter were achieved from exposure of 40.2% in equities, 27.1% in alternatives and 25.8% in credit and government debt, with the balance in cash of 6.9%. The fund manager has announced a change in benchmark effective from 1 April 2022. The current target of RP1+5% will change to ICE BofA Sterling 3-Month Government Bill Index plus 4.5% per annum. They have deemed a change necessary because market conditions have progressively made it more difficult to consistently achieve both the current return and risk objectives of the underlying Fund, which were originally set in a very different environment. This new return objective will better reflect the return outcomes achievable in the current market. There is also a reduction of 7basis point on the annual fee.
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. The mandate was amended in March'21 when the frontier element was liquidated and $11.3m was returned.
3.17.1 3.17.2 3.17.3	The December quarter saw an out performance of 2.0%. Stock selections in the China /Hong Kong added most relative value to performance whilst the lack of exposure to a weak Brazilian market also added alpha. The main drag was lower exposure to Taiwanese equities. 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. It was announced that BMO Financial Group's agreement to sell its EMEA asset management business to Ameriprise Financial, Inc., has received regulatory approval The BMO asset management business in EMEA became part of Columbia Threadneedle Investments, the global asset management business of Ameriprise in November 2021
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 2021 is $67.0m – this 100% of our commitment **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 2021 is $69.65m and distribution of $12.05m
3.19	**M&G Alpha Opportunities** This is the multi asset credit manager appointed and funded on 1st March 2021**.** The total allocation is approximately 5% funded mostly from profit made from equity protection in March 2020. <u>The mandate guidelines of M&G include</u> • Fund can invest across the full spectrum of developed market corporate credit (IG, HY, Loans) as well as securitised credit (ABS, MBS), some illiquid opportunities and defensive holdings (e.g. cash). • Investment process is predominantly bottom up, with a defensive value style that seeks to buy cheap mispriced securities. • Targets a return of 1 month LIBOR +3% - 5% (gross of fees) over an investment cycle (3-5 years) • No local currency EM debt is permitted • Low level of interest rate duration • Maximum exposure to sub-investment grade credit of 50% of assets, • Focus is primarily on Europe, although there is some exposure to the US (c. 15%). <u>Risk and triggers for review:</u> • Key man - risk • Issues at the firm level • Change in investment process/ structure or risk/return profile of the mandate. • Failure to deliver target return over 3 Year period of Cash +3% - 5% (gross of fees), unless there is a compelling market-based reason for underperformance • Downgrade of Mercer rating lower than B+ • Downgrade of Mercer ESG rating lower than ESG3. • Long term trend of staff turnover and changes within the investment team.
3.19.1	The December quarter performance was 0.04% against a benchmark of 0.9% and since inception an underperformance of -1.23%. The primary driver of the positive performance was the exposure to leveraged loans. Whilst industrial and financial bonds also produced modest positive contributions, with securitised assets detracting marginally from performance.

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 2021 as part of the regular monitoring of fund performance and Appendix 1- MJ Hudson commentary on managers. The February'22 edition of LGPS Current Issue is attached as Appendix 2 for information.

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:	David Hodgkinson	
	Corporate Director of Resources	Date:9/03/22
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