



Report of: Corporate Director of Resources

Meeting of: Pensions Sub-Committee

Date: 28th June 2022

Ward(s): n/a

Appendix 1 attached is exempt and not for publication as it contains the following category of exempt information as specified in Paragraph 3, Schedule 12A of the Local Government Act 1972, namely: Information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).

Private Debt Update Tranche 2

1. Synopsis

- 1.1 This is a further update report on 2019 Actuarial review position and the targeted investment returns required to keep contributions to the fund sustainable, and the investment strategy implications on asset allocation.
- 1.2 Members agreed mandate specification at the December 2020 meeting and appointed 2 private debt managers to cover 50% of the total 10% asset allocation.

2. Recommendations

- 2.1 To consider the allocation of a further % of assets to Private debt from the outstanding 50%.
- 2.2 To note and consider the attached Exempt Appendix1.
- 2.3 To agree to delegate authority to officers and our investment advisers to conduct further due diligence and recommend who best delivers value for money and complements our existing managers and proceed to procure.
- 2.4 To consult and seek approval from the Chair of Pensions sub-committee on the final recommended manager
- 2.5 To agree to delegate to the Corporate Director of Resources, in consultation with the Director of Law and Governance, authority to negotiate and agree terms and conditions of the fund management agreement(s) with the recommended and agreed manager(s).

3. Background

Introduction

- 3.1 The 2019 actuarial valuation was completed in March 2020 and as part of the process, preparatory work was undertaken to determine the funding position and an investment strategy review that could support sustainable contributions from employers. The agreed target investment return of CPI+3.2% was re-evaluated in the light of Covid-19 impact on markets. The risk and return target options were discussed and a new target investment return of CPI +2.8% was proposed with asset allocation changes that would support the short to medium term net negative cashflow position of the Fund and also achieve our decarbonisation and governance goals.
- 3.2 Private Debt asset class is privately negotiated debt typically used when public loans are not available to the borrower, usually used to finance privately owned companies. Some of the characteristics include direct loan contracts with strong covenants secured by the firm assets if your loan is a senior debt. The main risks include defaults and illiquidity.
- 3.3 Members appointed one US and one European manager at the June 2021 meeting where 50% of the asset allocation was committed to ensure diversification.
- 3.4 In order to meet the agreed asset allocation of 10% and have diversification, a second tranche of procurement after a year was deemed feasible and a long list of recommended managers was sought from Mercer research team. A short list of 2 was agreed for another US private debt manager and Mercer, MJ Hudson and officers met with them. They presented on performance, ESG credentials, investment process, and fund specifications and current portfolios and final close.

Exempt Appendix 1 attached covers the Islington agreed mandate, cashflow of existing commitments and how much more commitment is required to reach our target asset allocation as well as a high- level summary of the key metrics of the two managers interviewed have been tabled in Exempt Appendix 1.

- 3.5 Members are asked to consider the contents of the exempt appendix 1 and agree to proceed to procure another US Manager. If that is agreed Officer ask that Members agree to delegate authority to Director of Corporate Resources in consultation with the Director of Law and Governance, authority to negotiate and agree terms and conditions of the fund management agreement(s) with the recommended and agreed manager(s).
- 3.6 Members are asked to consider and express a view but to allow officers to explore further details and due diligence of the 2 managers available and recommend the manager that will deliver value for money and achieve our risk and return targets.
- 3.7 Members also need to take into consideration the following issues;
- that Private debt can take 3 to 5 years to reach full allocation
 - a plan needs to be in place on how soon we want to reach full strategic allocation of 10%
 - cash flow matching of these commitments
 - manager vintages for diversification
 - availability of managers because investments are generally in closed funds.

4. Implications

4.1 Financial implications

4.1.1 The cost of providing independent investment advice is part of fund management and administration fees charged to the pension fund.

4.2 Legal Implications

The Council, as the administering authority for the pension fund may appoint investment managers to manage and invest in a private debt portfolio on its behalf (Regulation 8(1) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 (as amended)).

A competitive tendering exercise has been undertaken for the appointment of a private debt manager in accordance with the requirements of the Public Contracts Regulations 2015 and the council's Procurement Rules. The council will conduct an independent due diligence to ascertain its own assurance of the appointed managers. The sub-committee may appoint the highest evaluated manager as recommended in Exempt Appendix 1, provided that it is satisfied that their offers represents value for money and is satisfied as to the matters set out in paragraph 4.2.2.

The sub- committee must

- (i) reasonably believe that the recommended investment manager's ability in and practical experience of financial matters makes them suitably qualified to make investment decisions for the Council
- (ii) have proper regard to the advice of the Corporate Director of Resources and its external advisers, in relation to the proposed appointment.

4.3 In considering the recommendations in this report, members must take into account the information contained in the Exempt Appendices 1 to this report.

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>

4.4 Equalities impact assessment

None applicable to this report. 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.

5. Conclusion and reasons for recommendation

- 5.1 Members are asked to consider key metrics of the managers in Exempt Appendix 1 and allow officers to explore further and conduct due diligence on the 2 managers available. In the interest of meeting the final close in October, agree to delegate authority to Director of Corporate Resources in consultation with the Director of Law and Governance, authority to negotiate and agree terms and conditions of the fund management agreement(s) with the recommended and agreed manager(s).

Appendix: Exempt Appendix 1- Update on Private Debt

Background papers:

None

Final report clearance:

Signed by:

Corporate Director of Resources

Date

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