

London Borough of Hammersmith & Fulham

Report to: Pensions Sub-Committee

Date: 23/06/2020

Subject: Investment Strategy Update

Report of: Phil Triggs, Director of Treasury and Pensions
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Summary

This paper provides an update on the London Borough of Hammersmith & Fulham Pension Fund's investment activity since the Pension Fund Sub-Committee approved the delegation of all decision-making to the Chair, in consultation with the Director for Treasury and Pensions in April 2020.

Recommendations

The Sub-Committee is requested to:

- a. Formally approve the investment decision to investment 15% of the pension fund's investment assets into the LCIV Global Equity Sustain Fund.
- b. Approve the decision to a partial/full disinvestment from the M&G Inflation Opportunities Fund and commence the search for a replacement manager.

Wards Affected: None

LBHF Priorities

Our Priorities	Summary of how this report aligns to the LBHF priorities
<ul style="list-style-type: none">Building shared prosperity	Being an outperforming investor means that as part of the Pension Fund's fiduciary duty, its investments should be able to assist in making a positive financial contribution, sharing prosperity and lessening the financial impact on council tax payers.

Financial Impact

The financial implications of these investments will be continually monitored to ensure that members' pensions are safeguarded.

Legal Implications

None

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Background Papers Used in Preparing This Report

None

Investment Strategy Update

1. Background

- 1.1. The Pension Fund Sub-Committee agreed to delegate all its decision making powers to the Chair for a period of six months from 22 April 2020. The decision came after the Council's decision to cancel most of its public meetings as it faced the unprecedented challenge in responding to the COVID-19 pandemic.
- 1.2. Given the uncertainty in the financial markets due to the unknown implications of the global response to this pandemic, the Sub-Committee agreed it would be essential for critical decisions to continue to be taken to protect the fund and safeguard members' future pensions payments.
- 1.3. The Sub-Committee would continue to meet virtually on a regular basis to ensure that all members were kept up to date on the investment performance and risk management of the Pension Fund. All decisions made by the Chair during this period would be recorded and reported at the next available meeting of the Sub-Committee.

2. Decision: Investment in Global Active Manager

- 2.1. Following the disinvestment from the LCIV UK Equity Fund, completed in December 2019, the Fund's 45% strategic allocation to equities was entirely invested in the Legal & General World Low Carbon Equity Index Fund. As at 31 March 2020, the Fund had £411.5m of its investment portfolio invested in the passive fund.
- 2.2. During the month of April 2020, the Sub-Committee, in consultation with the pension fund's officers and investment consultant, met several times to discuss how best to position itself to minimise its downside risk exposure and take advantage of the prevailing uncertainty in the financial markets at the time.
- 2.3. Subsequently, the Sub-Committee decided to allocate a third of the pension fund's equity allocation (15% of its overall investment portfolio) to an active equity manager and requested its investment consultant to present a shortlist of suitable strategies for the pension fund.
- 2.4. On 11 May 2020, four investment managers presented their strategies to the Sub-Committee. After further discussion amongst the members, an agreement was reached to appoint Morgan Stanley, who manage the LCIV Global Equity Sustain Fund, as the pension fund's new active equity manager.
- 2.5. The Sub-Committee expressed a clear preference for Morgan Stanley's investment process, citing the concentrated portfolio and lower correlation to the market. The Sub-Committee was particularly impressed with how the investment manager integrates environmental, social and governance (ESG) factors into their investment process. The pension fund considers ESG related

risks to be a significant factor in the long-term sustainability of the global environment.

3. Decision: Disinvestment in Inflation Linked Investment

- 3.1. The pension fund has been invested in the M&G Inflation Opportunities Fund (IOF) since 2015. As at 30 April 2020, the pension fund had £113.0m invested with the fund.
- 3.2. In February 2020, the pension fund approved an asset allocation of 10% to inflation strategies and 5% to property. In order to meet the inflation objectives of this mandate, the IOF has a sizeable allocation to long lease property. This allocation effectively means that the pension fund's exposure to long lease property is around 9%, and exposure to UK commercial property (including income strips and ground rents) is around 13.5%.
- 3.3. Although the IOF has outperformed its return objective since inception, from a diversification standpoint, it has largely underperformed its expected sector allocation. 84% of the fund is exposed to UK commercial property compared with the expected 55% target allocation.
- 3.4. In addition, the IOF has a much larger exposure to the office, hotel and leisure sectors which have been significantly impacted by the lockdown measures put in place earlier this year as a means to minimise the spread of the coronavirus disease.
- 3.5. Whilst the full impact of these measures on these sectors is still unclear, the fund has already faced some challenges in rent collection which has led to more rent deferrals from the tenants.
- 3.6. As a result, the pension fund faces an increase to its cash flow risk which could lead to increased difficulties in paying out pension benefits if this is not addressed.
- 3.7. Therefore, the Pension Fund Sub-Committee is recommended to either partially or fully disinvest from the M&G Inflation Opportunities Fund and commence the search for a replacement manager to achieve the fund's diversification targets.

4. Risk Management Implications

- 4.1. Risks are outlined within the report.

5. Other Implications

- 5.1. None

6. Consultation

6.1. None

List of Appendices:

(EXEMPT) Appendix 1: Active Manager Selection

(EXEMPT) Appendix 2: UK Property Market Exposure