TEESSIDE PENSION FUND

Administered by Middlesbrough Council

AGENDA ITEM 6

TEESSIDE PENSION BOARD REPORT

11 JULY 2016

INTERIM CHIEF FINANCE OFFICER – MARK TAYLOR

INFRASTRUCTURE AND LOCAL INVESTMENT PROTOCOL

1. PURPOSE OF THE REPORT

1.1 At the last meeting of the Teesside Pension Board held on 26h April 2016, the Chair asked for a report to be produced on infrastructure, particularly referencing local investment.

2. RECOMMENDATIONS

2.1 That the Board notes the report and pass any comments.

3. FINANCIAL IMPLICATIONS

3.1 There are no financial implications resulting from this report.

4. BACKGROUND

4.1 The Teesside Pension Fund has historically generally avoided direct investment in the Tees Valley area. This was primarily to ensure that the Fund did not find itself inhibited by conflicts of interest in the management of those assets.

4.2 The Fund has not entirely avoided such investment, including a £5 million commitment in the 1990's to the Teesside Private Equity Fund. This was an arm's length investment, backing enterprises both locally and nationally.

4.3 The concept of investing pension contributions locally is attractive, to ensure that the economic activity of providing affordable pensions, benefits as wider a range of local stakeholders as possible.

4.4 However, unlike other aspects of local investment by the public sector, an investment in itself needs to generate an acceptable economic return. The Fund cannot factor into its calculations secondary benefits, such as social or any other economic benefits that do not provide direct investment return.

4.5 The Chancellor of the Exchequer has indicated that Local Government Pension Schemes should do more to invest in infrastructure. Whilst it is yet to be seen what measures may be put in place to enforce such investment, in future it may be the case that the Fund finds itself obligated to increase such allocations. It may consider it desirable, where all other factors are equal, to see that such investment occurs in the Tees Valley area.

4.6 In addition, two reports have recently been published which both put the spotlight on investment in the Tees Valley:

- Tees Valley: Opportunity Unlimited (authored by Lord Heseltine), and
- Transforming Place through Devolution (authored by the Tees Valley Combined Authority).

4.7 The second of these reports specifically states that the Teesside Pension Fund could be used as a funding source:

> *"Local investment via Teesside Pension Fund may be another potential funding source. As a recent example the Greater Manchester Pension Fund has invested £25m into a joint venture investment to fund housing development. The Teesside Pension Fund is worth £3.2bn, if it invested 0.0075% per annum in local housing and infrastructure projects this would equate to £24m."*

5. INFRASTRUCTURE

5.1 Currently the Fund has a small proportion invested in infrastructure assets; these are limited liability partnership funds invested in healthcare PFI contracts. The main route to access this asset class is through similar partnerships. These usually have management fees and performance bonus fees which in most cases are a sufficiently high hurdle to prevent investment.

5.2 As part of the criteria for LGPS investment reform, the DCLG are asking Pools to provide capacity and capability to allow funds to increase their investment in infrastructure. In order to assist further infrastructure investment, the Treasury and Department of Communities and Local Government has provided the following definition:

> *"Infrastructure assets are the facilities and structures needed for the functioning of communities and to support economic development. When considered as an investment asset class, infrastructure investments are normally expected to have most of the following characteristics:*

- *Substantially backed by durable physical assets,*
- *Long life and low risk of obsolescence,*
- *Identifiable and reliable cash flow, preferably either explicitly or implicitly inflation-linked,*
- *Revenues largely isolated from the business cycle and competition, e.g. through long term contracts, regulated monopolies or high barriers to entry, and/or*
- *Returns to show limited correlation to other asset classes.*

Key sectors for infrastructure include transportation networks, power generation, energy distribution and storage, water supply and distributions, communications networks, health and education facilities, and social accommodation.

Conventional commercial property is not normally included, but where it forms part of a broader infrastructure asset, helps urban regeneration or serves societal needs it may be. Infrastructure service companies would not normally be included. The development, construction and commissioning of infrastructure assets is included in the broad definition.

Individual infrastructure investors will have further additional criteria they apply before making investments, such as current yield, time to income generation, management strength, risk mitigation measures, and amount of leverage."

6. LOCAL INVESTMENT PROTOCOL

6.1 Local investments can take many forms, including but not limited to:

- Real Estate Investment with a view to development,
- Private Equity participation in local enterprises,
- Investments in alternate routes to consumer credit, such as credit unions and peer to peer lending,
- Large scale infrastructure schemes such as transport links or public facilities, and
- Loans secured on assets.

6.2 These type of investments carry specific risks over and above those of traditional financial assets and as a relatively new asset class, has no long term reliable return data comparable to other portfolio assets. Some of the specific risks include:

- Bespoke project nature with different risk return makeup and economic sensitivities,
- Development projects are often based on simulations and therefore carry high future uncertainties ,
- Directly affected by Political and regulatory changes , and
- Highly illiquid assets.

6.3 In exchange for excess investment risk, the Fund would require additional return premiums. Risk levels can be reduced or shared by the inclusion of a sponsoring authority guarantee on income. At the lowest risk level the project would be required to meet a small margin over the Fund's expected long term rate of return.

6.4 Due to the nature and risks of infrastructure projects, not all proposals will create investment opportunities for the Fund. A formal protocol for local public bodies to approach the Fund with local investment opportunities was discussed and agreed at the

Teesside Pension Fund and Investment Panel meeting held on 29 June 2016. A two stage approach was agreed:

- Initial proposals received must be at the stage of a viable business plan to allow for a detailed investment appraisal to be completed, including costs, benefits, risks and timing implications. These would then be internally assessed with external advice taken where required, to identify portfolio suitability and risk return trade off, with riskier projects potentially requiring a partial guarantee from the leading project authorities.
- If the project is considered a potentially viable fund investment a report from the Chief Finance Officer, or whoever is the lead responsible officer for the Fund, would be submitted to the Investment Panel for consideration, to approve the resources required for a second stage of detailed due diligence and the resources required. After robust due diligence a detailed report on the investment would be submitted to the Investment Panel for final approval.

6.5 In accordance with the current Local Government Pension Scheme reforms to pool assets and for collective investment vehicles to carry out the "stock selection" investment decisions for Funds in the future, once the Borders to Coast Pension Partnership (BCPP) is able to evaluate and invest in infrastructure assets, all proposals will be put to BCPP for their consideration.

CONTACT OFFICER: Paul Campbell (Head of Investments & Treasury Management)

TEL. NO.: 01642 79024