TEESSIDE PENSION FUND & INVESTMENT PANEL

A meeting of the Teesside Pension Fund & Investment Panel was held on 29 June 2016.

PRESENT: Councillors S E Bloundele (Chair), Councillor J Rostron (Vice-Chair); Councillors R Brady, J G Cole, D P Coupe, G Purvis and L Young

Other Local Authority Members:

Councillor J Beall - Stockton Council

ALSO IN ATTENDANCE: Employers' Representative: Peter Fleck
Investment Advisors: F Green and P Moon
Property Advisor: A Owen
Unison: A Watson

OFFICERS: P Campbell, B Carr, A Hill, P Mudd and M Taylor

APOLOGIES FOR ABSENCE: Councillor C Massey, Councillor D McCabe, Councillor J Sharrocks, D Houghton, A Martin and N Wright.

DECLARATIONS OF INTERESTS

Name of Member	Type of Interest	Item/Nature of Interest
Councillor J Beall	Non Pecuniary	Member of Teesside Pension Fund
Councillor B Brady	Non Pecuniary	Member of Teesside Pension Fund
Councillor J Rostron	Non Pecuniary	Member of Teesside Pension Fund
Peter Fleck	Non Pecuniary	Member of Teesside Pension Fund
F Green	Pecuniary	Advisor to Teesside Pension Fund
P Moon	Pecuniary	Advisor to Teesside Pension Fund

1 MINUTES - TEESSIDE PENSION FUND AND INVESTMENT PANEL - 9 MARCH 2016

The minutes of the meeting of the Teesside Pension Fund and Investment Panel held on 9 March 2016 were taken as read and approved as a correct record, subject to the inclusion of Councillor Beall's apologies for absence.

2 FUND MANAGERS REPORT

The Interim Chief Finance Officer submitted a report to inform Members how the Investment Advisors' recommendations were being implemented.

The report provided a summary of the advice received from the two Investment Advisors at the previous meeting of the Panel held on 9 March 2016 together with information with regard to stock selection strategies, including a detailed report on transactions undertaken.

The Interim Chief Finance Officer referred to the Asset Allocation summary included at Page 6 of the report. The Panel was advised that the Customised Benchmark set investment in the FTSE at a much higher level than other Pension Funds and the benchmark was out of kilter with the Fund's actual portfolio.

ORDERED that the report be noted.

3 INVESTMENT ADVISORS' REPORT

The Investment Advisors each gave their views on the current global economic, political and market conditions, and reviewed the current position of the Fund. They drew Members attention to the current volatility in asset, commodity and currency markets and both expected this to continue given the news flow surrounding last week's EU Referendum outcome, the US elections later this year, and the continuing threat from ISIS. The outcome of the EU Referendum drew considerable comment from both Investment Advisors and Members since the outcome was not as expected and caused greater volatility in capital markets.

Both Advisors explained that markets did not like uncertainty, which explained the volatility in markets, but this should be used to the Fund's advantage with opportunities to purchase assets when values were low, and reduce investment when markets rallied.

In discussing the short term asset allocation, both Advisors acknowledged the current allocation compared to both the customised benchmark and other Funds' allocations. The Interim Chief Finance Officer enquired:-

- Why there was such a large difference between the Fund's short term asset allocation as previously recommended by the Investment Advisors and the customised benchmark and the average Local Government Pension Scheme (LGPS) Fund, and

- Why the Independent Advisors were not recommending either rebalancing back to the customised benchmark or revising it.

The Interim Chief Finance Officer recommended that the Independent Advisors provide a written report which sets out the reasons for the current asset allocation position in these economic conditions when compared to both the existing customised benchmark and the average LGPS Fund.

The Investment Advisors advised Members that the actuarial review was underway and it was common that after its completion, the Actuary carriied out an Asset/Liability Study. It was part of this Study where a customised benchmark was reviewed and revised if considered appropriate.

The Advisors' general view was to carry on with the allocation strategy set at the previous Panel meetings with growth assets preferred over protection assets. Previously, the Advisors had set recommended short term asset allocation ranges for the Investment Managers, however, with the volatility in all capital markets (equities, bonds, currency and commodities), this short term range be withdrawn for the next three months until the next Panel meeting.

The Advisors stated that if equity markets weakened, this would provide an opportunity to invest further in equities on a company specific basis, but emphasised the benefits of investing in UK equities after the recent falls in both equity and UK currency values. If equity markets strengthened, this would provide an opportunity for Investment Managers to reduce the equity allocation.

It was expected that after the outcome of the EU Referendum the value of the property portfolio would decrease, however, as long term investors the Fund could be a beneficiary of falling property values, as overseas owners look to exit the market and property fund managers were forced to sell at lower than market value to meet their investor's redemptions. If any post EU Referendum opportunities arise, it was recommended that the Fund take advantage of these otherwise hold current positions.

In respect of Alternative Investments, both Advisors continued to hold the view that Alternative Investments, particularly infrastructure, absolute return investments and taking pricing opportunities in the commodity markets were attractive to the Fund. The Advisors welcomed a recent investment in this asset class and encouraged further investment where it provided the Fund with diversification at a reasonable cost, and the risk adjusted return meets the actuarial require rate of return.

Both Advisors continued to express growing concern over high bond prices and low yields. Previous comments were reiterated where the Advisors would be happy to see a reduction in bonds, even from the current low levels.

Both Advisors continued to stress that bond yields at current levels did not meet the Fund's actuarial obligations and reiterated their previous comments that the current market volatility and the Fund's strategy could lead to cash levels oscillating between uncomfortably high and uncomfortably low levels.

The Interim Chief Finance Officer enquired whether written reports from the Investment Advisors would be made available after the meeting and for future Panel meetings reports were made available in advance in line with the committee's governance procedures to give Members sufficient time to consider their report and commentary in advance of meeting. Mr Green agreed to share his report with the Interim Chief Finance Officer.

ORDERED as follows:-

1. That the Investment Advisors' reports be noted and their asset allocation recommendations be carried out.

2. That the Investment Advisors provide a written report which sets out the current asset allocation when compared to the customised benchmark and average LGPS Fund's allocation.

3. That the Investment Advisors provide written reports in advance of future Investment Panel meetings in time for Members to read and review, with a verbal update provided on any relevant events between the date of the reports and the date of the Panel meeting.

4 **CBRE PROPERTY REPORT**

The Fund's Property Advisor submitted a report that provided an overview of the current property market and informed Members of the individual property transactions relating to the Fund.

The Panel was advised that rental values for UK Prime property had grown by +1.4% led by Industrial and London Offices. The transaction volumes for Q1 were 26% down on 2015 but to put this into perspective, they were 15% up on 2014 and 19% up on 2013. The figures for the two months to the end of May were very similar.

Leading up to Brexit prime investment yields had remained stable, therefore, with increasing rents and stable yields, the All Property Index showed capital growth of +1.2% for Q1, led by Industrial.

The Property Advisor advised that it was their perception that the UK Property Market would remain stable and solid but the run-up to Brexit was characterised by potential willing vendors reluctant to market their assets during Q2. Additionally a number of purchasing funds either withdrew from the market, or stood by due to a lack of stock. Typically, vendor agents were instructed to prepare assets for a post summer holiday marketing exercise beginning in September, anticipating a Remain vote and a stable market.

Following the result of the Referendum, there was a high degree of uncertainly, both politically and financially. It was too early to say how it would affect the Real Estate Market. It was highlighted that the property market was much slower to react than for example the stock or currency markets. The current situation was as follows:-

- REITS were down, yields were rising;
- Retail funds were nervous about outflows;

It was noted that the markets were risker and volatile and the Property Advisors would be closely monitoring pricing that risk, also resultant transaction volumes over the next 2-3 months by monitoring:-

- The occupational markets;

- Consumer confidence/Retails Performance;
- The retail fund markets; and,
- Property Companies within FTSE.

However, it was noted that uncertainty could bring opportunity with the £1 falling, and perhaps result in a small easing of prices in most use sectors. If UK Property maintained stable fundamentals, this market could become attractive to those looking for sensible returns.

The Panel was advised that as at 31 March 2016, the portfolio comprised 24 mixed-use properties located throughout the UK with a value of £184.5m. This reflected an overall Net Initial Yield of 5.24%, and an Equivalent Yield of 5.53%. In April the Advisors had negotiated a single-let warehouse which meant that the value of the direct property portfolio had increased to around £200m.

A summary of the portfolio activity was provided to the Panel. The Chair referred to the property on old Brompton Road and queried whether there had been any progress with the creation of additional residential floor space on the roof. The Panel was advised that there had been a number of issues around obtaining planning consent mainly with regard to the cost and the likelihood of obtaining consent. The Advisors were in the process of compiling a business case to pursue planning permission as it could be very profitable for the Fund if planning permission was obtained.

ORDERED that the report be noted.

5 **PERFORMANCE REPORT**

The Interim Chief Finance Officer submitted a report, the purpose of which was to report on the performance of the Fund.

The Panel was referred to Paragraph 6.1 of the report which stated that the total Fund return for the calendar year 2015 was 2.2%, against a benchmark return of 4.1% and the average fund return of 2.9%. This placed the Fund in the 62nd percentile of funds in the WM All Funds Universe, a universe made up of public and private sector funds. It was highlighted that the 1st percentile ranking was the highest, 50th percentile was the median and the 100th percentile was the lowest ranking of performance. This was the return for the calendar year, as was standard practice for the report, not the financial year. The financial year's performance result would be published in the Annual Report and Accounts.

The Fund's performance over both 3 and 10 years was positive, 6.1% pa and 6.0% pa respectively. Over 3 years the Fund underperformed its benchmark by 2.8% pa and its peers by 2.2% pa (91st percentile ranking), and over the longer period of 10 years, the Fund has also underperformed its benchmark by 0.2% and its peers by 0.1% pa (58th percentile ranking).

Reference was made to Paragraph 4.3 of the report. The Panel was advised that the way in which the Fund's investments performed was measured by the WM Company, a leading provider of performance services to public and private sector pension schemes. WM Company was currently part of State Street, a US and multi-national bank and custodian. State Street had decided not to continue to provide the performance monitoring service in the UK as from March 2016. The decision was unexpected and it left the Fund without a provider.

The Fund would need to source another provider, but it was highlighted that the Panel could need to compromise in future on the performance information received, e.g. percentile rankings against all Funds and the Local Authority Funds may not be available in the future.

A Member stated that there was some concern that the Fund had under-performed the benchmark over the three year and ten year period in respect of asset allocation and stock selection. The Panel was advised that over the past five years the markets had been volatile which made investing more difficult and falling oil and iron ore prices had a negative impact on the Fund's position in 2014 as the Fund held a larger than average proportion of investment in companies relating to these commodities.

A Member commented that there would likely be a significant change to the Fund's investments when the Fund became part of the pooling arrangement and he queried whether the Fund could reconsider having a managed fund model. The Panel was advised that the new pooling arrangements would provide an opportunity to work with other Funds to achieve economies of scale in investments. The Chair advised that it had been agreed that there would be an Interim Report of the asset allocation of the Fund.

ORDERED as follows:-

1. That the report be noted.

2. That the Head of Investments and Treasury Management be authorised to seek a replacement to the WM Company to provide future performance monitoring reports in respect of the Fund.

6 **SECURITIES LENDING REPORT**

The Interim Chief Finance Officer submitted a report, the purpose of which was to inform Members of the risks and potential income for the Fund from starting a securities lending programme.

The Panel was advised that securities lending involved the Fund loaning shares, bonds or exchanged traded funds (EFTs) that it owned in a company to a counterparty for a period of time in exchange for a fee and collateral covering the loaned holdings for the period of the loan.

Many other Pension Funds carried out this practice and it was considered an efficient use of assets. The issue had been considered by the Fund, ten years previously, and in 2008, preparations were being made to implement a securities lending programme but the banking sector and equity markets had experienced problems with many banks requiring bailouts from taxpayers. As a consequence, the programme was abandoned.

It was highlighted that the LGPS (Management and Investment of Funds) Regulations 2009, restricted the balance loaned out to a maximum of 25% of the total fund's value. Collateral was always taken from the borrower in excess of the value of the loaned security.

The practice was usually carried out where a company was unable to settle a trade and they needed a short term loan. It was known as 'shorting' where a company sells stocks or other securities or commodities in advance of acquiring them, with the aim of making a profit when the price falls. Many of the Local Government Pension Funds carried out this practice and none of them had reported making a loss over the last fifteen years. The Interim Chief Finance Officer advised that it was not clear whether the other Pension Funds loaned securities up to the maximum of 25% but this could be clarified.

The Panel was advised that during the loan period, the lender retained its economic interest in the security as the borrower was required to pay sums or property representing any coupon or dividend distributions that occurred during the period of the loan. It was highlighted that full legal and beneficial ownership was transferred to the borrower, including the voting rights for the loan period. If the Fund established a policy to recall all shares, the amount the Fund would receive for the loan of the securities would be significantly reduced. The Fund could however have a right of recall on the shares if they wished to vote on a particular issue.

The main risks associated with securities lending and the mitigants were listed in Page 10 - 12 of Appendix B. These included:-

- Counterparty risk,
- Market risk,
- Operational risk,
- Legal & contractual risk,
- Tax risk,

- Cash collateral & liquidity risk, and
- Lending Agent default risk.

The Panel was advised that Appendix A to the report contained a detailed proposal by the Fund's Custodian, BNP Paribas Securities Services, and Appendix B contained the latest Agency Lending brochure from BNP Paribas.

Members were advised that the opportunity to gain income from securities lending was a temporary measure as the ability to do this would cease once the Fund became part of the BCPP pool.

The Fund's Custodian would act as the lending agent for the securities. The next phase would be to issue a service level agreement and if BNP were taking a large proportion of the loan fee it would need to be submitted to the Panel for consideration.

ORDERED as follows:-

1. That Members authorise the Head of Investments to set up a securities lending programme with the Fund's Custodian, including a power of attorney, if needed, for the Custodian/Securities Lending Agent to act on the Fund's behalf when organising and settling securities lending transactions and collecting income due.

2. That the Head of Investments be authorised to use his discretion to decide whether or not the loaned securities should be recalled to allow the Fund to vote on its full holding.

7 **LOCAL INVESTMENTS**

The Interim Chief Finance Officer submitted a report, the purpose of which was to facilitate a protocol enabling investment of the Teesside Pension Fund's assets in the Tees Valley area.

The Panel was advised that the Fund had historically avoided direct investment in the Tees Valley area. The reason for this was primarily to ensure that the Fund did not find itself inhibited by conflicts of interest in the management of those assets.

The Chancellor of the Exchequer had indicated that Local Government Pension Schemes should do more to invest in infrastructure. It was highlighted that a report had been submitted to the Tees Valley Combined Authority in February 2016 naming Teesside Pension Fund as a possible source of funding for infrastructure projects.

In order to assist further infrastructure investment, the Treasury and Department of Communities and Local Government had 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.'

Currently, there was no formalised protocol for local public bodies to approach the Fund with local investment opportunities. It was suggested that any local area investment proposals be submitted to the Fund for consideration however it was emphasised that in accordance with the Fund's fiduciary duties, proposals could only be evaluated and accepted or declined on the individual projects investment potential.

Any proposals received must have a viable business plan to allow for a detailed investment evaluation to be carried out, including detailed costings, benefits, risks and timescales. The proposal would 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 a project was considered as a potential viable fund investment, a report from the Chief Finance Officer (or whoever was the lead responsible officer for the Fund), would submit a report to the Investment Panel for consideration, to approve the necessary resources required for a second stage of detailed due diligence and the resources required. Once the second stage was completed, a detailed report with regard to the investment would be submitted to the Panel for final approval.

It was highlighted that in accordance with the current LGPS 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) was able to evaluate and invest in infrastructure assets, all proposals would be put to BCCP for consideration.

The Panel was advised that using Fund assets to facilitate local area investment could benefit both the Tees Valley area and could add value to the Fund's asset mix, however not all projects would be suitable and no such investment would be undertaken without the approval of the Investment Panel.

A Member expressed concern with regard to whether consideration of investments in the Tees Valley area would present a potential conflict of interest for both officers and members. The Interim Chief Finance Officer advised that the primary consideration would be if the business case demonstrated the ability to generate an acceptable economic return and the objectives of the proposal were deliverable. The Panel was advised that the Fund could not factor into its calculations secondary benefits, such as social or any other economic benefit that did not provide direct investment return.

A Member advised that all elected Members were bound by the Members' Code of Conduct and they also had access to legal advice if required. He advised that there was case law that stated that Pension Funds could look at the wider benefits when investing funds and the Fund also had the benefit of the scrutiny of the Teesside Pension Board whose role was to ensure that the correct procedures were followed in terms of the Fund’s investments.

A Fund Advisor stated that he also had concerns with regard to the potential for conflicts of interest and the fact that Officers/Members could feel pressurised into agreeing to investments because they would benefit the local area. The Interim Chief Finance Officer advised that there were already robust procedures in place and as a Section 151 Officer he had never had any pressure placed on him to agree to investments where the economic benefit did not provide direct investment return.

ORDERED that the recommended protocol and policy enabling investment of the Teesside Pension Fund's assets in the Tees Valley area be approved.

8 **DRAFT ACCOUNTS**

The Interim Chief Finance Officer submitted a report, the purpose of which was to present to Members, the 2015/2016 Draft Accounts for the Teesside Pension Fund (attached at Appendix A to the report).

The Head of Investments and Treasury Management made particular reference to the following:-

- The membership of the Fund was 69,775, an increase of 1,721 over the previous year spread between active members, deferred members and pensioners;
- The issue with leavers in the previous year was as a result of the transfer out of Durham Tees Valley Probation Service in 2014/2015 which amounted to £76m;
- There had been a rise in management expenses of £500k as a result of increased trading and transactions costs;
- Investment income had risen by £5m

The Panel was advised that the Draft Accounts would be subject to audit and the audited accounts would be presented to the Panel in September 2016.

It was highlighted that the Teesside Pension Fund and Investment Panel Terms of Reference 3(iii) needed amending to reflect the correct title of the Head of Investments and Treasury Management.

ORDERED the Draft Accounts for 2015/2016 be noted.

9 **TREASURY MANAGEMENT REPORT**

A report by the Interim Chief Finance Officer was submitted, which included detail of the management of the Fund's cash balances, including the methodology used.

The counterparty list and associated limits as at 31 March 2016 was detailed at paragraph 6.1 of the submitted report.

As at 31 March 2016, the Fund had £104.9m invested with approved counterparties at an average rate of 0.428%. A graph attached at Appendix A to the report showed the maturity profile of cash invested and the average rate of interest obtained on the investments for each time period. As an example, 27.93% of the Fund's cash investments were repayable in the period 2 weeks to 1 month at an average interest rate of 0.510%.

ORDERED that the report be noted.

10 **PERSONAL SHARE DEALING**

The Interim Chief Finance Officer submitted a report in accordance with the Management Agreement to inform Members of personal share dealing activity.

Members were advised that as part of the requirements of the Management Agreement officers were required to report all personal share dealings to the Head of Investments and Treasury Management, who was responsible for maintaining the Register for such dealings. It was highlighted that the following transactions had been undertaken:

- 16 May 2016 - 100 Centrica shares;
- 14 June 2016 - 100 Vodaphone shares;

In accordance with the above agreement the purchases of the shares had been reported to the Head of Investments and Treasury Management.

ORDERED that the report be noted.

11 **EXCLUSION OF PRESS AND PUBLIC**

ORDERED that the press and public be excluded from the meeting for the following items on the grounds that, if present, there would be disclosure to them of exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A of the Local Government Act 1972 and that the public interest in maintaining the exemption outweighed the public interest in disclosing the information.

12 **BORDERS TO COAST PENSION PARTNERSHIP - UPDATE**

The Interim Chief Finance Officer submitted a report, the purpose of which was to follow up the reports on LGPS Investment Reform presented at the meetings of the Teesside Pension Fund & Investment Panel (the Panel) held on 9 February 2016 and 9 March 2016, and to update Members on the proposed, joint proposal to be submitted to the Department for Communities and Local Government (DCLG) by 15 July 2016.

ORDERED as follows:-

1. That the recommended key aspects of the Borders to Coast Pension Partnership (BCPP) to be submitted to the DCLG be agreed. Specifically, key aspects of the submission addresses:

- An FCA (Financial Conduct Authority) registered structure to be implemented;
- Decision making authority within BCPP and that to be retained by Teesside Pension Fund (the Fund);
- An initial overview of how the Fund will monitor and hold BCPP to account;
- The costs, benefits and risks of the governance and operational models chosen; and
- How BCPP proposes to build “capability and capacity”; to invest in infrastructure at scale.

2. That delegated authority be given to the Chair, or Vice Chair in his absence, to agree the final wording on the joint submission on behalf of the Fund.

3. That the Memorandum of Understanding (MOU), including the Terms of Reference for both the Members Steering Group and Shadow Operations Group (Appendix D) be agreed.

13 **DURHAM TEES VALLEY AIRPORT**

The Interim Chief Finance Officer submitted a report, the purpose of which was to provide the Panel with an update in relation to the situation with regard to the Admission Agreement with Durham Tees Valley Airport (DTVA).

ORDERED that the recommendations detailed at No. 1 and 2 of the report be agreed.