TEESSIDE PENSION FUND & INVESTMENT PANEL

A meeting of the Teesside Pension Fund & Investment Panel was held on 8 March 2017.

PRESENT: Councillors Bloundele, Blyth, Brady, Coupe, G Purvis and Rostron

Other Local Authority Members:
Councillor Beall, Stockton Borough Council
Councillor Hall, Hartlepool Borough Council

OFFICERS: J Bromiley, P Campbell, A Hill, S Lightwing, P Mudd

APOLOGIES FOR ABSENCE were submitted on behalf of Councillors Massey and Walters, P Fleck, A Martin and A Peacock.

DECLARATIONS OF INTERESTS

Name of Member	Type of Interest	Item/Nature of Interest
Councillor Beall	Non Pecuniary	Member of Teesside Pension Fund
Councillor Brady	Non Pecuniary	Member of Teesside Pension Fund
Councillor Rostron	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 - 7 DECEMBER 2017**

The minutes of the meeting of the Teesside Pension Fund and Investment Panel held on 7 December 2016 were taken as read and approved as a correct record.

2 **FUND MANAGER'S REPORT**

A report was presented to inform Members how the Investment Advisors' recommendations were being implemented. Information was provided with regard to stock selection strategies, including a detailed report on transactions undertaken. An independently produced valuation of the Fund's assets was also presented.

It was highlighted that the Investment Advisors continued to favour growth assets over protection assets.

The total value of all investments, including cash, was £3,682 million, compared with the last reported valuation as at 30 September 2016 of £3,601 million. At the beginning of the financial year the asset valuation was just over £3 billion and there had been an increase of approximately 20% to date which was credit to the Investment Advisors who had stuck with the allocation plan through periods of relatively low growth.

With regard to the asset allocation it was highlighted that the Fund was considerably underweight its customised benchmark and should look to increase its allocation to this asset class if suitable investment opportunities were available.

It was highlighted that the Transaction and Monthly Valuation reports were currently provided online and in hard copy to all Panel Members. The Chair suggested that in future only the Transaction Report for the period would be produced in hard copy.

ORDERED as follows:

1. that the report was noted.

2. in future, the Monthly Valuation would only be available to Fund Members online and not in hard copy.

3 **INVESTMENT ADVISORS' REPORTS**

A report was presented to update Members with the current capital market conditions, and set an appropriate short term asset allocation to best take advantage of the conditions.

The Panel's Independent Investment Advisors provided an update to Members on current global economic, political and market conditions. The Advisors' recommendations were set out in reports attached as Appendices A and B to the submitted report.

Both Advisors continued to favour growth assets over protection assets. Bonds did not meet the actuarial requirements for the Fund at the current yield levels and should continue to be avoided at around these levels unless they were held as a short term alternative to cash. Cash should continue to be built up as divestments from other markets and invested when opportunities allowed.

There was consensus that equity markets had been volatile, with additional volatility in currency markets, which had been beneficial to the Fund with its current weighting in this asset class. It was proposed that the short term asset allocation was amended by increasing the UK range from 30 to 36 and the Overseas range from 44 to 50.
The Advisors expressed caution over Europe into this year's elections in key European countries.

Both Advisors continued to favour further investment into direct property on an opportunistic basis where the property had a good covenant, yield and lease terms.

ORDERED as follows that:

1. The report was noted.
2. The proposed short term asset allocation was approved.

4 **CBRE PROPERTY REPORT**

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

CBRE predicted total UK Real Estate investment for 2016 was £49 billion, which was down 30% on 2015. It was anticipated that 2017 would be lower, albeit the UK's economic fundamentals remained strong. Transaction levels had remained subdued in the light of the uncertain political outlook. Sellers were deciding to wait out the currency uncertainty rather than accept a lower price. Foreign investors holding UK assets had also lost out to the currency weakness, rather than being beneficiaries.

The outlook in retail for 2017 looked set to be challenging due to an increase in costs and a likely decrease in consumer spending. The Rates revaluation would affect retailers, particularly in London, where some rates were set to increase by over 100%. The National Living Wage would also add to retailers' costs and it was expected that a proportion of all these increased costs would be passed on to consumers. The CBI forecast that consumer spending growth would fall from 2.7% in 2016 to 1.2% in 2017. Inflation was predicted to be as high at 4% by the end of this year.

With regard to retail investment, the year ended with competitive bidding and good interest for prime and best secondary stock - high street, retail parks and shopping centres. Interest in secondary and tertiary stock was lower and it was anticipated that this trend would continue for the foreseeable future. The lower exchange rate encouraged continued interest in prime assets from foreign investors and sovereign wealth funds.

In the industrial sector the continued shift from the high street towards E-commerce had created a growing demand for distribution space. There was now a severe shortage of prime vacant stock, particularly units of over 200,000 square feet in London and the Golden Triangle. It was predicted that low interest rates and the depth of investor and occupier demand would ensure that prime yields remained low, with the potential for further compression given the increasingly positive rental growth statistics.

Within the regional office sector, where there was a balanced occupier demand/supply equation, the investment markets were stable and fairly priced stock would sell, albeit the investor demand was nowhere near as strong as it was for retail and industrial assets. There might be opportunities offering good value, particular whilst there was a lack of prime stock in industrial and retail.

In conclusion, the availability of primary quality stock in the three principal use sectors was limited. It was anticipated that there would be competitive bidding for such assets which would buoy pricing and then valuation yields. CBRE would continue to seek well located assets, in good physical condition, well-let to good covenants and focus on those areas where underlying fundamentals would lead to rental and capital growth in the short and medium terms. CBRE would also continue to seek stock which had strong capital protection qualities.

With regard to portfolio activity, the Fund sold its asset in Loughton, Essex for £12.3 million, representing a Net Initial Yield of 3.46% and a premium asset to value of 29%. The Fund also completed on the acquisition of a single let distribution warehouse for £15 million.

It was confirmed that the arrears on the three accounts highlighted on page 7 of CBRE's report had now been collected.

In relation to the Asset Management Commentary at page 20 of the report, it was noted that terms had now been agreed in relation to Old Brompton Road, the ongoing rent review negotiations listed had been concluded and the lease re-gear in Colchester had also been completed.

ORDERED that the report was noted.

5 **LOCAL INVESTMENTS - UPDATE**

A report was presented to update Members of the Investment Panel on progress made with local investments.

Discussions had taken place with CBRE regarding their assistance in local investments in other parts of the country, using LGPS Funds. The process they had adopted in the past fitted in the protocol of using their expertise after the initial assessment was completed by the Fund and CBRE making a recommendation back to the Fund once more detailed terms of the investment and due diligence was completed.

Additional meetings had taken place with other potential investment/asset management firms who might or might not be able to assist both the Fund and local public bodies to facilitate local investments in the Tees Valley area. These were at an early stage and needed further development.

The Fund had carried out some early stage discussions with the Tees Valley Combined Authority (TVCA), with further discussion scheduled. The TVCA was working on its own protocol to enable it to present potential investment opportunities to the Fund. Further progress was anticipated in the near future.

ORDERED that the report was noted.

6 **LGPS INVESTMENT REFORM (POOLING ASSETS) UPDATE**

A follow up report on LGPS Investment Reform was presented to inform Members of the Teesside Pension Fund and Investment Panel (the Panel) of the latest developments in setting up the new Pool, BCPP (Border to Coast Pension Partnership).

The sub group looking at the Operating Model had tendered for tax advisors (Deloitte), been in dialogue with Funds and the Independent Advisors/Consultants to set the asset allocation template and was in the process of tendering for advice for procurement of the new Depository and Asset Servicer.

The people sub group had tendered for and contracted a recruitment consultant (Odgers and Berndtson) to assist with creating the remuneration package for, and recruiting, the senior executives and non-executives of BCPP. Preparations had started to search for suitable premises in Leeds and the TUPE of existing staff.

At the Member sub group held on 31 January 2017, the outline remuneration package for the executives and non-executives for BCPP were discussed. The outline, draft packages, which required the agreement of each Fund, were as follows:

Executive posts:

- Chief Executive up to £250,000 (flexible package).
- Chief Operating Officer/Chief Finance Officer up to £210,000 (flexible package).
- Chief Investment Officer up to £210,000 (flexible package).

There was no bonus/PRP and no LGPS membership for the above posts. It was clarified that the postholders would be independent of BCPP. If it was not possible to recruit an appropriate candidate to these posts the matter would be returned to the Member sub group. The post of Risk Officer/Compliance Officer still required consideration.

Non-Executive posts:

- Chair up to £40,000.
- 2 x Non-Executive Directors up to £20,000.

The sub-group for Governance had procured legal advice from Eversheds LLP for BCPP and Squire Patton Boggs (SPB) LLP for each Fund. Eversheds LLP had prepared the key documents required for the Pool to function with SPB LLP reviewing on behalf of the Funds. These documents were almost at a state of agreement for all Funds.

A standard report had been prepared for each administering authority to obtain authority from each partner Council to set up the Joint Committee to oversee the investment activities of the BCPP and for each Council to acquire the required shareholdings. The Fund's report was presented to full Council on 15 February 2017 and the recommendations were agreed. All reports would be presented to the administering authorities of each BCPP partner before the end of March and full Joint Committee and shareholder meetings to be held in April 2017.

Member representatives from other local authorities requested that a report summarising the current position on the pooling arrangements was provided for local authority employers.

At one meeting of the BCPP Partners it was suggested that the Joint Committee should allow the Trade Unions to participate as non-voting Members and represent Scheme Employees. Their decision to put in place the governance arrangements to create the Joint Committee was postponed to a meeting late in March 2017, after gauging opinion from the other BCPP Partners. The Chair reported that lengthy discussion had taken place in respect of this issue and a unanimous decision had not been reached.

A transition plan was in development to identify and mitigate the risks to the Fund of pooling the investment of its assets with BCPP. The key risks identified to date were to staffing, assets and governance and accounting. The staff currently managing the Pension Fund worked mainly in the Loans and Investment section, with pension administration services outsourced to Kier

Business Services and some of the accounting function carried out by the Council's Finance section. All the staff in the Loans and Investment section were listed for TUPE (Transfer of Undertakings (Protection of Employment). If those staff moved to BCPP under TUPE, the Fund would not have sufficient staffing resources to manage the activities of BCPP and the legacy assets not transferred (eg cash, property etc), service the Pension Board and Investment Panel, monitor the activities of pension administration, and, key parts of the Fund's Report and Accounts would not be completed.

In addition, as the Service in Middlesbrough could effectively close and move to Leeds, staff were looking at protecting their own futures and this had detrimentally affected moral, with some key staff having already left the service leaving gaps in skills and knowledge to run the section. The transition plan would look at creating an effective strategy to identify the immediate and future (post-pooling) requirements of the Fund and mitigate the above risks.

The key risks to assets was the continued management of existing investment assets, the identification of assets to transfer to BCPP and the actual transfer itself, monitoring the investment management of the BCPP in the future, and management of any legacy assets not transferred. The key to mitigating the asset risks was identifying the assets to transfer to BCPP for management. However there were three issues with this as follows: BCPP did not have a timetable for receiving assets to start managing them; BCPP would need to create a team from the existing staff of three internally managed Funds in the BCPP, plus additional new staff in order to continue with low cost, active management by an in-house team; and the Minister had not yet set out the criteria for the strong Value for Money case required to delay placing assets in the pool.

Currently the Fund was managed at officer level through the Loans and Investments Section. The transition plan needed to address this and retain key skills and knowledge required to continue to manage the Fund, post pooling, otherwise the Fund could be vulnerable to breaching LGPS regulations and unable to produce accurate and adequate Annual Report and Accounts.

ORDERED as follows that the:

1. information provided was noted.
2. outline, draft remuneration packages for the Executives and Non Executives of the BCPP were approved.
3. Panel was in favour of Trade Union non-voting membership of the BCPP Joint Committee, and delegated authority to the Chair of the Panel to represent this view with the BCPP Joint Committee.
4. the Head of Investments and Treasury Management would draft a report summarising the current position on the pooling arrangements for local authority employers.

7 **PENSION GOVERNANCE REVIEW - UPDATE**

A follow up report was presented to inform Members of the Teesside Pension Fund and Investment Panel (the Panel) of progress to date with the governance review following as an action from the 2015/2016 External Auditor report.

A working group comprising members of the Panel and the Board had been established and a meeting had been arranged for 7 April 2017.

AON Hewitt had been engaged to carry out an independent review of governance arrangements in accordance with terms of reference, a copy of which was attached at Appendix A to the submitted report. To date, AON Hewitt had asked for key documents for review and had held discussions with Fund officers to ascertain current arrangements. AON Hewitt were due to publish a report later this week which would form the basis of discussion at the meeting of the working party. The report would be circulated in advance of the meeting.

The working party would identify a way forward with regard to the External Auditor's recommendations.

ORDERED that the information provided was received and noted.

8 **INVESTMENT ADVISORS TENDER - UPDATE**

F Green and P Moon left the room at this point in the meeting.

A report was presented to update Members of the Panel with progress made with the tender for Investment Advisors to the Panel.

At the last meeting, the Panel agreed to tender for the services of two Independent Investment Advisors for a period of ten years, with reviews/breaks available after four and seven years. Tendering at a fixed price of £12,500 per annum plus expenses for a maximum period of ten years was under the European Union procurement threshold.

The issue of off-payroll working and income tax (IR35) had been investigated, and a method of tendering with a specification based on outcomes had been devised. This allowed recruitment through the tender process of a consultant and not a disguised employee. A proposed tender specification was attached at Appendix A to the submitted report.

Some further benchmarking had taken place to assist Members to identify the outcomes expected of Investment Advisors from other Funds. Details were attached at Appendix B to the submitted report.

Prior to developing a full tender, an investigation into whether or not the Investment Advisors should have professional indemnity insurance and the size of that insurance was required.

ORDERED as follows that the information provided and the progress made to date was noted.

9 **ANNUAL BUSINESS PLAN 2017/2020**

F Green and P Moon re-joined the meeting.

The annual Business Plan 2017/2020 was presented for approval. The proposed management expenses budget for 2017-2018 was £1,643,000.

In order to comply with the recommendations of the Myners Review of Institutional Investment it was agreed that an annual Business Plan should be presented for approval. The Business Plan contained financial estimates for the investment and management of the Fund.

The Teesside Pension Fund Business Plan was designed to set out how the Investment Panel operated, what powers were delegated and to provide information on key issues. The Business Plan sat alongside the Management Agreement, which set out the delegated powers and responsibilities of officers charged with the investment management function.

The Business Plan for 2017/2020 was attached at Appendix A to the submitted report. The Plan had been updated to include an Annual Report to Council, a revised Annual Plan for Key Decisions and the estimated outturn for 2016/2017 for the management expenses budget and proposed budget for 2017/2018.

It was highlighted that that the proposed budget for 2017/2018 represented an 11% increase from the previous year. The majority of this small increase reflected the growth in the valuation of properties in the Fund's portfolio since the management expense for property management was calculated as a percentage of the property valuation. Additional increases were also proposed for the cost of information systems to take account of the adverse foreign exchange movement between the US Dollar and the GB Pound. There were also Staffing costs increases to take account of the cost of living rise and slight rise in the employer contribution rates for Pensions.

ORDERED as follows that the Teesside Pension Fund Business Plan 2017/2020 and Annual Report for Middlesbrough Council were approved.

10 **FUND ACTUARIAL VALUATION AND FUNDING STRATEGY STATEMENT**

A report was presented to inform Members of the results of the triennial valuation of the Teesside Pension Fund and the updated Funding Strategy Statement.

The Administering Authority was required by Regulation 62 of the Local Government Pension Scheme Regulations 2013 to appoint an Actuary to carry out a full valuation of the Fund as at 31 March 2016 and as at 31 March every third year afterwards. The main purpose of the valuation was to review the financial position of the Fund and determine the rate at which employing bodies in the Fund should contribute in future to ensure that the existing assets, when combined with future contributions from both employers and scheme members would be sufficient to meet future benefit payments from the Fund.

The position of the Fund was very good and, on a whole of fund basis, the funding level was 101%. The value of assets (£3.1bn) exceeded the liabilities by £24.6m. This was a small decrease of £12.4m compared to the last valuation where the Fund was also 101% solvent.

The employers' average cost of future service benefits was 15.7% of pensionable pay with effect from 1 April 2017: this was an increase from the 14.4% set at the 2013 valuation. The main reasons for the increase were that the Actuary had a more pessimistic view of future returns achievable from the investment assets owned by the Fund; Membership changes, in particular a fall in active Members contributing to the Fund; and an increase in pensioner Members receiving payments from the Fund.

Whilst the Fund was fully funded overall, the funding level of individual employers varied. Some employers still had deficit which needed to be recovered and the payments required were spread over a number of years (the deficit recovering period). At this valuation the deficit recovery period had been set at 20 years, an increase from 11 years at the last valuation. The reason for the increase was to assist and stabilise employer contribution rates and the affordability of the Fund for employers whilst ensuring the Fund remained solvent.

Following the actuarial valuation it was standard practice to undertake an Asset/Liability Study. The Study looked at the long-term liabilities of the Fund and constructed a benchmark setting out what mix of investments would be best suited to match those liabilities over the medium and long-term. The Study would be carried out by the Fund's Advisors and the Head of Investments in conjunction with the Fund Actuary.

Subsequent to 2004 the Funding Strategy Statement (FSS) had been revised for each triennial valuation. A copy of the updated FSS was attached at Appendix A to the submitted report. Since the previous valuation, there were changes to the assumptions used in the Actuarial calculation of the funding targets and a change in the treatment of different employers in the Fund. A number of key assumptions were included in the FSS. The main unfavourable movement from the 2013 valuation was the discount rate. In order to mitigate this, the trajectory period had been increased to 25 years and the deficit recovery period had increased to 20 years, in line with recommended market levels.

In past valuations, the same funding target assumptions were used across all employers. The employer covenant risk was not taken into account in the calculations, and, with some employers, the risk of calculating the employer contribution rate on an on-going basis only for these employers to face a cessation valuation on exit from the scheme at a lower discount rate, based on the gilt rate. After this valuation a full assessment of employer covenant risk would be undertaken and reflected in future versions of the FSS.

ORDERED as follows that:
1. The outcome of the triennial valuation for 2016 and the updated Funding Strategy Statement were noted and agreed.
2. An Asset/Liability Study would be carried out and presented to the Investment Panel.
3. A review of Employer Covenant Risk would be carried out and presented to the Investment Panel.

11 **INVESTMENT STRATEGY STATEMENT**

A report was presented to inform Members in relation to the Fund's Investment Strategy Statement (ISS). The ISS set out the investment strategy for the Fund.

The new LGPS (Management and Investment of Funds) 2016 regulations came into force from 1 November 2016 and four key changes were made to the previous 2009 regulations as follows:

- The introduction of an Investment Strategy Statement, replacing the Statement of Investment Principles.
- The removal of Table of Limits on Investments (Schedule 1), placing the responsibility of setting appropriate limits on each Fund.
- The introduction of allowing funds to invest without restriction as to quantity in Treasury approved collective investment schemes (ie pooling).
- The introduction of power for the Secretary of Statement for DCLG to intervene where an Investment Strategy was deemed not acceptable or a fund did not make suitable arrangements to make investments determined by the Secretary of State.

The new regulations removed the existing schedule of limitations on investments and authorities would be expected to take a prudential approach, demonstrating that they had given consideration to the suitability of different types of investment, had ensured an appropriately diverse portfolio of assets and an appropriate approach to managing risk.

This was set out in the ISS which authorities were required to prepare, having taking proper advice and appropriate consultation with interested parties, and publish by 1 April 2017.

ORDERED as follows that the Investment Strategy Statement was approved.

12 **TREASURY MANAGEMENT REPORT**

A report was presented on the treasury management of the Fund's cash balances, including the methodology used.

As at 31 December 2016 the Fund had £387.2 million invested with approved counterparties at an average rate of 0.3.03%. Appendix A to the submitted report detailed the maturity profile of cash invested and the average rate of interest obtained on the investments for each time period.

ORDERED that the information provided was received and noted.

13 **PERSONAL SHARE DEALING**

A report was presented on personal share dealing activity to comply with the requirements of the Management Agreement.

The following share transaction was undertaken and reported to the Head of Investments:

On 23 November 206 a purchase of 100 Vodafone ordinary shares was undertaken.

ORDERED that the information was received and noted.