

TEESSIDE PENSION FUND & INVESTMENT PANEL

A meeting of the Teesside Pension Fund & Investment Panel was held on 28 June 2017.

PRESENT: Councillors Bloundele, (Chair), Brady, McGloin, Rostron and Walters

ALSO IN ATTENDANCE: Property Advisors: A Owen and A Peacock
Unison Representative: A Watson
EY, External Auditor Representative: S Kenny
Aon Hewitt: M Ferguson
Tees Valley Combined Authority: A Fellows

OFFICERS: J Bromiley, P Campbell, G Hall, S Lightwing

APOLOGIES FOR ABSENCE Councillors Blyth, Coupe, McTigue, G Purvis, J Sharrocks and A Martin and P Fleck.

DECLARATIONS OF INTERESTS

| Name of Member | Type of Interest | Item/Nature of Interest |
|-----------------------|-------------------------|---------------------------------|
| Councillor Brady | Non Pecuniary | Member of Teesside Pension Fund |
| Councillor Rostron | Non Pecuniary | Member of Teesside Pension Fund |

1 **MINUTES - TEESSIDE PENSION FUND AND INVESTMENT PANEL - 8 MARCH 2017**

The minutes of the meeting of the Teesside Pension Fund and Investment Panel held on 8 March 2017 were taken as read and approved as a correct record.

2 **FUND MANAGER'S REPORT (INCLUDING TRANSACTION REPORT)**

A report of the Strategic Director Finance, Governance and Support was presented to inform Members how the Investment Advisors' recommendations were being implemented.

Information was provided regarding activity between January and March 2017 setting out returns across some of the major asset classes. An asset allocation summary was also provided.

The total of all investments, including cash, was £3,859 million, compared to the last reported valuation as at 31 December 2016 of £3,682 million.

ORDERED that the report was noted.

3 **INVESTMENT ADVISORS' REPORTS**

A report of the Strategic Director Finance, Governance and Support 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.

Usually, at each Investment Panel meeting, the Panel's Independent Advisors provided an update to Members on current global economic, political and market conditions, and recommended an appropriate short term asset allocation for the Fund given these conditions. However, a review of Advisors had been carried out and as part of the tender exercise the previous Advisors' last Panel meeting was in March 2017. New Advisors were not yet in place to provide advice to Members for today's meeting.

Attached at Appendix A to the submitted report was a report from the Head of Investments and Treasury Management setting out the political, economic and market background since the previous meeting.

In light of there being no Advisors to provide advice, it was considered appropriate to continue with the previous short term asset allocation. The current political, economic and market conditions were similar to previous advice provided at meetings and did not suggest any need to make any major strategy changes.

ORDERED as follows that:

1. The report was noted.
2. There was no change to the short term asset allocation.

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.

At 31 March 2017 the portfolio comprise 24 mixed-use properties located throughout the UK with a value of £204.325 m. This reflected an overall Net Initial Yield of 5.25% and an Equivalent Yield of 5.64%.

The Fund sold its asset in Loughton, Essex for £12.3 million, representing a Net Initial Yield of 3.46% and a premium to asset value of 29%. There had been no acquisitions during the period, however an offer was underway on an industrial site which could add £16 million to the value of the portfolio. Several rent reviews had been concluded that had resulted in uplifts.

In response to a query regarding external cladding on buildings following the recent Grenfell Tower tragedy, it was confirmed that the Fund did not own any buildings with the same type of cladding. The Fund did own one property which had brick cladding. It was also noted that the Fund did not generally invest in residential properties and the type of cladding used on units in retail parks contained a different type of non-combustible insulation.

ORDERED that the report was noted.

5 **POOLING UPDATE**

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

The latest meeting of the Member Steering Group/Joint Committee, was held on 6 June 2017. Members were updated on progress by BCPP as follows:

- Update on BCPP project delivery and implementation budget.
- Update on the governance documentation and incorporation of BCPP Ltd.
- Refinement of BCPP corporate entity and cost sharing principles.
- Development of the Target Operating Model (TOM) and asset template progress.
- Update on the property search.
- Options for terms and conditions of Employees of BCPP Ltd.
- Company committee structures and the roles of Non-Executive Directors.
- Governance requirements for BCPP Ltd as a Financial Conduct Authority (FCA) regulated entity.
- Update on the Executive search, remuneration and recruitment process.

The Head of Treasury and Management provided further explanation in relation to the incorporation of BCPP, the property search and executive recruitment process, the detail of which was included in the submitted report.

It was highlighted that the key risk 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 BCPP in the future and management of any legacy assets not initially transferred.

A workshop was held to clarify the position of the Investment Panel over the future of the Fund's investment management arrangements, ie managing the Fund's assets in the long term and in the period up to BCPP taking over investment management responsibilities. The potential benefits and risks of different investment strategies available to the Fund were discussed and agreement was reached to comply with the spirit of the new legislation and pool the Fund's investments with BCPP.

As an interim measure, given the current staffing risks discussed at previous Panel meetings, it was agreed that the Strategic Director Finance, Governance and Support and the Head of Investments and Treasury Management should be authorised to deviate from internal management, where necessary, to greater use of pool funds. Additional resources would be needed to appoint a Transition Manager and potentially purchase additional consultancy support to assist the Fund with the transformation.

In relation to staffing, a staffing transformation plan had been developed to identify the future (post-pooling) staffing requirements of the Fund, and mitigate the risks to the current staffing establishment. A copy of the first draft staffing structure was attached to the submitted report at Appendix D (ii) which would enable the Fund to manage the activities of the pool after the transfer of assets, manage the assets not transferred to the pool and carry out the other governance and accounting work required.

The Fund's employers had been contacted by email and a plan was in place to present the transition plan to the four Local Authority employers in the Fund and present details of pooling and the transformation plan at an Employers Forum the Fund was going to arrange.

Whilst pooling of the Fund's investment assets did not have an impact on employee contribution rates or pension benefits, Teesside Pension Fund scheme members would receive information as part of the bi-annual newsletters to active members and pensioner members.

ORDERED as follows:

1. Authority to change the investment management strategy from internal management to a mix of internal management and pooled funds to manage the whole equity and bond portfolios in the run up to pooling was delegated to the Strategic Director Finance, Governance and Support and Head of Investments and Treasury Management.
2. The authority to decide the extent of the change and which investment markets would be managed through pooled funds, and flexibility allowed, should circumstances change prior to pooling to allow the mix of internal management and pooled funds change to match the staffing resources in place was delegated to the Strategic Director Finance, Governance and Support.
3. Authority to procure a Transition Manager and any other additional consultancy support needed as part of the transformation plan, and which exceeded current budget was delegated to the Strategic Director Finance, Governance and Support and the Head of Investments and Treasury Management.
4. Authority to refine the proposed new structure and implement the staffing transformation plan as outlined in Section 9 of the report was delegated to the Strategic Director Finance, Governance and Support.

6

GOVERNANCE REVIEW - UPDATE

A report of the Strategic Director Finance, Governance and Support was presented to inform Members of the Teesside Pension Fund and Investment Panel of progress to date with the governance review. Aon Hewitt had carried out an independent review of governance arrangements and produced a report, a copy of which was attached to the submitted report at Appendix C. AON Hewitt had also produced draft revised terms of reference for the Panel and the Board and Michael Ferguson from AON Hewitt was introduced to the Panel.

As a result of the review and the work completed by the working group, the following key changes were proposed:

- The Panel would change its name to the Teesside Pension Fund Committee (the Committee).
- Membership of the Committee and Board would be for four years, fitting in with the electoral cycle.
- The Panel currently had membership availability for scheme members/trade unions, but these were non-voting positions. The Committee would have two voting positions for scheme members/trade unions.
- The Teesside Pension Board Members would serve for a period of four years, fitting in with the electoral cycle.
- Pension Board Members would be able to attend Pension Fund Committee meetings as observers, including any exempt items.
- The current business plan was focussed more on investments. This plan would be extended to include more Pension Administration and Governance, including key performance indicators and budgets for pension administration and governance.
- An annual Employer Forum would be introduced for scheme employers to attend and receive updates on the Fund.

A number of policies had been identified as required by the Local Government Pension Scheme (LGPS) Regulations or related guidance, but were either missing or out of date. AON Hewitt were therefore instructed to produce the following draft policies for consideration and adoption by the Fund:

- Conflicts of Interest Policy.
- Governance Policy and Compliance Statement (including a delegation of functions to officers).
- Procedure for Reporting Breaches of the Law.
- Risk Management Policy.
- Training Policy.

In addition, Kier Business Services were asked to produce an Administration Strategy and a Communications Strategy.

The terms of reference for the Teesside Pension Fund Committee and Teesside Pension Board, and the policies presented to the Panel would be presented to the Teesside Pension Board for their input. Both terms of reference would then be presented to a meeting of Middlesbrough Council in September 2017, together with other required changes for inclusion in the Council's Constitution.

The Governance Policy and Compliance Statement, Administration Strategy and Communications Strategy were still in draft form and would be completed for presentation at the September 2017 Panel meeting.

In addition, an exercise would be undertaken to update the Fund's risk register. The risk register would be updated to reflect the recommended format by CIPFA, and adopted as part of the Risk Management Policy.

Following the adoption of the recommended changes and new policies, a process will be introduced to check adherence to the Pension Regulator's Code of Practice.

Finally, individual training plans would be created for all Committee and Board Members, as well as key Fund Officers. Attendance at training by at least 75% of the Pension Fund Committee Members would be required.

ORDERED as follows that the following documents were approved :

1. Terms of Reference - Teesside Pension Fund Committee (Appendix D)
2. Terms of Reference - Teesside Pension Board (Appendix E)
3. Conflicts of Interest Policy (Appendix F)
4. Procedure for Reporting Breaches of the Law (Appendix G)
5. Risk Management Policy (Appendix H)
6. Training Policy (Appendix I)

7 **SUSPENSION OF COUNCIL PROCEDURE RULE NO 5 - ORDER OF BUSINESS**

ORDERED that, in accordance with Council Procedure Rule No 5, the Committee agreed to vary the order of business.

ORDERED that agenda items were considered as follows: Agenda Items 10 to 17, Agenda Item 9 and Agenda Items 18 to 19.

8 **EXTERNAL AUDIT PLAN**

The External Auditor, EY, presented the Audit Plan which set out the proposed audit approach and scope for the 2016/2017 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2015 Code of Audit Practice, the Statement of Responsibilities issued by the Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements.

The Plan summarised the Auditors' initial assessment of the key risks driving the development of an effective audit for Teesside Pension Fund and outlined the planned audit strategy in response to those risks.

The External Auditor highlighted the financial statement risks which included: risk of management override, valuation of directly held properties and valuation of complex pooled investment vehicles.

The Auditor also drew attention to EY's initial assessment of overall materiality for the financial statements of the Pension Fund which was £31.3 million based on 1% of net assets as at 31 March 2016. The materiality amount would be re-assessed and updated if necessary on receipt of the draft 2017 financial statements. Any uncorrected audit misstatements greater than £1.5 million would be reported to the Panel.

The fee for the 2016/2017 audit was £28,535.

The on-site lead for the audit was Nick Armstrong.

ORDERED that the report was noted.

9 **MEMBER TRAINING OPPORTUNITIES**

A report of the Strategic Director Finance, Governance and Support was presented to inform Members of the Teesside Pension Fund and Investment Panel of upcoming opportunities for training, either with Border to Coast Pension Partnership (BCPP) partners or through the Local Government Association (LGA)

Details of courses available were provided in the report. The Chair urged any Member who wished to undertake training to do so.

ORDERED as follows that any Member wishing to attend the Member training courses should contact the Head of Investments and Treasury Management.

10 **INVESTMENT PERFORMANCE REPORT**

A report of the Strategic Director Finance, Governance and Support was presented to report on the performance of the Teesside Pension Fund. The Fund's investment performance was

measured by Portfolio Evaluation Limited (PEL), the leading provider of performance services to public and private sector pension schemes. These results were reported to the Investment Panel in accordance with the requirements of the Management Agreement.

2016 was a positive year for the Fund and most investors in general. Growth asset classes including Equities, Property and Alternatives produced positive returns and Bond performance was strong. Against a background of strong, rising markets, Teesside Pension Fund built up cash as profits were taken out of Equities and Bonds were sold down to near zero. In the year £189.1 million (net) was divested and cash increased by approximately £250 million to £400 million.

The total Fund return for the calendar year 2016 was 20.8%, against a benchmark return of 18.5%. The financial year's performance result was published in the Annual Report and Accounts.

The Chair congratulated the Head of Investments and Treasury Management and his team for the Fund's performance during difficult circumstances.

ORDERED that the report was noted.

11 **PROPERTY SOLICITOR TENDER OUTCOME**

A report of the Strategic Director Finance, Governance and Support was presented to inform Members of the outcome of the competitive tender process for the provision of property legal services.

Evaluation of the five tenders received was on the basis of price and quality, with 40% of the available points awarded on price and 60% awarded on the basis of quality criteria. It was recommended that Firm A was appointed subject to the successful completion of the ten day standstill period.

It was intended that the start date of the new contract would be 17 July 2017, although a different start date might be mutually agreed.

Fees related to Firm A, based on the estimated level of activity were £88,188 per annum.

ORDERED as follows that Firm A was appointed, subject to successful completion of the ten day standstill period.

12 **TREASURY MANAGEMENT REPORT**

A report of the Strategic Director Finance, Governance and Support was presented to report on the treasury management of the Fund's cash balances, including the methodology used.

Panel Members were advised that Middlesbrough Council was currently reviewing its arrangements for treasury management, including appointing an independent treasury advisory company. In future, the treasury management policies for the Council and the Fund would differ, and a policy appropriate to the Fund would be brought to a future meeting for approval. Until then, the Fund would continue with the existing policy.

As at 31 March 2017, the Fund had £401.6 million invested with approved counterparties at an average rate of 0.344%.

ORDERED that the report was noted.

13 **CUSTODIAN CONTRACT EXTENSION**

A report of the Strategic Director Finance, Governance and Support was presented which sought approval to exercise the option to extend the contract for custodian services.

The Fund's custodian services contract was appointed to BNP Paribas Securities Services in February 2013 following a tender process. The contract awarded was for a five year period with an option to extend, at the Fund's discretion, for a further period of one year.

The financial implications to the Fund were to continue making payments for custodian services for an additional year. The proposed budget for 2016/2017, as set out in the latest Business Plan, was £40,000. Should the Fund tender for service at this time, it was anticipated that the annual cost would rise significantly, as the last tender provided a cost opportunity with a significantly reduced tender amount by BNP Paribas Securities Services.

In addition, the Custodian provided safe custody of the vast majority of the Fund's £3.8 billion assets.

ORDERED that approval was given to exercise the option to extend by a further year, in accordance with the terms of the last tender and current contract.

14 **MIFID II UPDATE**

A report of the Strategic Director Finance, Governance and Support was presented to update Members of the Teesside Pension Fund and Investment Panel of the Markets in Financial Instruments Directive II (MiFID II) and its impact on the Teesside Pension Fund.

MiFID II was a European Law that provided harmonised regulation for investment services across the 31 member states of the European Economic Area. The new regulation/directive would be applicable from January 2018 and would affect the Fund in three ways:

- Client Classification - stricter provisions for public sector entities.
- Inducements - restrictions on provision of free of charge research to clients.
- Recording of Communications - records retentions increased to five years.

ORDERED as follows that:

1. The report was noted.
2. The Head of Investments and Treasury Management would complete the opt up process, where needed, from retail client status to elective professional status.

15 **PERSONAL SHARE DEALING**

A report of the Strategic Director Finance, Governance and Support was presented on personal share dealing activity to comply with the requirements of the Management Agreement.

The following share transactions were undertaken and reported to the Head of Investments:

On 3 April 2017, 1 BP ordinary share was acquired as a script dividend.

On 5 May 2017, 45 BP ordinary shares were purchased.

ORDERED that the information was received and noted.

16 **LOCAL INVESTMENTS UPDATE**

(The CBRE representatives left the room at this point in the meeting).

A report of the Strategic Director Finance, Governance and Support was presented to update Members of the Investment Panel on progress made with local investments.

Alison Fellows, Chief Investment Adviser for the Tees Valley Combined Authority (TVCA) was introduced to the Panel.

The Fund and TVCA had developed a draft MoU, a copy of which was attached to the submitted report, setting out how they would work together in the future. In addition, a

methodology was being developed with CBRE to enable the Fund and TVCA to present investment opportunities to the Fund. From the Fund's perspective the MoU was not binding and a protocol was in place for local public bodies to approach the Fund with local investment opportunities. The TVCA was also looking for some assistance with the expressions of interest they received so that an appropriate funding route could be determined for such projects.

The Chief Investment Officer explained that the TVCA had some devolved funding from Central Government and could also borrow funds to spend to support economic growth in the Tees Valley. The TVCA would discuss projects that might be of interest to the Fund on a quarterly basis. This would be an informal arrangement and once the TVCA understood the Fund's requirements better it would hope to bring forward suitable opportunities.

Discussions had been held with CBRE regarding their assistance in local investments in other parts of the country, using Local Government Pension Scheme Funds. The process they had adopted in the past fitted into the Fund's 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 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 TVCA, with further discussion to take place.

The Head of Treasury and Management explained that local investments would fit into the Alternatives asset class, which currently had an allocation target of 5% of the whole Fund. The 2016 Regulations did not allow an Administering Authority's investment strategy to permit more than 5% of the total value of all investment of Fund money to be invested in entities that were connected with that Administering Authority. It was proposed therefore that for the medium term, local investments would remain in the Alternatives asset class, with the overall asset class continuing with an asset allocation limit of 5%. It was also proposed that for the medium term, an asset allocation limit of 5% of the total funds was applied, to ensure compliance with Regulations.

ORDERED as follows that:

1. The report was noted.
2. The draft Memorandum of Understanding between the Fund and the Tees Valley Combined Authority (TVCA) was approved.
3. Resources were allocated to utilise CBRE's expertise to develop the investment process between the Fund and TVCA.

17

TENDER FOR PROPERTY INVESTMENT AND MANAGING AGENT SERVICE

A report of the Strategic Director Finance, Governance and Support was presented to inform Members of the Panel of the existing contractual arrangements for managing the Fund's direct property portfolio and obtain approval to tender for this service again.

Currently the Fund was charged a rate of 0.18% of the valuation of the total direct property portfolio. For the financial year 2016/2017 the total charge amounted to approximately £360,000.

The Fund's contract with CBRE had been extended for a further year in 2016, in line with the existing contract's terms.

Management of this asset class would eventually move to Border to Coast Pension Partnership (BCPP), however it was currently unclear when that transfer would take place. In view of this uncertainty it was suggested that a medium length contract with two extensions, for example four years plus two years extension, plus a further two years extension would be appropriate.

ORDERED that approval was given to tender for property investment and managing agent services (non-discretionary management of the portfolio) for a period of four years, with options to extend for a further two years, plus an additional two years (potential total contract length eight years).