TEESSIDE PENSION FUND COMMITTEE

A meeting of the Teesside Pension Fund Committee was held on 19 September 2018.

PRESENT: Councillors Bloundele, (Chair), Coupe, Lewis, McGloin, Rathmell (as substitute for Mohan) and D Rooney, Rostron, Walters

Other Local Authority Members:
Councillor Beall, Stockton Borough Council
Councillor Massey, Redcar and Cleveland Borough Council

ALSO IN ATTENDANCE: Unison Representative: T Watson
CBRE: A Antoniades, A Owen, A Peacock

OFFICERS: W Brown, P Campbell, S Lightwing, N Orton, J Shiel

APOLOGIES FOR ABSENCE were submitted on behalf of Councillors Black and Mohan, and P Fleck.

DECLARATIONS OF INTERESTS

Name of Member	Type of Interest	Item/Nature of Interest
Councillor Beall	Non Pecuniary	Member of Teesside Pension Fund
Councillor Beall	Non Pecuniary	Agenda Item 15 - Named Substitute Member of the Tees Valley Combined Authority
Councillor Massey	Non Pecuniary	Member of Teesside Pension Fund
Councillor D Rooney	Non Pecuniary	Member of Teesside Pension Fund
Councillor Rostron	Non Pecuniary	Member of Teesside Pension Fund

1 MINUTES - TEESSIDE PENSION FUND COMMITTEE - 26 JULY 2018

The minutes of the meeting of the Teesside Pension Fund Committee held on 26 July 2018 were taken as read and approved as a correct record, subject to a minor amendment.

2 INVESTMENT ACTIVITY REPORT

A report of the Strategic Director Finance, Governance and Support was presented to inform Members how the Investment Advice recommendations were being implemented and to provide information with regard to stock selection strategies, including a detailed report on transactions undertaken. The former Fund Manager's Report had been updated and re-named to reflect that the Fund was now pooling with Border to Coast Pension Partnership (BCPP).

The Fund continued to favour growth assets over protection assets. Bonds would continue to be avoided unless they were held as a short-term alternative to cash. Cash had built up to 18% due to divestments from Pacific Equity, the Fund would look to use this cash to move away from its overweight position in equities and invest further in Alternatives. The controlled reduction of equities into cash would continue over the next quarter with an upper target cash level of £800 million (20% of the Fund). If the value of other asset classes fell, particularly Equities, there was a possibility that the short-term cash level could rise over the maximum set below.

Equity markets had been volatile, with additional volatility in currency markets, which had recently been beneficial to the Fund with its high weighting in this asset class. The short-term allocation strategy and range provided flexibility to continue and either increase or decrease investments when market opportunities arose.

Investment in direct property should continue on the same basis: on an opportunistic basis where the property had a good covenant, yield and lease terms.

Investment in Alternatives offered the Fund diversification from equities and bonds. However, the Fund was considerably underweight its customised benchmark and, providing suitable investment opportunities were available, the Fund should look to increase its allocation to this asset class up to the customised benchmark level. A summary of Equity Returns was provided at paragraph 4.6 of the submitted report.

Appendix A to the submitted report detailed transactions from the period 1 April-30 June 2018. There were net sales of approximately £199m in the period, this compared to net sales of £46m in the previous reporting period. Cash balances increased to £723m from £503m, representing 18% of the Fund's investments.

Discussion took place around investments in the tobacco industry and it was highlighted that the Fund did not currently own any listed equities, although the Unit Trusts held by BCPP had underlying assets that contained tobacco shares. It was also noted that, as quasi trustees, the Committee's duty was to the stakeholders of the Fund, to be financially viable, making sure there was sufficient funding to pay members and keeping employer contributions as low as possible.

The Fund Valuation detailed all the investments of the Fund as at 30 June 2018, and was prepared by the Fund's custodian, BNP. The total value of all investments, including cash, was £4,096 million. This compared with the last reported valuation, as at 31 March 2018, of £3,900 million.

An analysis of the summary valuation showed the Fund's percentage weightings in the various asset classes, compared with the Fund's customised benchmark and the advisors' short-term asset allocation range.

ORDERED that the report was noted.

3 **INVESTMENT ADVISORS REPORT**

The Interim Head of Pensions Governance and Investments presented a report to update Members with the current capital market conditions, and set an appropriate short term asset allocation to best take advantage of these conditions.

The tender for the new Investment Advisors closed on Friday 14 September 2018 and following the recruitment process it was anticipated that two new Advisors would be in post in time for the December meeting.
A report setting out the political, economic and market background from the Interim Head of Pensions Governance and Investments was attached as Appendix A to the submitted report.

The Fund now had a zero position in bonds, with cash as the only protection asset available. It was proposed that the Fund looked into introducing a short term protection strategy, looking at protecting recent rises in the Fund's valuation through divestment from equities and protecting equity values through use of derivatives.

Cash levels at the end of June 2018 were at 18% (£723 million). Cash balances had risen with divestment from Equities as part of the Fund's transformation plan ahead of pooling. Some of this cash would be redeployed at a future date. It was proposed that the controlled reduction of equities into cash continued over the next quarter with an upper target cash level of £800 million (20% of the Fund).

Investigations were underway looking at an equity protection strategy. The Fund would look at options for collateral and may need to acquire bonds. In the long run, bond yields would rise to levels that met the actuarial requirements for the Fund and should continue to be avoided at these yield levels unless they were held as a short term alternative to cash or as part of an equity protection strategy in a collateral account.

Cash had built up as divestments from other asset classes had continued. At this time high cash levels were assisting with protecting the Fund, as a diversifier from Equity market downturns. Cash levels had been allowed to rise in the short-term towards the maximum level set at the customised benchmark for protection assets (20%).

Equity markets had risen strongly over the past few years, with additional volatility in currency markets, both of which had been beneficial to the Fund since the date of the last Actuarial Valuation with the Fund's high weighting in equities. The short-term allocation strategy and range provided flexibility within this asset class, however, reducing equity levels was a big feature of the proposed new customised benchmark.

Investment in direct property should continue on the same basis as previously presented to the Panel: make purchases on an opportunistic basis where the property had a good covenant, yield and lease terms. Investment in Alternatives, such as general and local infrastructure and private equity, offered the Fund diversification from equities and bonds.

The Fund was considerably underweight its customised benchmark in this asset class and, providing suitable investment opportunities were available, the Fund should look to increase its allocation to this asset class up to the customised benchmark level.

ORDERED as follows that:
1. The report was noted.
2. The short-term asset allocation as detailed at paragraph 5.13 of the submitted report 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.

As at 30 June 2018 the portfolio comprised 27 mixed-use properties located throughout the UK, with a combined value of £266.71m. This reflected an overall Net Initial Yield of 5.36%, and an Equivalent Yield of 5.55%. The portfolio comprised principally prime and good secondary assets.

There were no sales or acquisitions in Q2 2018. Since the report was issued, the Fund had acquired a retail park in Congleton, Cheshire, at a cost of £15 million, with a yield of 6.5%. Due diligence was almost complete on a prime retail asset of high quality in a good location at a cost of £20million. It was highlighted that both acquisitions had come to the Fund off-market, which was a sign of the Fund’s good reputation in the property market.

The total Collectable Arrears on the entire portfolio was £31,396.63 at 11 July 2018. Of the Collectable Arrears, 77.9% related to three tenants, the remaining 22.1% related to 13 different tenant accounts, all of which were being pursued for payment.

The direct property portfolio held by the Fund was valued at £266.71m (June 2018), equating to 6.5% of the overall Fund value. The Fund’s level of real estate exposure was generally considered underweight, compared with similar pension funds.

ORDERED that the report was noted.

5 **FUNDING UPDATE REPORT - 2018**

A report of the Strategic Director Finance, Governance and Support was presented to inform Members of the outcome of the Actuary’s Funding Update Report as at 31 March 2018.

The Fund’s Actuary, AON Hewitt, was asked to provide a Funding Update Report as at 31 March 2017. The report was based on the movement in the Fund’s assets over the period since 31 March 2016, but did not consider changes to the Fund’s membership base.

The purpose of the report was to guide the Fund and prepare Pension Fund Committee and Board Members and Scheme Employers for the next Actuarial Valuation, which had an effective date of 31 March 2019 and would be carried out over the financial year 2019/20. A comparison to the 2016 Actuarial Valuation and previous funding update was detailed at paragraph 5.2 of the submitted report. This funding update was produced on the basis of no change to the investment strategy of the Fund.

A second update had been commissioned to reflect the proposed changes to the investment strategy following the Asset Liability Study reported to the Teesside Pension Fund Committee in March 2018.

The Fund's Actuary had been asked to look at mortality for the Fund, looking at targeting mortality rates away from national and regional statistics to something that better reflected the Fund's membership with targeted post-code mortality rates.

The change in funding level and surplus was due to a combination of the 2017/2018 investment performance report being lower than the previous year and below the required rate of return, and the outlook for future market returns had deteriorated, reducing the discount rate and increasing the cost of future benefits and increasing the future service rate.

A note of caution was that the Actuary, when setting the assumptions used in each valuation, was working on long term (25 year) assumptions. Favourable updates to the funding level were welcomed, but any action taken should be for the long term benefit of the Fund; improving solvency and long term cost efficiency in line with the Department for Communities and Local Government requirements for management and investment of Local Government Pension Scheme Funds, as well as for the Fund's wider stakeholders.

ORDERED that the report was noted.

6 **BUSINESS PLAN 2018/21 - PROGRESS REPORT**

A report of the Strategic Director Finance, Governance and Support was presented to update Members with progress against the Business Plan for the Fund.

The revised 2018/2019 forecast income and expenditure was set out the Business Plan, and was summarised at paragraph 3.1 of the submitted report.

The Business Plan for 2018/2021 included:

- The purpose of the Fund, including the 2018/19 Teesside Pension Fund Service Promise;
- The current governance arrangements for the Fund;
- The performance targets for the Fund for 2018/19, and a summary of the performance to date for 2017/18;
- The arrangements in place for managing risk and the most up to date risk register for the Fund;
- Membership, investment and funding details for the Fund;
- A forecast outturn for 2017/18 and a full estimate for income and expenditure for 2018/19;
- A revised annual plan for key decisions and a detailed forward work programme for 2018/19 and an outline work plan for 2019-2021; and
- The annual report to Council.

The report updated Members with progress against the following key elements of the Business Plan:

- The key performance indicators for the Fund (attached at Appendix A to the submitted report).
- An up to date risk register (attached at Appendix B to the submitted report).

- The estimated outturn for the Pension Fund 2018/19 budget (attached at Appendix C to the submitted report).
- Progress against the detailed work programme for 2018/19 (attached at Appendix D to the submitted report), including a new assessment against the Pension Regulator Code of Practice (Code 14) (attached at Appendix E to the submitted report).

The Interim Head of Pensions Governance and Investments highlighted that the assessment against the Pension Regulator Code of Practice had now been completed.

In relation to the risk register, the assessment of Kier's long term viability had not been completed due to the sale of their admin pensions service to XPS. However, an assessment of XPS had been completed and scored as low risk.

With regard to progress on the Forward Work Plan, it was noted that some posts in the new staffing structure for Pensions Governance and Investments remained vacant and this had impacted on other items in the Plan which currently had an amber rating including the review of Employer Covenant Risk and the Pension Customer Service Strategy.

Areas that needed to be addressed as highlighted in the Pension Regulator's and Scheme Advisory Board Compliance Checklist areas included Member and Officer training and implementation of a formal conflicts register.

The Chair, on behalf of the Committee, thanked the Interim Head of Pensions Governance and Investment and Officers for the work completed and excellent progress made to date.

ORDERED that progress against the Business Plan, including the estimated outturn for the 2018/2019 Pension Fund budget was noted.

7 **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.

As at 30 June 2018, the Fund had £690.9 million invested with approved counterparties at an average rate of 0.60%. This was an increase of £204.9 million over the last quarter. Cash levels had been allowed to rise as the Fund sold out of equities and in preparation to transfer assets into the Borders to Coast Pension Partnership and passive index tracking.

Appendix A to the submitted report showed the maturity profile of cash invested. It also showed the average rate of interest obtained on the investments for each time period.

ORDERED that the report was noted.

8 **PERSONAL SHARE DEALING**

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

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

- On 15 August 2018, 150 Vodafone Group shares were purchased.

Given the change in roles at the Fund, with Border to Coast Pension Partnership (BCPP) managing shareholdings and the team at Teesside managing units in BCPP sub-Funds, it was proposed that the Management Agreement requirements regarding personal share dealing should be amended to reflect this change in circumstance.

It was proposed that the Management Agreement was amended to a new reporting responsibility to the Teesside Pension Fund Committee only for any personal share dealing which corresponded with any direct shareholdings the Fund owned.

ORDERED as follows:
1. That the report was noted.
2. That the Management Agreement was amended to reflect a new reporting responsibility to the Teesside Pension Fund Committee for any personal share dealing which corresponded with any direct shareholdings the Fund owned.

9 **PROPERTY DEBT - CBRE PRESENTATION**

The Committee received a presentation from CBRE in relation to Real Estate Lending, or Property Debt. The presentation included information in relation to the real estate lending market, the opportunities that existed for lending and how it could be done. Examples of various different lending projects were also provided.

ORDERED that the information provided was noted.

10 **ANY OTHER URGENT ITEMS WHICH IN THE OPINION OF THE CHAIR, MAY BE CONSIDERED.**

Members were reminded that there were 10 places available at the BCPP Annual Conference on 8 and 9 November 2018. Any Member wishing to book a place could contact the Head of Investments and Treasury Management.

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 **FORWARD INVESTMENT PROGRAMME**

A report on the Forward Investment Programme was presented.

ORDERED as follows:
1. That the report was noted.
2. The Forward Investment Programme was approved, with agreement in principle on the direction of changes to the asset allocation over the next 1 to 3 years.

13 **LOCAL INVESTMENTS - UPDATE REPORT**

The Head of Investments and Treasury Management gave an update on Local Investments.

ORDERED as follows:
1. The report was noted.
2. No further action was taken in relation to the local investment proposal discussed.

14 **KIER PENSION SERVICE CONTRACT**

A report on the Kier Pension Service Contract was presented.

ORDERED that:
1. the report was noted.
2. the current operating model was scoped and documented in order to inform the Committee on future potential options for the delivery of the pension administration service.

15 **CUSTODIAN CONTRACT**

A report on the Custodian Contract was presented.

ORDERED as follows:
1. The report was noted.
2. The current strategy of reducing the need for a custodian and the procurement of a new service provider, in line with procurement policy, was approved.