

TEESSIDE PENSION FUND COMMITTEE

A meeting of the Teesside Pension Fund Committee was held on 7 March 2018.

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

ALSO IN ATTENDANCE: Property Advisors: A Owen and M Berry
Unison Representative: A Watson
External Auditor: H Rohimun
BCPP: R Elwell and C Hitchen
AON Hewitt: L Hill

OFFICERS: P Campbell, G Hall, S Lightwing, R Walker

APOLOGIES FOR ABSENCE were submitted on behalf of Councillors Coupe, G Purvis, Massey (Redcar and Cleveland BC), Beall (Stockton BC) 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 COMMITTEE - 21 DECEMBER 2017**

The minutes of the meeting of the Teesside Pension Fund Committee held on 21 December 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 Advice recommendations were being implemented, and to provide information with regard to stock selection strategies, including a detailed report on transactions undertaken, which was attached at Appendix A to the submitted report.

Advice was to continue to favour growth assets over protection assets, bonds did not currently meet the Fund's actuarial requirements and therefore should be avoided at those levels; the remaining bonds in the portfolio had been sold this quarter. At this time the Fund held no bonds.

At the current level of 12% it was felt that the Committee should be mindful of allowing cash to build up any further. Cash should not rise too much further in the short term to above the maximum short term level set at the customised benchmark for protection assets (15%). Cash was at 11% at the end of December.

Investment in direct property should continue on the same basis as previously presented to the Panel; on an opportunistic basis where the property had good covenant, yield and lease terms. A further investment in direct property was made in the quarter, a £24m purchase.

Investment in Alternatives, such as general and local infrastructure and private equity offered the Fund diversification from equities and bonds. They came with additional risks of being illiquid. Traditionally they had costly management fees and investment in this type of investment could be a slow process. However, the Fund was considerably underweight in 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. Commitments for two funds were made in the quarter (£15m and £10m), with drawdowns of £3.7m during the quarter.

There was comfort with the short term allocation strategy set for equity markets. 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.

With regard to the Transaction Report, there were net purchases of approximately £26m in the period. This compared to net purchases of £43m in the previous reporting period. Cash balances increased to £462m from £448m.

The Head of Investments and Treasury Management informed the Committee that the Fund had had to write-off approximately £1m in shares held in Carillion. It was also reported that the Fund had voted against the proposed remuneration package for the Chief Executive of Persimmon at the annual meeting.

The Fund Valuation detailed all the investments of the Fund as at 31 December 2017, and was prepared by the Fund's custodian, BNP. The total value of all investments, including cash, was £4,074m. The detailed valuation was available on the Fund's website: Teespen.org.uk. This compared with the last reported valuation, as at 30 September 2017 of £3,923m.

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

ORDERED that the report was noted.

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 these conditions.

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

With the initial results from the Fund's Asset/Liability Study being presented later in the meeting, and in the light of there being no Independent Investment Advisors in place to provide Members with investment advice and propose short term asset allocation, it was appropriate to look at protecting the valuation of the Fund given recent volatility in bond and equity markets.

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

ORDERED as follows that:

1. The report was received and noted.
2. The short term asset allocation set out in the table at 5.1.3 of the submitted report was approved.
3. The new strategy to protect the Fund's valuation through divestment from equity into cash and use of derivatives as part of an equity protection strategy 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.

Market conditions remained tough especially in prime industrial assets and it was likely this

would continue. CBRE continued to pay attention to sourcing stock off-market and working with certain agents. The successful purchase of B&Q in Hull in January 2018 had resulted from being identified whilst looking at another asset.

The direct property portfolio held by the Fund was £104m in January 2012 and was now currently valued at £261m. The portfolio comprised principally prime and good secondary assets. The weighted average unexpired term was 9.4 years to the earlier of first break or expiry, and 10.9 years to expiry, ignoring break dates. The vacancy rate was currently 0.9% of Estimated Rental Value. Only 2 units were not let at the current time.

Looking ahead, the portfolio was forecast to provide 6.1% return from now to 2022. Over the same time period, the total index was forecast to perform 3.9%. This was due to a number of factors, partly the low vacancy rates, being overweight in industrial and retail which were forecast to perform well, and underweight in offices which was forecast to perform least over the next five years.

ORDERED that the report was noted.

5 **ASSET LIABILITY STUDY**

A report was presented to inform Members of the outcome of the Asset/Liability Study, as undertaken by AON Hewitt in conjunction with the Head of Investments and Treasury Management.

The Fund's Actuary carried out an Actuarial Valuation every three years which determined the contribution rates for the Fund as a whole and each employer in the Fund. These contribution rates were calculated by the Actuary in order to meet the Fund's current and future liabilities. The Asset/Liability Study was the next step from the Actuarial Valuation and, together with the proposed customised benchmark, looked at the Fund's requirements over the long-term. The Fund's Investment Advisors would continue to assess market and economic conditions and make short term asset allocation recommendations to the Investment Panel to take advantage of current conditions.

AON Hewitt had carried out the Fund's Asset/Liability Study (ALS) and this was presented in detail to the Committee. A copy of the presentation was attached at Appendix 1 to the report.

The purpose of the ALS was to assess the Fund and determine the most appropriate strategic asset allocation. AON Hewitt had also made an assessment on the Fund's probability of funding success and the indicative discount rate - both important factors going forward to subsequent Actuarial Valuations, with a potential impact on the Fund's funding level and employer contribution rates.

AON Hewitt had analysed the existing customised benchmark, assessed a de-risked benchmark, and two other alternative benchmarks which reduced equities and increased illiquid alternative and protection assets. The key summarised outcome of this assessment was detailed at paragraph 5.2 of the submitted report.

From the analysis, the move to reduce equities by 20% and overall growth assets (equities and illiquid alternatives) by 5%, and increase protection assets by 5%, best suited the Fund, but would be a move that was contrary to recent Investment Advisor advice. However, the purpose of the move was to reduce volatility, particularly from equity markets. The Fund was in a healthy position being fully funded and protecting this position as well as keeping employer contribution rates at low levels were key elements of the Fund's Funding Strategy Statement.

It was also recognised that the customised benchmark, as the strategic asset allocation, was set to meet the requirements of the Fund over the long term and short term issues in different asset classes and markets would continue to making reaching the benchmark a long term aspiration. In addition, given the size of the move away from equities and the increase in illiquid alternative investments, it would take time to achieve the investment allocations

forecast.

It was proposed that a strategy was developed for reducing equities by 20% (approximately £800m reduction) and increasing allocation to illiquid alternatives (approximately £600m) and protection assets (approximately £200m). It was envisaged that this move would take time and would span over the cut-off date of 31 March 2019 for the next Actuarial Valuation. It would also require assistance from Border to Coast Pension Partnership (BCPP) to achieve this aim.

It was confirmed that no major changes in asset allocation or the customised benchmark would take place until new Independent Investment Advisors were in place with the Fund and had had the opportunity to assess the ALS and provide guidance.

ORDERED as follows that:

1. The report and presentation were received and noted.
2. The report and new customised benchmark were accepted in principle, with a strategy for moving from the existing customised benchmark to the proposed new customised benchmark to be presented to a future meeting of the Committee.
3. If appropriate, Committee Members would receive training in the proposed new asset classes before a decision was made on the final make-up of the customised benchmark.

6 **BUSINESS PLAN - 2018/21**

The Annual Business Plan 2018/21 was presented to the Committee for approval.

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

A copy of the Business Plan for 2018/21 was attached at Appendix 1 to the submitted report and had been updated to include:

- The purpose of the Fund, including the 2018/19 Teesside Pension Fund Service Promise (Appendix A).
- 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 (Appendix B).
- The arrangements in place for managing risk and the most up to date risk register for the Fund (Appendix C).
- 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 (Appendix D).
- A revised annual plan for key decisions and a detailed forward work programme for 2018/19 and an outline work plan for 2019-2021.
- The annual report to Council (Appendix E).

ORDERED that the report was approved.

7 **EXTERNAL AUDIT PLAN**

The External Auditor presented the Teesside Pension Fund Audit Planning Report for the Year Ended 31 March 2018.

The report summarised the External Auditor's initial assessment of the key risks driving the development of an effective audit for the Teesside Pension Fund, and outlined the planned audit strategy in response to those risks.

The Auditor drew the Committee's attention to the significant risks identified for the current year audit as follows:

- Misstatements due to fraud or error.
- Valuation of complex pooled investment vehicles.
- Valuation of directly held properties.

The risks identified could change to reflect any significant findings or subsequent issues identified during the audit.

For planning purposes, materiality for 2017/2018 had been set at £77.1m. This represented 2% of the Fund's prior year net assets value. It would be reassessed throughout the audit process.

Details of the process and strategy for delivering the audit, the areas where EY or third party specialists would provide input for the audit, the timetable and the audit fee were included in the report.

ORDERED that the Teesside Pension Fund Audit Planning Report for the Year ended 31 March 2018 was approved.

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 transactions were undertaken and reported to the Head of Investments:

- On 19 January 2018, 200 Centrica ordinary shares were purchased.
- On 13 February 2018, 100 Vodafone ordinary shares were purchased.

ORDERED that the report was received and noted.

9 **TREASURY MANAGEMENT REPORT**

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

The counterparty list and associated increased limits approved at the last meeting and implemented on 2 January 2018, were detailed in the submitted report. As at 31 December 2017, the Fund had £448.5m invested with approved counterparties at an average rate of 0.42%.

Attached at Appendix A to the submitted report was a graph showing the maturity profile of cash invested and the average rate of interest obtained on the investments for each time period.

The Treasury Manager was under instruction to keep at least 50% of cash investments relatively liquid (one month or less), in order to fund pension payments and investments. As at 31 December 2017, 53.3% (£249m) of the investments would mature within one month.

ORDERED that the report was received and noted.

10 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.

11 PENSION CUSTOMER STRATEGY

A report of the Strategic Director Finance, Governance and Support in relation to the Pension Customer Strategy was presented.

ORDERED that:

1. The report was received and noted.
2. The proposed changes to the existing contract with Kier for the provision of a Pension Administration Service, as detailed in the report, were approved.
3. The proposed plan for the implementation of those services, as detailed in the report, were approved.

12 BCPP PROGRESS PRESENTATION - RACHEL ELWELL

Rachel Elwell, Chief Executive of Border to Coast Pension Partnership (BCPP), gave a progress update in relation to BCPP.

ORDERED that the presentation was received and noted.

13 POOLING UPDATE

An update on the latest developments with pooling and the Border to Coast Pension Partnership (BCPP) was provided by the Head of Investments and Treasury Management.

ORDERED as follows that:

1. the role profile for Non-Executive Director posts with BCPP was noted.
2. any Member interested in the Non-Executive Director posts would contact the Head of Investments and Treasury Management.
2. the amendment to the set up budget, as agreed by the BCPP Joint Committee meeting in January 2018, was noted.
3. the Fund's current strategy for managing overseas equities would be reviewed with approval of any amendments delegated to the Chair, Vice Chair, Section 151 Officer and Head of Investments and Treasury Management.

14 LOCAL INVESTMENT OPPORTUNITY - DISTRICT HEATING

A report on a local investment opportunity was presented by the Head of Investments and Treasury Management. Additional advice was provided at the meeting by CBRE.

ORDERED as follows that:

1. the report was received and noted.
2. CBRE would proceed to carry out the next phase of due diligence.

15 OTHER LOCAL INVESTMENTS - TEESSIDE UNIVERSITY

A report on a local investment opportunity with Teesside University was presented by the Head of Investments and Treasury Management.

ORDERED that the report was received and noted.

16 **NEWRIVER REIT AUDIT REPORT**

The Head of Investments and Treasury Management presented an Internal Audit Report regarding the NewRiver REIT transaction.

ORDERED that:

1. the report was received and noted.
2. the next steps were agreed.

17 **INVESTMENT ADVISOR TENDER - UPDATE**

The Head of Investments and Treasury Management updated the Panel with regard to the Investment Advisor Tender.

ORDERED as follows that:

1. the report was received and noted.
2. the recommendations at 6.3 and 6.4 of the submitted report were agreed.

18 **GAD UPDATE**

The Head of Investments and Treasury Management reported on the dry run of the GAD Report. The full report would be presented to the Committee once complete.

ORDERED that the report was received and noted.