LONDON BOROUGH OF CAMDEN	**WARD:** All
REPORT TITLE: Long Lease Property	
REPORT OF: Executive Director Corporate Services	
FOR SUBMISSION TO: Pension Board	**DATE:** 8 October 2020

SUMMARY OF REPORT:
This report presents the report by our Investment Consultant, Isio, on the proposed Long Lease Property (LLP) mandate which was proposed as part of the Investment Strategy Review in July 2020. The Pension Committee agreed:

1. the appointment of the London CIV Inflation plus sub-fund to manage 5% of the Fund's assets (£90m) as set out in paragraph 3.1
2. to fund this mandate by withdrawing assets from Standard Life and Ruffer first and then with cash in hand from the contribution prepayment as detailed in paragraphs 2.9 and 2.10.

Local Government Act 1972 – Access to Information
No documents requiring to be listed were used in the preparation of this report:

Contact Officer: Nigel Mascarenhas
Interim Director of Finance
Finance
Corporate Services
Dennis Geffen Annexe
Camley Street
London. N1C 4DG

Telephone 0207 974 1904
Email nigel.mascarenhas@camden.gov.uk

RECOMMENDATIONS:

The Pension Board is asked to note the contents of this report

Signed by

Interim Director of Finance ……**Agreed** …………...

Date …**29 September 2020**…….

1. INTRODUCTION

1.1. The Fund reviewed its Investment Strategy during 2020 and this culminated in a report to Pension Committee in July. This agreed in principle to create and asset allocation to long lease property of 5% of the Fund.

1.2. In the Investment Strategy review the reasons for looking at Long lease property and its benefits were seen as:

- The Fund has a close link to **inflation** (drawn out by 'value at risk' analysis in the Investment strategy review) given the membership benefits linked to CPI and long lease property is closely linked to inflation with underlying assets often being linked to RPI (retail price inflation). Investment in an asset class such as long lease property will mean assets on this proportion of the Fund match liability movements which is an attractive characteristic;
- The Fund can tie up investments in asset classes for the medium to long term and so can benefit from an '**illiquidity premium**' which short term investors cannot benefit from as they need cash to be available quickly;
- **Volatility** in returns from the Fund's largest asset allocation; equity. Returns from long lease property are more stable and do not suffer the extreme turbulence that equities do;

1.3. The independent investment adviser commented on the proposal in July that she was supportive of the decision to allocate to long lease property which offered stable, inflation-linked investment with a reasonable expected return. She agreed that the London CIV's Inflation plus sub-fund should be examined against our requirements as a suitable fit. She also raised some points for further investigation during the due diligence:

- the **deployment rate** of the fund (the rate at which funds are invested as this asset class does not manage money upfront but makes investments over time and 'calls' investor funds as and when needed to fund underlying investments
- the **internal credit rating process -** how individual investments in the sub-fund are examined based on their underlying security
- any **investment restrictions** of the sub-fund
- how the underlying manager, Aviva, **allocates deals** between this fund and other funds it has
- how the **current economic climate** has impacted on LLP

1.4. Our Investment Consultants, Isio, have been commissioned to review the London CIV's Inflation Plus fund, which had been identified as a good fit for this asset allocation. Their work was also scoped to examine other best in class managers and their work forms Appendix A and B. Isio were asked to consider Environmental, Social and Governance issues in their brief as well as the Independent investment advisor's points.

1.5. At the Investment Strategy Review stage key long lease property characteristics were stated as:

- Expected return (net): Gilts + 2-3% p.a.
- Cash yield: c.4-5% p.a. net paid quarterly
- Volatility: 8% p.a.

1.6. The London CIV's Inflation plus fund has an expected income yield of 3% and is structured to comprise long lease property, infrastructure debt, real estate debt, ground rents, real estate income strips and private corporate debt (so not wholly Long lease property). Currently there are 2 investors with funds committed of £100m. The CIV is discussing investment in this sub-fund with 3 other London funds and has capacity for £1.5bn of investment.

2. SUMMARY OF DUE DILIGENCE ON LONG LEASE PROPERTY

2.1. **Appendix A** sets out Isio's report on long lease property and the fit of the London CIV's Inflation plus sub-fund to our requirements. Isio will be present at Committee to present their findings. **Appendix B** contains some further details on long lease property which is a Part II appendix as it contains confidential information and is therefore not available to the public.

2.2. The London CIV's sub-fund is managed by Aviva and they have also been invited to attend Committee to present their strategy and field Members' questions on their product. Their presentation will follow and will form **Appendix C**.

2.3. Some key points from Appendix A on the London CIV's Inflation plus sub-fund (managed by Aviva) are set out below with some additional information added:

a) the investment process is highly rated by Isio
b) the fund invests in 60-70% long lease property but also invests in other related investments
c) the approach to ESG is highly rated (voting, engagement and reporting could be developed more)
d) Some examples of ESG credentials are BREEAM developments (the leading environmental rating and sustainability assessment tool for buildings) in Aberdeen, a regeneration project in Stevenage including affordable residential units, investment in the world's largest offshore wind farm (Hornsea one), a carbon neutral office in Scotland, Student accommodation in Brighton and an energy from waste facility in Merseyside.
e) The ESG targets in the sub-fund tend to be qualitative rather than quantitative but Aviva have plans to develop this. They plan to put smart meters in their properties to allow better monitoring of energy usage, include more sustainable assets such as wind farms, include green clauses in new or renegotiated leases and report social impacts quarterly with case studies
f) It is not clear if the fund has a Global Real Estate Sustainability Benchmark (GRESB) rating
g) The credit quality of all assets is investment grade (BBB or above). This is split 50% BBB, 20% BB and 30% A rated with a minimum of 80% > BBB.
h) The inflation linkage is high which meets one of our strategic objectives
i) Investments in the Inflation plus sub fund aim to be fully drawn down (invested) within one year. Investment is similar to our other closed ended funds that call capital as it is needed to fund purchases. This is comparatively faster than other LLP offerings

j) Transaction costs for entering into LLP fund are typically c6% (most of this is stamp duty at c5% but there are other costs too including administration, legal and other fees). The Inflation plus fund has lower costs c3-4% as it has a lower LLP proportion.
k) The target return of the Inflation plus fund is RPI + 1.5-2%. This is towards the lower end of LLP class returns but is in-line with general expectations (long term RPI can be assumed to be 3%)
l) The lock-up period is for 4 years and thereafter investors can redeem up to 10% each month. This means subscribing funds are required to be long term investors.

2.4. Overall Isio believe the Inflation plus fund is a good fit for the Fund's requirements.

2.5. The independent investment advisor raised some issues with regard to LLP when this was examined as part of the Investment Strategy Review. These have been addressed on pages 15-16 of Appendix A.

2.6. The **Independent Investment advisor comments** that she agrees that the LLP offering stands up well when compared to other pooled offerings. The fund meets the objectives of increased inflation protection, accessing the illiquidity premium and provision of income. In addition, it will lower volatility of returns and diversify returns amongst other investment classes use by the Fund.

2.7. Aviva and the London CIV should give further assurance over the deployment period which seems shorter than would usually be expected. In general more detail on ESG issues would be appreciated together with a firm action plan of when further goals and milestones will be achieved.

2.8. The independent investment adviser also agrees that current market conditions mean attractive long-term deals may now be available with lower competition for these assets.

2.9. In terms of **funding the new mandate** the investment strategy review in July aimed to sell down equities (c10% overweight versus the strategic benchmark) and Diversified growth funds (a reduced allocation from 15% down to 5%) to rebalance back towards the strategic asset allocations. DGFs with Standard Life (£42m) and Ruffer (£62m) are already earmarked for the new Infrastructure mandate (£106m committed with £7m drawn to date). However, calls for infrastructure will not be that quick in the coming year to completely sell down on both these managers' holdings.

2.10. Furthermore, the Council is due to make a secondary contribution prepayment of £57m (this had been delayed due to the COVID crisis whilst the Council reconsidered its plans in light of changed cash flows). There will also be other decisions around the proposed substitution of funds for the Improvement and Development Agency which will require assets of c£140m to be transferred to Merseyside when the transfer goes ahead and this will therefore change the proportions of assets held. Therefore the proposal for funding the new long lease property mandate is that in the short term (2020) funds from Ruffer and Standard Life are used to fund any calls on Long lease property firstly as well as

Infrastructure. If that is insufficient, cash from the Council's prepayment will be used. A plan will be brought back to the November Committee on funding Long lease property in the medium term.

3. FINANCE COMMENTS OF THE EXECUTIVE DIRECTOR CORPORATE SERVICES

3.1. Appointing an investment manager is one of the most important decisions that Pension Committee take (aside from agreeing the Investment Strategy). Members should take time to understand the offer on the London CIV Inflation plus fund and ensure they are comfortable that this offers returns that are in-line with other offerings and the Fund's expectations. Members must also take in to account a number of other factors such as the investment philosophy, process, investment parameters and risk management. Both officers and advisers recommend that the London CIV are appointed to fulfil the Fund's Long lease property asset allocation after careful due diligence.

4. LEGAL COMMENTS OF THE BOROUGH SOLICITOR

4.1. The Local Government Pension Scheme Statutory guidance on asset pooling states that a Pension Committee has legal responsibilities for the prudent and effective stewardship of LGPS funds and should take a long term view of investments and costs. They should take account of the benefits across the scheme as a whole, in the interests of scheme members, employers and local taxpayers, and should not seek simply to minimise costs in the short term.

APPENDICES

Appendix A – LCIV Inflation Plus fund assessment
Appendix B – Part II Additional information on Long lease property **(NOT FOR PUBLICATION)**
Appendix C – Aviva presentation