AGENDA ITEM: X

City of Westminster

Committee Report

Decision Maker:	**PENSION FUND COMMITTEE**
Date:	**24 June 2021**
Classification:	**General Release**
Title:	**Asset Allocation Update and Residential Property Review**
Wards Affected:	**All**
Policy Context:	**Effective control over council activities**
Financial Summary:	**There are no direct financial implications arising from this report.**
Report of:	**Phil Triggs** ***Tri-Borough Director of Treasury and Pensions*** **ptriggs@westminster.gov.uk** **020 7641 4136**

1. EXECUTIVE SUMMARY

1.1 This report details the Fund's current strategic asset allocation compared with the target, and how the asset composition will change following drawdown of the Fund's illiquid asset classes.

1.2 Additionally, this report will explore sectors of the residential property asset class with the aim of exploring a suitable inflation protection mandate.

2. RECOMMENDATIONS

2.1 The Committee is recommended to:

- agree upon the desired strategic benchmark for the whole Fund; and
- consider whether an investment within residential property is suitable for the Fund, to be funded by a reduction in equities of 5%.

3. ASSET ALLOCATION CONSIDERATIONS

Current Investment Strategy

3.1 The Fund's strategic asset allocation policy at 31 March 2021 had 65% allocated to equities, 19% to fixed income, 11% to infrastructure and 5% to property. As at 31 March 2021, the Fund was overweight to equities by 5.6% and, while the allocation to equities has contributed positively to the Fund's performance, this allocation has also increased the Fund's volatility and portfolio risk. In addition to this, there is still a residual allocation of 4.0% to Longview, which will be used to fund the draw downs to the infrastructure allocations.

3.2 The Committee agreed to fully divest from the Hermes Core Property fund during 2020, with the proceeds realised during January 2021. The proceeds from this sale will be used to fund the Macquarie and Quinbrook renewable infrastructure mandates. The allocation to renewable energy infrastructure is expected to be circa 6%, with the remaining 5% allocation to Pantheon. The Pantheon allocation is expected to be lower than anticipated, following currency movements and positive performance within other asset classes of the Fund.

3.3 Based on investment values as at 31 March 2021, the following projected allocations are assumed once the infrastructure allocations are fully drawn down.

Asset Class	**Projected Allocation (%)**	**Current Benchmark Allocation (%)**
Global Equity	66.7	65.0
Fixed Income	19.4	19.0
Property	4.1	5.0
Infrastructure Equity	3.7	11.0
Renewable Infrastructure	5.6	
Cash	0.5	0.0
Total	**100.0**	**100.00**

It is expected that there would be a cash balance of £9.5m remaining once all infrastructure funds are fully drawn down. This should be sufficient to protect against any changes in exchange rates which may affect the future draw downs.

De-risking the Fund

3.4 Equity markets performed strongly during 2020, following the falls in markets amid the global outbreak of COVID-19. The FTSE All World is currently trading at 20% higher than its level at the start of 2020. However, stock valuations remain heavily dependent on the vaccination roll out, which would lead to an end of COVID restrictions and increased economic growth. It is feared that a sharp rise in inflation may cause central banks to tighten fiscal policy sooner than anticipated, and this could impact the future earnings of certain stocks.

3.5 Given the significant increase in the funding level to 100% as at 31 March 2019, the Committee may wish to consider an equity reduction of 5% to crystallise on the gains made. Our investment advisor, Deloitte, has suggested that an allocation to residential property may be a suitable investment to protect against future inflation movements.

4 RESIDENTAL PROPERTY

4.1 There is potential within the real estate asset allocation with alternative opportunities within the current market, alongside the long lease property mandate. The driver for these changes is the current undersupply of housing relative to the rapidly growing UK population, with home ownership seen as a high priority in comparison with other developed economies. In addition to this, ESG implications are expected to be of increased exposure within property mandates and how these impact on financial returns.

4.2 Commercial property returns are expected to weaken over the next five years, with yields at an all time low. There has also been a slow down in the rental growth market, alongside the impact COVID-19 will have on the UK property market going forward. Therefore, investment managers have started to look for alternative opportunities within the residential property market.

Affordable Housing

4.3 Affordable Housing (AH) is aimed at low-income workers who are not in the financial position to buy properties. Median house prices have increased by over 200% in the last 20 years, compared with salary increases of 60%, leading to a substantial reduction in affordable housing. AH is covered by Section 106 agreements, with developers needing to allocate a proportion of housing developments as affordable.

4.4 These properties are typically let to local authorities, housing associations or directly to tenants, with additional security in that most of the lease agreements are government backed. It is estimated that 60% of returns within AH is generated from rental income, with the remaining 40% attributed to capital appreciation.

Social Supported Housing

4.5 Social Supporting Housing (SSH) is accommodation built specifically for vulnerable individuals with physical or psychological difficulties. Vulnerable individuals are typically in receipt of housing benefits, and the statutory duty for providing secure accommodation falls within the remit of local government. SSH agreements with housing associations are index-linked to annual inflation rates, with responsibility for administrative tasks and tenant care provided by the associations.

4.6 It is estimated that by 2030, 60,000 vulnerable individuals will need a specialised form of accommodation with the figures at 39,000 in 2015. Therefore, it is anticipated that there will be a large undersupply in the market, with demand likely to increase given the long-term occupancy characteristics. The return target for SSH is typically a cash yield of 5 to 6% per annum, with returns expected from income and capital appreciation.

Private Rented Sector

4.7 The Private Rented Sector (PRS) is described as the purchase or development of a property purely for long-term rental income. This includes Build to Tent (BTR) developments, with an estimated £3bn invested in this area in the year to September 2020. The growth in this sector can be attributed to undersupply of new housing, affordability issues and attitudes towards renting properties changing. Additionally, economies of scale and increased taxation on individuals owning properties has led to a reduction in the number of private landlords.

4.8 PRS is typically found in areas of high house purchase cost, within commutable distances to large cities and schools with excellent Ofsted ratings. Investment returns are primarily achieved through long-term rental income, with long leases agreed with tenants.

5 RECOMMENDATIONS AND NEXT STEPS

5.1 The Committee is invited to discuss and agree the most appropriate strategic asset allocation for the Fund going forward. In addition to this, as recommended by the investment advisor, the Committee may wish to consider residential property as a suitable allocation for the Fund. There is potential to de-risk the Fund further by reducing the equity allocation to 60%, with a recommended 5% to be allocated to residential property.

If you have any questions about this report, or wish to inspect one of the background papers, please contact the report author:

Billie Emery bemery@westminster.gov.uk

BACKGROUND PAPERS:

None

APPENDICES:

Appendix 1: Deloitte Asset Allocation Update and Residential Property Review