City of Westminster

# Committee Report

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| **Decision Maker:** | **PENSION FUND COMMITTEE** |
| **Date:** | **16 December 2021** |
| **Classification:** | **General Release, Appendix 3 is exempt** |
| **Title:** | **Asset Rebalancing and Equity Transition Analysis** |
| **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**<br>***Tri-Borough Director of Treasury and Pensions***<br><br>**ptriggs@westminster.gov.uk**<br>**020 7641 4136** |

## 1. EXECUTIVE SUMMARY

1.1 This report details the Fund's current strategic asset allocation, as at 31 October 2021, compared with the target allocation. As per the Investment Strategy Statement (ISS), the Fund has trigger points for rebalancing the portfolio allocations. In addition, analysis on estimated transition costs, overlap and volatility for the London CIV (Baillie Gifford) Global Alpha Growth Paris Aligned fund is explored. Please appendix 2 for the fund fact sheet.

## 2. RECOMMENDATIONS

2.1 The Committee is recommended to:

- rebalance the Fund, topping up underweight asset classes with the overweight allocations in equity and cash/equivalents.
- commission a full analysis of transition costs, with the view of transitioning the London CIV Global Alpha Growth mandate into the Paris Aligned version.

## 3. ASSET ALLOCATION REBALANCING

### Overview

3.1 As per the Investment Strategy Statement (ISS), the Fund has trigger points for reviewing and rebalancing the portfolio allocations. The following table outlines the Fund's strategic asset allocation compared with actuals as at 31 October 2021.

3.2 The total market value of the Fund at 31 October 2021 was £1.950bn. It is worthwhile noting that the Fund is expecting another circa £30.5m in deficit recovery lump sums before 31 March 2022. This will be held within cash and equivalents, while drawdowns and reallocations take place.

| Strategic Asset Allocation | Target | Review Range | 31 Oct 21 | |
|---|---|---|---|---|
| | | | Actual | Variance |
| **Listed Equities** | **60.0%** | **+/-3.0%** | **71.1%** | **11.1%** |
| Passive Equities | 20.0% | | 23.1% | 3.1% |
| Global - Active | 40.0% | | 48.0% | 8.0% |
| UK - Active | 0.0% | | 0.0% | 0.0% |
| **Cash & Equivalents** | **0.0%** | **+/-0.0%** | **3.9%** | **3.9%** |
| Cash/Short Duration Bonds | 0.0% | | 3.9% | 3.9% |
| **Fixed Income** | **19.0%** | **+/-1.9%** | **17.8%** | **-1.2%** |
| Global Bonds | 6.4% | | 12.6% | 6.2% |
| Private Debt | 6.3% | | 0.0% | -6.3% |
| Multi Asset Credit | 6.3% | | 5.2% | -1.1% |
| **Infrastructure** | **11.0%** | **+/-1.1%** | **3.3%** | **-7.7%** |
| Infrastructure | 5.0% | | 2.5% | -2.5% |
| Renewable Infrastructure | 6.0% | | 0.8% | -5.2% |
| **Property** | **10.0%** | **+/-1.0%** | **3.9%** | **-6.1%** |
| Affordable/Social Housing | 5.0% | | 0.0% | -5.0% |
| Long Lease Property | 5.0% | | 3.9% | -1.1% |
| **Total** | **100.0%** | | **100.0%** | **0.0%** |

3.3 The Fund's current strategic asset allocation policy has 60% allocated to equities, 19% to fixed income, 11% to infrastructure and 10% to property. As at 31 October 2021, the Fund was overweight to equities and cash/equivalents by 11.1% and 3.9% respectively. While much of this will be used to fund the infrastructure drawdowns and the new affordable and social supported housing mandate(s), this still leaves the Fund underweight to fixed income and long lease property.

3.4 The allocation to infrastructure is also expected to be lower than anticipated, following currency movements and positive performance within other asset classes of the Fund.

## Equity

3.5 The current composition and target allocation of the global equity mandates is shown in the following table. The London CIV Global Alpha fund now accounts for 24.5% of the total Fund value, LGIM passive equities total 23.1%, 19.5% is held within the London CIV Global Sustain and 4.0% remains with Longview.

| Strategic Asset Allocation | Target | Actual | Variance |
|---|---|---|---|
| **Listed Equities** | **60.0%** | **71.1%** | **11.1%** |
| LGIM Future World | 20.0% | 23.1% | 3.1% |
| London CIV (MSIM) Global Sustain | 20.0% | 19.5% | -0.5% |
| London CIV (Baillie Gifford) Global Alpha | 20.0% | 24.5% | 4.5% |
| Longview Global Equity | 0.0% | 4.0% | 4.0% |

3.6 As per the London CIV Absolute Return Fund cover report, it is recommended that the Longview equity fund (circa £77m) is sold and transitioned into cash and equivalents.

## Fixed Income

3.7 As agreed at the Committee meeting on 21 October 2021, the Fund will be appointing a new private debt manager and the fixed income allocation will be split equally amongst buy and maintain bonds, multi asset credit (MAC) and private debt. Therefore, rebalancing of the fixed income mandates will be addressed once a private debt manager is selected.

## Property

3.8 The Abrdn (formerly Aberdeen Standard) Long Lease Property mandate is currently underweight by 1.1%, therefore there is potential to invest an additional circa £22m in the fund. It should also be noted that there is currently no waiting list to enter the fund, and that the mandate provides an element of inflation protection, with 74.4% of rental income linked to either CPI or RPI. There have been no defaults within the fund over the last year and it is anticipated that 100% of rents will be collected during 2021 (99% collected during 2020). The fund has returned 8.1% net of fees since inception, outperforming the benchmark of Gilts + 2.0% by 2.2%.

3.9 The Fund will be appointing a new Affordable Housing and Social Supported Housing manager(s), with the decision to be made at the Committee meeting on 16 December 2021. This allocation is anticipated to be 5% of total fund value, which equates to circa £95m. This will be funded by the overallocations in equity and cash/equivalents.

## Infrastructure

3.10 It is projected that the infrastructure allocations will also be underweight once fully drawn down, with Pantheon expected to be underweight by 1.3%, and Quinbrook and Macquarie both estimated to be 0.5% underweight.

3.11 The Quinbrook Renewables Impact fund is still open for new investment, with pipeline investments of over £800m, including battery power, solar, energy grid storage control and management assets totalling 1,213 megawatts. Quinbrook has drawn 13% of commitments as at 31 October 2021 and the net total value to capital paid in (TVPI) is 1.11x, which equates to an 11% gain on capital invested at 30 September 2021. The fund is anticipated to be largely fully drawn by Q1 2023.

3.12 The Macquarie Renewable Energy Fund 2 (MGREF 2) had its final close in January 2021, raising over €1.6bn in committed capital. The fund has drawn 13% of commitments to 31 October 2021, and the internal rate of return (IRR) was 8.5% gross of fees at 30 September 2021. Macquarie has yet to announce plans for a third renewable infrastructure fund, but this is likely to be during 2023.

3.13 The fundraising period for the Pantheon Global Infrastructure Fund (PGIF) III has now finished. However, Pantheon has started raising capital for Fund IV. As at 31 October, the PGIF III fund had a net IRR of 22.3% in the one year period, outperforming the benchmark of three-month LIBOR + 8% by 14.2% and the fund was 68% drawn. The PGIF IV fund has a target first close of quarter 4 of 2021, with a target size of $2.5bn. Pantheon has an infrastructure pipeline of $8bn in opportunities, of which $3.4bn are in advanced stages of due diligence. The fee structure for PGIF IV is slightly different to that of PGIF III, which results in a lower overall fee over the life of the fund. Please see Appendix 1 for the PGIF IV fact sheet.

## Conclusion

3.14 The Committee is recommended to rebalance the portfolio by topping up the under allocations to the long lease property fund and the Quinbrook renewable energy fund, using the over allocations to equity and cash/equivalents. This equates to circa £22m to be transitioned into the long lease property fund and circa £10m into the Quinbrook Renewables Impact mandate. Given that Pantheon has launched a new infrastructure mandate, it is recommended that this is revisited in the new year to allow for appropriate due diligence.

## 4. LONDON CIV GLOBAL ALPHA PARIS ALIGNED FUND

### Overview

4.1 During April 2021, the London CIV launched a Paris Aligned version of the Baillie Gifford Global Alpha Equity fund. The Paris Aligned fund is an exclusions-based version of the traditional Global Alpha fund, which the City of Westminster currently holds, and both funds are managed by the same investment team with the same fees and similar investment objectives.

4.2 The key differentiator between the two strategies is that the Paris Aligned version also contains the following line in its investment objective: *'The Sub-fund also aims to have a weighted average greenhouse gas intensity that is lower than that of the MSCI ACWI Climate Paris Aligned Index'.* Please see Appendix 2 for the London CIV Global Alpha Paris Aligned fact sheet.

### Overlap

4.3 As at 30 September 2021, there was a sector and geographical overlap of circa 90% between both funds. In the quarter to 30 September 2021, the Global Alpha mandate returned -0.6% net of fees, whereas the Paris Aligned version returned -1.6% net of fees. The two products are built on the same platform, using the same process and have the same return objectives, so a very high correlation of returns is expected. However, there is no guarantee that performance of the Paris Aligned version will track performance of Global Alpha.

4.4 The Paris Aligned version has a quantitative assessment process to screen out companies with particular levels of exposure to the fossil fuels industry, plus a qualitative one to screen out companies that will not play a role in the transition to a low carbon future. The fund currently excludes seven of the Alpha core portfolio. Please see Appendix 3 for a list of excluded companies.

### Transition Costs

4.5 The London CIV consults with an external advisor to run analysis on transition costs, including explicit costs (taxes, commissions) and implicit costs (impact, opportunity costs). Given the large stock overlap between the current Global Alpha mandate and the Paris Aligned fund, the transition would be facilitated by an in specie redemption and subscription. Due to the large overlap and the in specie nature of the transfer, any transition costs are expected to be low. Please see Appendix 3 for an analysis of estimated transaction costs.

**Volatility**

4.6 Both the Global Alpha and Paris Aligned mandates have a similar risk and volatility profile, with tracking errors of 5.69% and 5.10% respectively. A tracking error indicates how closely performance is aligned with the benchmark and risk undertaken due to active management. Larger deviations from the benchmark cause higher tracking errors, with most active managers having tracking errors in the region of 4% to 7%.

**Conclusion**

4.7 The Committee is recommended to commission a full analysis of transition costs, with the view of transitioning the London CIV Global Alpha Growth mandate into the Paris Aligned version. The London CIV external advisors will be able to provide an estimate of these costs pre-trade within a confidence interval.

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

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**BACKGROUND PAPERS:**

None

**APPENDICES:**

Appendix 1: Pantheon PGIF IV Fact Sheet
Appendix 2: London CIV Global Alpha Paris Aligned Fact Sheet
Appendix 3: London CIV Global Alpha Paris Aligned Analysis (exempt)