SOUTH YORKSHIRE PENSIONS AUTHORITY

INVESTMENT BOARD

25 JUNE 2015

PRESENT: Councillor S Ellis (Chair)
Councillors: R Wraith (Vice-Chair), K Rodgers, M Stowe and B Webster

Officers: J Hattersley (Fund Director), M McCarthy (Deputy Clerk), S Smith (Head of Investments SYPA), F Bourne (Administration Officer SYPA), M McCoole (Senior Democratic Services Officer) and N Copley (Finance Service Director)

Trade Union Members: G Warwick (GMB) and R Askwith (Unison)

Investment Advisors: T Gardener and L Robb

Apologies for absence were received from: Councillor A Sangar, Councillor J Scott, N MacKinnon, F Tyas and F Foster

1 APOLOGIES

Apologies for absence were noted as above.

2 ANNOUNCEMENTS

None.

3 URGENT ITEMS

RESOLVED – That an urgent item be taken at Item 18a on the agenda entitled 'Index Linked Bond Exposure: Proposal to Vary Constituents'.

4 ITEMS TO BE CONSIDERED IN THE ABSENCE OF THE PUBLIC AND PRESS

RESOLVED – That the following agenda items be considered in the absence of the public and press:-

Item 19 Illiquid Premium Allocation Update

Item 20 Illiquid Premium Allocation

Item 21 Standard Life Presentation

5 DECLARATIONS OF INTEREST

None.

6 MINUTES OF THE MEETING OF THE INVESTMENT BOARD HELD ON 12 MARCH 2015

RESOLVED – That the minutes of the meeting of the Investment Board held on 12 March 2015 be agreed and signed by the Chair as a correct record.

7 WORK PROGRAMME

The Board considered its' Work Programme to 10 March 2016.

RESOLVED – That the Work Programme be noted.

8 UPDATE ON MATTERS THAT HAVE ARISEN SINCE THE LAST MEETING

The Fund Director updated Members on the following issues:-

i) The Scheme Advisory Board had recently issued proposals to invite interested parties to assist in developing options in relation to the increased separation of LGPS funds from their administering authorities. One of the options involved a stronger role for the Section 151 officer; another was for the establishment of joint committees for more than one authority; or complete separation of the pension fund from the host authority. In the past, the CLG had looked at the Fund's constitution as a model going forwards, and this seemed to be one of the three options for discussion.

ii) A number of enquiries had been made by Fund Members in relation to the vote on Sir Martin Sorrell's remuneration at WPP. These had been prompted by a lobbying group and were received after the Fund had already exercised its' vote in accordance with its voting guidelines. The Fund had responded to those Members to explain how it had voted and why. The Fund was aware of an initiative being led by three asset managers namely RPMI RailPen, Royal London and Standard Life, to approach Roberto Quarta, the new Chair of WPP, to suggest that succession planning should commence, in order to plan for the future. Members' views were sought as to whether this should be supported.

RESOLVED – That Members supported the suggestion that WPP should begin succession planning around the CEO and should participate in any appropriate shareholder action.

9 SOUTH YORKSHIRE PENSION FUND: KEY FACTS

The Board was presented with a Key Facts document, which was a snap shot educational tool, primarily for new Members.

L Robb suggested that the wording relating to the Asset and Liability Study should focus upon the need to increase returns in UK equities rather than the low volatility approach suggested by Mercers but which was rejected.

Councillor Rodgers commented that it was important to monitor the number of active members in the Fund.

RESOLVED – That the report be noted.

10 ACTUARIAL VALUATIONS 2013 AND 2016

A report of the Fund Director was submitted to draw to Members' attention issues that needed to be considered ahead of the actuarial valuation due at the end of March 2016.

A report had been submitted to the Authority Meeting on 11 June 2015, on the potential issues and questions that needed to be addressed ahead of the actuarial valuation in March 2016. These related inter alia to bond yields, inflation and pay growth assumptions, whether to include the impact upon certain specific employers or classes of employers of a significant increase in employer contribution rates, and the impact of yield movements on all Fund employers, together with the assessment of appropriate recovery periods.

The starting position had to be that the Fund's deficit position was unlikely to improve between now and 2016 or since 2013. It was pertinent for the Board to consider how to address the matters and whether any changes were required to the strategy to be put forward to the 2016 valuation process. It was noted that any increase in deficit could lead to an increase in notional contribution requirements. Despite investment returns having out performed expectations over the last 3 years, they had not done so to a significantly large extent to overcome the increase in liability costs, which was down to the historically low level of bond yields. The Fund Director suggested that the Board gave consideration to the increased volatility in bond yields over the last few months, and that it would be helpful if the Board offered guidance over where they thought bond yields might be later this year or in 2016.

A broad discussion ensued between Members and the Advisors. The latter expected to see an increase in inflation rates and bond yields, although it was difficult to predict when this would happen. T Gardener commented that it would be interesting if the Actuary did the valuation on an optimistic but realistic basis. TG wondered what the funding position would have been had the alternate assumptions been used rather than those finally chosen. He thought that the Fund should press the actuary to develop a series of potential solutions.

JNH commented that advisors and officers had put forward various scenarios to the actuary in the past and had tended to take a pragmatic view.

The Fund Director commented that it was important for the district councils' Section 151 Officers (Directors of Finance) to be aware of the pension implications of any decisions made in relation to outsourcing or changes to service delivery models.

Councillor Ellis was pleased that the report was presented in a timely fashion to allow discussions to commence. It was important for the Authority to ensure that discussions continued and gained momentum.

The Advisors suggested that a follow-up report be brought to the next Board Meeting and, in the meantime, undertook to convey their views, including consideration of Sections 4.5 and 4.6 of Appendix A to the report, to officers for inclusion in the report. Advisors also suggested that the employers had to consider the short term pressures they faced in the context of the longer term funding issues and that the Authority ought to determine how robust it would be in relation to individual contributing employers.

RESOLVED – That Members:-

i) Gave consideration to the points raised within the report.

ii) Agreed that an update report be presented to the next Board Meeting.

iii) Agreed to give consideration to Sections 4.5 and 4.6 of Appendix A to the report, to provide feedback at the next Board Meeting.

11 LOCAL AUTHORITY PENSION FUND FORUM: JANUARY 2015 BUSINESS MEETING

A report of the Fund Director was submitted to inform Members that the minutes of the Forum's January 2015 business meeting had been issued.

The last business meeting of the Forum had been held on 24 March 2015 in London.

Members noted that the Forum had discussed a fringe meeting programme proposed for the 2015 party conference season, and whether it should seek to establish an All-Party Parliamentary Group on the LGPS post the election.

RESOLVED – That the report be noted.

12 SHAREHOLDER ENGAGEMENT: STATEMENT ON CORPORATE GOVERNANCE AND CORPORATE SOCIAL RESPONSIBILITY

A report of the Fund Director was submitted to reaffirm the current policy Statement on Shareholder Engagement and the Authority's responsibilities as a shareholder.

The Authority periodically reviewed its Shareholder Engagement Statement to ensure that it reflected current best practice.

It was noted that the Authority's voting guidelines had been reviewed against current best practice, and only minor amendments had been made. It would be appropriate to retain and revisit the present Statement on Shareholder Engagement, following the outcome of the FRC Stewardship Code review.

RESOLVED – That Members reaffirmed the current Statement on Shareholder Engagement.

13 PROPERTY PORTFOLIO: MANAGEMENT ISSUES UPDATE

A report of the Fund Director was submitted to update Members on matters relating to the asset management of the investment property portfolio.

Members were updated on the following:-

- Empty Property Rates - There had been an increase in the sum spent on empty property rates during 2014-15 due to a refurbishment project and the letting situations in Guildford and Warrington.
- Insurance Issues – The agricultural business, which had previously been awarded to a mutual insurer (who was not a party to the framework agreement), had now been awarded to a framework bidder at a premium of 20% higher than last time.
- Leases and Covenant Strength – It was noted that the Fund was currently exploring a potential development funding agreement and that voids continued to improve.
- Renewable Energy – The Government had made announcements in relation to tariff support for onshore wind farms. Only one project was being evaluated at the moment and this could be caught within those proposals.
- Legislation Update – The new Construction (Design and Management) Regulations had come into force on 6 April 2015, which would abolish the CDM co-ordinator function and replace it with a new role of 'principal designer'.

RESOLVED – That the report be noted.

14 OVERSEAS EQUITIES

A report of the Fund Director was submitted to advise Members and Advisors on the overseas equity allocation and its distribution across markets.

The Fund Director gave background information as to how the present benchmark was selected. It had been recognised at the time that the US had the largest, most dynamic and entrepreneurial economy in the world, but the view of the Advisors had been to look further at emerging developing markets. This had resulted in a bias towards the Pacific and the greater Far East.

T Gardener suggested that work be carried out to evaluate whether the present benchmark was appropriate for the next 3 or 4 years.

RESOLVED – That the Board:-

i) Noted the contents of the report.

ii) Agreed that further consideration be given to the approach and that a report be presented to the next Board meeting.

15 ASSET & LIABILITY STUDY 2013: REAL ESTATE BENCHMARK

A report of the Fund Director was submitted to advise Members of discussions that had taken place concerning the future composition of the real estate element of the Fund's customised benchmark. This followed the discussions held at the December 2014 Board.

RESOLVED – That the Board agreed:-

i) To amend the real estate customised benchmark and adopt the IPD Balanced Monthly and Quarterly Fund Index as the overarching benchmark with effect from 1 July 2015.

ii) For portfolio reporting and attribution purposes the Fund to use the IPD Balanced Monthly Index for commercial real estate and the IPD UK Rural Property Investment Index for agricultural properties.

iii) The revised Standard Life Investment Management Agreement restrictions.

16 EMERGING MARKET EQUITY EXPOSURE

A report of the Fund Director was submitted to update Members on the present position regarding Fund exposure to emerging market equities.

Councillor Wraith commented the paper was highly technical and queried whether a simplified overview of strategies could be considered. The Fund Director said it would be difficult to simplify it as it is a difficult subject.

Tim Gardener pointed out that he and Leslie Robb came as Advisors while this was ongoing and they were not sure they would have gone this way but it was wrong to alter it when so much work had been done. Leslie Robb thought it was a good opportunity to revisit some of the discussions now as the portfolio has been in place for a while and there was some element of it being unsatisfactory at the time.

The Fund Director expressed concerns regarding the Latin American Large Cap Manager who was underperforming; there would be a significant cost implication to changing managers. He suggested that one of the options within the review would be the possibility of developing in-house expertise to undertake the work, using the existing broker contacts; it was noted that to put this out to a global equity manager would significantly increase fees, and the performance returns may not be commensurate with the fee.

LR suggested the whole issue of the EM equity allocation should be reviewed within 12 months but preferably within the context of reviewing the whole overseas equity exposure. TG agreed with this unless something occurred which would precipitate such a review.

Councillor Ellis suggested that an update report be presented to the next Board Meeting, to include a timeline for a global review; and that discussions be held with the Fund Director and Advisors in the interim.

RESOLVED – That Members:-

i) Noted the contents of the report.

ii) Agreed that an update report be presented to the next Board Meeting, to include a timeline for a global review.

17 ECONOMIC IMPLICATIONS OF THE UK GENERAL ELECTION

A report of the Fund Director introduced a paper published by a US Investment Bank on the implications for investors of the outcome of the UK General Election.

Members noted that the paper argued that the outcome of the UK general election on 7 May 2015 did not imply major changes to the British economic outlook and little change for the Bank of England's monetary policy. The planned referendum on the continued UK membership in the EU was the largest uncertainty, which the Prime Minister had promised to hold before the end of 2017. If voters chose to leave the EU, the UK could lose some of the economic benefits that EU membership conferred.

RESOLVED – That the report be noted.

18 QUARTERLY REPORT TO 31ST MARCH 2015

The Board reviewed the performance of the Fund during the quarter ended 31 March 2015.

The Fund ended the last quarter with an underweight position to bonds (in particular high yield bonds) and cash, an in-line position to equities and overweight position to alternative funds, private equity funds and property.

For the quarter, the Fund had returned 5.6% against the expected return of 5.5%, with the Fund valuation rising from £5874.2m to £6245.2m.

Fixed interest returns were Henderson in-line at 3.2% against the benchmark of 3.2%; Index-linked gilts 4.0% against a benchmark of 4.7%; higher yield 2.3% against an expected 3.2%; emerging market 4.0% against an expected 2.6%.

UK equities had returned 5.0% against the expected benchmark return of 4.7%. International equities had returned 8.1% against the benchmark of 8.2%. Property had returned 2.5% against the benchmark of 3.0% whilst private equity had returned 6.3% against the benchmark return of 0.6%. Illiquid premium had returned 1.4% against the benchmark of 0.6%.

SJS described the rationale behind the decisions taken during the quarter and the broad investment background highlighting the decision by the ECB to commence a version of QE, its consequences for currencies and the perceived slowdown in the Chinese economy.

SJS stated that looking forward a pro-risk stance was still favoured but that caution was justified. Bonds remained historically expensive and some equity valuations were full but so long as central bank liquidity supported markets this scenario could continue for some time.

RESOLVED – That Members noted the contents of the report.

18a Index Linked Bond Exposure: Proposal to Vary Constituents

A report of the Fund Director was submitted to seek Member and Advisor comments on a proposal to vary the composition of the Fund's index linked bond exposure.

The Fund Director referred to the relatively low bond yields. He commented that as Members were aware, officers had been short of duration in the portfolio and this had adversely affected performance. However, when the WM universe data had been received the Fund had come in at the eighth percentile. However, a switch into comparable US Treasury TIP issues out of UK Index Linked Gilts would enhance the yield. Any such exposure would be currency hedged. Officers acknowledged that the present portfolio formed part of the protection allocation and that is why it was only being put forward as a temporary measure.

Whilst T Gardener supported the proposal on a short term investment-driven basis he raised concerns over the consequences for liability matching. If the switch proved to be a wrong decision it would happen at the same time as the funding level decreased. There was the potential for the Fund to face a double risk. He could not support the idea because of this risk.

L Robb shared TG's concerns over the potential consequences for asset-matching should the switch prove to be wrong. The Fund already had a significant duration bet and this proposal might just add unnecessary risk.

Members took a vote on the proposal, and it was agreed not to proceed further.

RESOLVED – That Members agreed not to proceed with the proposal.

19 EXCLUSION OF THE PUBLIC AND PRESS

RESOLVED – That under Section 100(A) of the Local Government Act 1972, the public be excluded from the meeting for the following items of business on the grounds that they involve the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A of the Act and the public interest not to disclose information outweighs the public interest in disclosing it.

20 STANDARD LIFE PRESENTATION

The Board received a presentation from Standard Life Investments on the commercial real estate portfolio.

The Board noted the following key points:-

- UK economic foundation was robust and projections were for this to continue; European economies were improving.
- UK real estate forecasts reflected modestly lower expectations and a normalisation of returns over the next few years.
- Europe was expected to catch up near term and outperform longer term.
- Rental growth momentum had taken over from yield shift as the main influence on prices.
- Robust single digit returns were anticipated from UK real estate over the next three years; slightly higher returns were expected on the continent.
- Returns were likely to remain attractive on a relative basis.

- Headwinds from European exposure were expected to be accretive to returns going forward.
- Long-term interest rate expectations had increased modestly.
- The Fund had outperformed the benchmark over 3 and 5 years.
- 1 year performance had been impacted by European exposure; Europe was forecast to outperform the UK over 3 and 5 years.
- Significant progress was being made on reducing Fund void rates with levels now below the market average and in accordance with the Fund IMA.

The Board noted that R Marshall would shortly be replaced as the Fund's client manager following an internal promotion. He would be replaced by James Britton.

Councillor Ellis thanked the representatives from Standard Life Investments for an assuring presentation, and she gave special thanks to R Marshall for his work provided to the Fund over the last 8 years.

RESOLVED – That the Board noted the presentation.

21 ILLIQUID PREMIUM ALLOCATION UPDATE

A report of the Fund Director was submitted to bring Members up to date with aspects of the portfolio's theme implementation. L Robb repeated his view that exploiting income in this way was appropriate.

RESOLVED – That the Board noted the report.

22 ILLIQUID PREMIUM ALLOCATION

A report of the Fund Director was submitted to seek Members' approval to investigate investing in a vehicle involved in the provision of affordable housing. The report also mentioned the possibility of investing in healthcare related properties. It was suggested that a blend of the two might enhance income returns. Whilst supporting in principle the concept of investing in affordable housing Members were much more cautious over healthcare provision citing reputational issues as being of concern.

RESOLVED – That the Board agreed that investing in affordable housing was an appropriate activity for the Fund and whilst not rejecting the idea of healthcare property investment expressed caution. Any further proposals relating to the latter should be referred to the Board by officers.

CHAIR