SOUTH YORKSHIRE PENSIONS AUTHORITY

INVESTMENT BOARD

22 JUNE 2017

PRESENT: Councillor S Ellis (Chair)
Councillors: K Harpham, J Mounsey, A Sangar, I Saunders and R Wraith

Officers: S Barrett (Interim Fund Director), N Copley (Treasurer), M McCarthy (Deputy Clerk), S Smith (Head of Investments SYPA), F Bourne (Administration Officer SYPA) and G Richards (Democratic Services Officer)

Trade Union Members: N Doolan-Hamer (Unison), D Patterson (UNITE) and G Warwick (GMB)

Investment Advisors: T Gardener, N MacKinnon and L Robb

Observer: Councillor Z Sykes

1 APOLOGIES

None.

2 ANNOUNCEMENTS.

None.

3 URGENT ITEMS.

None.

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

None.

5 DECLARATIONS OF INTEREST.

None.

6 MINUTES OF THE MEETING HELD ON 9 MARCH 2017

Further to minute 5, T Gardener clarified that he was employed by AON Investment Consultants.

RESOLVED – That the minutes of the Investment Board held on 9 March 2017 be agreed and signed by the Chair as a correct record.

7 WORK PROGRAMME

The Board considered its Work Programme.

It was noted that the item entitled 'Government Consultation on LGPS Pooling' would be amended to 'LGPS Pooling Update' and would be a standing item on each agenda.

'Investment Beliefs' would be an item on the December agenda.

The annual review of longer-term performance would be arranged for the September meeting.

It was agreed to review the Terms of Reference and then ensure the Work Programme was consistent with the Terms of Reference.

It was noted that, moving forward, the Work Programme would evolve to take pooling matters into consideration; performance would still be important but it would be BCPP investment performance as well as residual legacy assets under consideration.

RESOLVED – That, subject to the amendments above, the Work Programme be noted.

8 WORKFORCE DISCLOSURE INITIATIVE

A report was considered which sought Members' approval to become signatories to the Workforce Disclosure Initiative.

Members were informed that the Workforce Disclosure Initiative was a new project focusing on human capital management (HCM) reporting by companies and would comprise of an annual survey covering issues such as governance, workforce composition, training, health and safety and wage levels.

Members were reminded that there were high profile examples of companies where poor HCM had led to financial and reputational risk, for example Sports Direct.

Signatories would have access to the data generated, along with detailed analysis and sector comparatives. There would be no charge to the Authority as funding for the first two and half years was provided by the Department for International Development, there would be no obligation to remain as a signatory after this period.

RESOLVED – That the Authority agree to become a signatory to the Workforce Disclosure Initiative.

9 PROPERTY PORTFOLIO: MANAGEMENT ISSUES UPDATE

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

For the benefit of new Members, S Barrett informed the Board that Standard Life Investments were the company contracted to advise on property matters; of the circa £7bn fund, 10% was held in direct property.

Members noted that the sum spent on empty property rates had fallen but that the Warrington property continued to be a drain.

Cllr Wraith expressed concern that Warrington was a long-standing issue and queried what action was going to be taken.

S Barrett informed Members that there was a meeting arranged for the following week with Standard Life Investments and the matter would be discussed there.

Cllr Mounsey queried whether there was an option to sell the property and reinvest.

T Gardener commented that the value would be greatly reduced because the property was unoccupied; he would expect Standard Life Investments to continue trying to secure a tenant before considering selling the property.

In response to a question from Cllr Saunders regarding property investment in South Yorkshire, S Barrett replied that the strategic aims and requirements of any Local Government Pension Scheme was to meet their liabilities through an appropriate investment strategy; this was about the sustainability of the Fund and the ability of the assets to pay future liabilities. Local issues were not part of that decision framework. Any proposals involving local investment would need to meet sound investment criteria.

T Gardener commented that the point of investing in a mixture of properties was to diversify and at any one time it was likely that some properties would be empty. What was more worrying was the increase in the void rate to 7.4% as this was the proportion of rental not being received; as long as the prospective lettings were finalised this would be nothing to worry about.

S Barrett confirmed that a number of leases had been completed and the void figure should now be within the control parameters.

RESOLVED – That the report be noted.

10 AGRICULTURAL LAND PORTFOLIO

A report was submitted that commented upon the role and performance of the agricultural land portfolio as agreed at the last Investment Board meeting.

Members were reminded that the Fund had an agricultural land portfolio independently valued at c£170m in December 2016.

As the data extract contained within the report showed, long term performance had been strong although more recently it had disappointed; in the short term the decline had to be viewed in the context of the change that Brexit would have on UK farming. In the longer term it was felt that a case could be argued for a likely increase in value for what was a precious and finite resource.

The independent valuer (Savills) in an earlier report referred to a stagnant market and limited sales evidence. The Authority's own advisor (Bidwells), whilst agreeing the market had declined and that evidence was scarce, did not agree with the overall valuation arrived at by Savills and thought it was unduly harsh.

Standard Life forecast a total return for commercial property over the next five years of 4.7%. Savills' forecast for agriculture was 5.5%.

It was also worth noting that in their asset and liability report Mercers cited agricultural land as an alternative asset class which the Fund should consider investing in to obtain access to greater income security and inflationary protection.

L Robb commented that the report stated that the land was 'some of the richest arable land in the UK' and queried how this statement was vindicated. S Smith replied that the Authority's agricultural advisors provided the Authority with such information.

With regard to the charts at Appendix A to the report, T Gardener commented that information in the future would be more useful. The charts provided no signal as to whether to buy, sell or hold. The report seemed to be saying hold for the short term, but not necessarily for the next five years.

L Robb commented that the quality of knowledge on agricultural property in the UK was poorer than for other asset classes; predictions would not be as accurate as for other types of property. The Board need to be sure that it was really first class land and property. Although the assets had not performed well in the short term, the argument was probably for staying with them at the moment.

The report submitted today clearly recommended a holding position in that there was no clear case to dispose of the assets for thee moment; this position would be reviewed in due course and would take account of the management arrangements. The Board had agreed in March to increase its strategic allocation to real assets; the recommendation to hold was entirely consistent with that decision.

RESOLVED: - That the Authority agreed to continue to invest in agricultural land.

11 <u>OVERSEAS EQUITY ALLOCATION</u>

A report was submitted to determine an overseas equity benchmark and consider a change to the emerging market benchmark.

S Barrett reminded Members that the decision to reduce the Fund's investment in equities from 60% to 50% had been taken in March to take a more protective approach; a proportion of these were overseas equities.

S Smith informed Members that since 2000 the Fund had moved away from using the global index as a benchmark. This was partly because the US was a large part of the global index, approximately 60%, and it was felt at the time there would be more growth in Asia Pacific. The benchmark was moved to a regional basis with fixed weights attached to each region and was based on a broad view of the three main trading blocks' Gross Domestic Product.

The last time these weights were changed was 2009. Last year, after the Advisors questioned the position, a paper was brought to the Investment Board to review the process of setting the overseas benchmark.

Broadly, Officers and Advisors agreed GDP was the way forward to use as a basis for setting the benchmark. A decision on the benchmark was not made at that time and it was decided that the matter should be considered again after the investment strategy review of Fund Assets which would follow the March 2016 triennial valuation. This had now been done and reported to the March 2017 Board.

T Gardener informed Members that there were two ways of deciding where to allocate overseas equities, the first being market cap weighting, i.e. 60% in the US. The alternative way was to set a fixed weight benchmark which decided where to allocate between various regions. A fixed benchmark was something that Officers could work against and would be comfortable with.

The recommended change to the benchmark was not a massive change but it was a pragmatic change, it had been distributed across the world in a sensible way using GDP.

L Robb commented that there had been the Strategy Review that was put to the Board in March which recommended a reduction in equities to 50% over time. The change to the benchmark would also be implemented over time and he suggested it would be a worthwhile exercise to map the two in terms of implementation so that it would be clear what would be implemented over the next 6-12 months and which parts of it might wait until pooling had taken place; there needed to be a clear plan to avoid unnecessary costs.

S Smith confirmed that the portfolio would not be churned and the changes would be done in conjunction with any changes to the allocation. A timeline would be produced for the Board.

T Gardener suggested that the Overseas Equity benchmark should be reviewed every three years after the triennial valuation.

RESOLVED:

1. That the medium term strategic allocation for overseas equities is approved.

2. Agreed that the benchmark for the Other International Portfolio becomes FTSE Emerging Markets Index.

3. That the Overseas Equity benchmark be reviewed every three years after the triennial valuation.

12 <u>GOVERNMENT CONSULTATION ON LGPS POOLING</u>

S Barrett informed the Board that in future the pooling update would be a written report.

For new Members, briefings would be circulated to explain the background behind pooling and information on the Border to Coast Pension Partnership (BCPP).

S Barrett explained that SYPA were one of 12 Funds that formed the BCPP; the first meeting of the newly formed Joint Committee had been held on 5 June 2107, prior to that there had been informal Member Steering Group meetings.

The legal process had involved the creation of a new company of which there would be 12 shareholders. The property search was underway as was work on an IT solution and other support services.

Members were informed that the important issues in the next few months would be the appointment of the Chair of BCPP followed by its Chief Executive Officer.

Of the 12 member Funds, three were internally managed. The savings that were expected to be achieved through the operation of BCPP would be mainly through the driving down of external management costs' and for that reason SYPA, as an internally managed fund, would not achieve immediate savings.

The Chair explained that pooling arrangements were entirely driven by government, it was not something that SYPA would have chosen to do.

In answer to a question from a Member, S Barrett explained that the Authority consisted of two divisions, the Administration side, headed by Gary Chapman, which would not be affected by the pooling arrangements and the Investment division. Pooling would affect the Head of Investments and her Investment Managers who, if they so wished, would be TUPE transferred to BCPP. This would be somewhere around June 2018, subject to transitional issues.

What was still under consideration was what resource base needed to remain in South Yorkshire.

The Authority would still have responsibility for the asset allocation strategy and there would also be a need to challenge BCPP's performance. There would also be legacy assets to manage which could not be immediately transferred into the pool for a variety of reasons. New posts may be created to manage the post-pooling structure.

There were concerns for some back office staff who were potentially at risk. S Barrett would be discussing the matter with the Chair and Vice Chair and the Authority intended to work with Barnsley MBC for opportunities on a wider front. All these issues would be considered in a report to the October meeting of the Authority.

Cllr Saunders queried how the Authority could ensure the Authority had enough assets to meet its pension liabilities if the investment was being taken out of the Authority's hands and what sanctions would be available if BCPP didn't perform satisfactorily.

S Barrett replied that the Authority were moving to a position in which some of the other Funds were at the moment (i.e. externally managed). Those Funds would have a wide range of external fund managers, any one of whom could be changed if they didn't perform satisfactorily.

Although BCPP couldn't be replaced in the same way, governance arrangements were in place to hold BCPP to account and there was an exit strategy in place should a Fund determine to leave in extreme circumstances.

T Gardener commented that the Authority's control was as a shareholder. If BCPP was not performing well, all 12 Funds would be unhappy; the ultimate mechanism would be to fire the Chief Investment Officer but as BCPP would be monitored by 12 different groups there would be early warning signals of poor performance.

L Robb commented that the Chair, Chief Executive and Chief Investment Officer would have the opportunity to be leading players in a new Fund Management company and would want to deliver great results and a first class service but it would also be mindful to remember that good performance didn't happen overnight and not to exert too much pressure in the first 12 months.

In answer to a query from Cllr Wraith, S Barrett reported that as a consequence of pooling, 7 investment posts would be transferred to BCPP at this stage, although some new posts would be needed creating an opportunity for some resource to remain.

He reassured Members that there was a well-defined TUPE process in place in terms of BCPP and the Authority also had HR support from Barnsley MBC. Staff had been made aware of the risk issues and strategies were being developed to handle that. The Trades Union would be involved at all stages.

T Gardner queried what decisions would be taken by the Pool between now and the next meeting that would affect the Fund and to what extent officers would need the Board to aid these decisions. Equally, were there any decisions required between the next meeting and the meeting after that which the Board need to be prepared for, i.e. which pools does the Fund invest in. As the Board meets quarterly there was a concern that a decision would be needed between meetings.

S Barrett informed the Board that a meeting with the Advisors and the actuary had been arranged for immediately after the meeting at which they would run through technical issues. Any issues arising from this would be brought back to the Board.

T Gardener commented that the Authority needed to guard against getting bounced into a decision where Members had not had time to discuss and consider the issues carefully.

The Chair agreed; the tight timescale imposed by the government could cause problems. As happened previously extra meetings could be called if required so the whole Authority would take the decision. The point was well made about ensuring the Authority had time to consider decisions carefully.

S Smith commented that originally it was envisaged that most of the internal assets would transfer from day one. At a recent meeting, officers had been informed that this would not be the case as it could not be done, this meant that there would be a phased-in period. A timetable had been requested to ensure that the management implications of this change could be considered.

T Gardener commented that originally there were 13 Funds in the pool, including the South Yorkshire Passenger Transport Pension Fund and, although acknowledging the Fund was too small to be a shareholder from a value for money point of view, questioned whether their assets were still being transferred.

S Barrett replied that First Group had decided to request the merger of all their pension funds into the Greater Manchester Pension Fund. There was a transition plan in place and the assets would be transferred before pooling went live. It was hoped the assets would be as well managed as they had been while in South Yorkshire's care.

The Chair commented that the Passenger Transport Pension Fund Committee had been involved at all stages and were happy with the arrangements.

RESOLVED – That the update be noted.

13 QUARTERLY REPORT TO 31 MARCH 2017

The Board reviewed the performance of the Fund during the quarter ended 31 March 2017.

For the quarter the Fund had returned 4.6% against the expected return of 4.5% with the Fund valuation rising from £7.3m to £7.6m.

Generally, the global economic data was strong and provided momentum for the global equity market.

UK equities were supported by strong corporate results. In March, Article 50 was triggered which started the formal process for the UK to leave the EU. Since then, things had moved on and since the election result there was more uncertainty not less.

In the US equities were strongly influenced by the election result. Since then the infrastructure projects that had been expected to support the market had not come through and the market had dropped back somewhat; this was also due to the fact that the Federal Reserve had raised interest rates.

Eurozone equities fared well on receding political concerns regarding the result of the Dutch elections and the result of the recent French elections had improved the situation further.

The weakest results of the quarter were from Japan which were not helped by the Yen strengthening over the quarter.

The Fund ended the quarter with an underweight position to bonds, UK equities and Property, and an overweight position to overseas equities, private equity funds and alternative income funds.

D Patterson commented that while, realising the report was an executive summary, he would prefer a more comprehensive report that also detailed liabilities.

S Smith replied that a full Quarterly Report was still produced and could be circulated to Members electronically if they so wished.

With regard to higher cash levels, Members noted that this was due in part to some advance deficit contributions and the recent sale of a property in London; the Authority was currently looking for investment opportunities in property.

RESOLVED – That the report be noted.

CHAIR