Subject	**Process for Pooling Property Investments**	**Status**	For Publication
Report to	Authority	**Date**	11th June 2020
Report of	Director, and Head of Investment Strategy		
Equality Impact Assessment	Not Required	Attached	No
Contact Officer	George Graham Director	**Phone**	01226 772877
E Mail	ggraham@sypa.org.uk		

1 Purpose of the Report

To set out for members and gain approval for the process leading up to decisions in relation to the pooling of the Fund's property investments.

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2 Recommendations

2.1 Members are recommended to:

a. **Approve the process leading up to a decision in relation to the pooling of the Authority's property investments set out in the body of this report.**

b. **Note the on line learning materials being provided by Border to Coast.**

c. **Agree to support Border to Coast incurring further development costs in particular for the appointment of a Head of Property prior to formal approval of the product design.**

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3 Link to Corporate Objectives

3.1 This report links to the delivery of the following corporate objectives:

Investment Returns

To maintain an investment strategy which delivers the best financial return, commensurate with appropriate levels of risk, to ensure that the Fund can meet both its immediate and long term liabilities.

Property investment plays a key part in delivering the income which is increasingly required to fund the difference between benefits payable to scheme members and contributions from employers and active members. Therefore achieving a successful pooling process for this asset class is of considerable significance in driving the success of the overall investment strategy.

Responsible Investment

To develop our investment options within the context of a sustainable and responsible investment strategy.

As with any other asset class the Authority will wish to be assured that responsible investment is at the heart of the investment process designed to support any pooling product. In the context of property investment as well as the obvious potential benefits in terms of the environmental performance of buildings there is a significant opportunity in certain multi-let assets to deliver significant social benefits which the greater scale available in a pooled product should allow to be brought to fruition.

Effective and Transparent Governance

To uphold effective governance showing prudence and propriety at all times.

The process proposed in this report is intended to allow elected members to fully understand the implications of a decision to support the pooling of property investments, thus supporting the key principles of good governance.

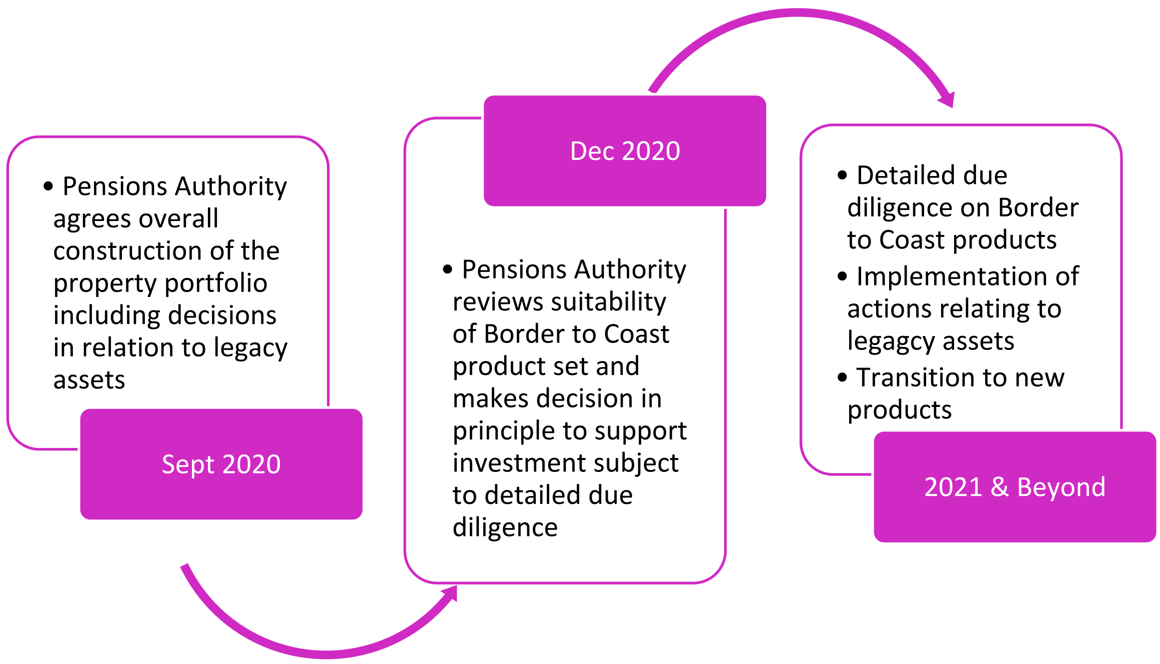
4 Implications for the Corporate Risk Register

4.1 The actions outlined in this report provide a process for mitigating the risk that Border to Coast provide products which do not meet the Authority’s needs which is set out in the Corporate Risk Register.

5 Background and Options

5.1 In line with the overall plan for pooling assets Border to Coast are now developing proposals for products which will allow the pooling of property assets. This is probably the most complex exercise of this sort which the Company and the partner funds will undertake given the illiquidity of property assets and the difficulty of transitioning out of indirect fund investments in this asset class. Given this complexity which in itself creates a number of risks in terms of managing the transition it is important that each stage of the process receives proper reflection and consideration, even if this might mean the whole process takes somewhat longer than is allocated in the current plan.

5.2 For SYPA, and indeed any of the other partner funds, this process presents an opportunity to reflect on what we want to achieve through investing in property as an asset class and how we want to construct our portfolio in order to achieve this. As part of this reflection we also need to give consideration to the various legacy assets (such as farms and local investments) that we hold within the property portfolio and how they fit into the overall picture, which is something that has not been done for some considerable time. This favours a multi-stage process along the following lines:



5.3 This process puts the decision making in the right order, allowing the Authority to consider what it wants to achieve from investing in property as an asset class and how it wishes to allocate its money across the different aspects of property before considering the Border to Coast products in the context of these decisions.

5.4 Border to Coast propose to develop two products:

- A UK Property Fund – This will use an Authorised Contractual Scheme structure (similar to but separate from the existing one used for listed assets). This will be largely made up of direct investments similar to SYPA's commercial portfolio complemented by investments in funds covering specialist area such as residential property and healthcare. If SYPA invests in this fund the current direct property portfolio would transfer to the ACS. Initially this portfolio would be managed in a similar way to the current SYPA portfolio with significant input from an investment manager. Over time it is expected that more activity would be undertaken in house leading to a gradual reduction in costs.
- A Global Property Fund – This would operate as a conventional fund of funds through a single GP/LP structure. A partnership would be developed with a fund manager to assist in fund selection etc. There would be opportunities for co-investment to reduce costs.

5.5 Overall the partner funds have allocated c£4.1bn to investment in property (in the UK and overseas), of which c£1.4bn is invested directly in UK property by four of the partner funds. It is likely that the direct investment portion of the Border to Coast UK fund will ultimately be c£2.5 – 3bn. This is a significantly different proposition to the current SYPA portfolio of c£0.5bn. In a portfolio of the proposed scale the average size of an asset is likely to be larger than currently and there is potentially more opportunity to take on development projects.

5.6 Border to Coast are providing further background information on their proposed products in the form of a recorded webinar for members and this will be made available to members in due course. This will allow members to follow up specific questions with officers in order to identify specific concerns which can be addressed in later stages of the process.

5.7 There are a number of significant questions which members will want to be convinced of in order to make an “in principle” decision to invest in December. These include:

- The costs and timescales for transition, at present while the transition process is designed to minimise costs and not leave capital waiting deployment it does seem unduly protracted particularly for assets currently invested in funds, and it does not appear that other potential approaches have been sufficiently investigated.
- The costs of running the new products relative to the current cost base. Current modelling (which it is accepted needs to be updated with more recent information) indicates a payback period for SYPA of nearly 10 years. While the product promises better risk adjusted returns these are far from guaranteed and may be even further off given the length of time likely to be needed to reshape the portfolio. While SYPA has never gone into pooling solely to deliver savings at some point it does need to deliver tangible benefits for the Authority and this will be the subject of separate and wider discussions with the company and other partner funds.
- The balance of the proposed risk and return targets where currently there appear to be significant differences between partner funds. This is a significant issue for all partners as if the “right” answer is not arrived at a fund may need to change its strategic asset allocation to fit the products which Border to Coast can make available on a commercially viable basis. This debate currently has much further to run, and in fairness is very much a partner fund rather than a company issue.
- The quality of the other direct property assets being used to seed the new UK fund. In fairness this is more of an issue for those funds not currently holding direct property and the process of transfer provides protections for investors through the role of the depositary. All four directly managed funds are operating similar strategies and there are significant similarities in the portfolios (with SYPA and Teeside in one case owning neighbouring properties), and while every portfolio will have its problems this is not an area where major issues are anticipated, although this needs to be fully substantiated.

5.8 There is clearly much further work and discussion for partner funds, however, ultimately this has to happen, and the Company should not be prevented from undertaking the wide range of work needed to develop these products that needs to take place regardless of the conclusions reached on any of these issues. Specifically this includes the need to strengthen the team through the appointment of a Head of Property and the recommendations at the head of this report include one to support any request for a further allocation of development costs for these purposes.

5.9 In addition to the above issues which are specifically related to the Border to Coast products and which will need to be addressed at the December Authority meeting members will need to consider whether they wish to invest in both products and if so what the balance between the two should be. This specific issue will be addressed in September, as it is not product specific but a judgement on how best to deploy capital within the asset class.

6 <u>Implications</u>

6.1 The proposals outlined in this report have the following implications:

Financial	There are three sorts of financial implication referred to in the body of this report. Short term – the need to incur additional expenditure on the development of the two investment products prior to them “going live” and seeing assets transition. At this stage these costs are being maintained within the levels identified in the plans shared with partner funds, the issue is phasing.

	Medium term – the costs of transitioning assets to the new structures which are significant in terms of legal and survey costs for example in relation to each of the current directly held properties. Potentially these represent a significant additional drag on performance for SYPA as we will bear not just the costs incurred as the seller of assets to the new fund but a share of the cost of costs incurred by the new fund as the buyer of the assets. Given the nature of property as an asset class this is an inevitable difference to the transition arrangements in place for listed assets. Long term – the ongoing costs of running the new investment structures. As indicated there is a significant elapsed time before SYPA sees any reduction in costs from this exercise, particularly given our relatively low exposure to fund investments in this asset class. While some benefit may be achieved through improved returns this is highly speculative and while the proposed operating model may be more robust than SYPA's this is neither provable nor something to which a value can be attached.
Human Resources	SYPA staff are currently involved in a number of areas of the management of the property portfolio including the management of insurance and collection of rents, However, this does not constitute a sufficient part of any individual's work for TUPE to apply. Any issues arising will be addressed as part of proposals for the restructuring of the Finance and Corporate Services Team which will be brought forward later in the year, but given the need to accommodate tasks which are not currently adequately addressed it is expected that the impact of changes in this area can be relatively easily absorbed.
ICT	None
Legal	None at this stage. There will be a need to secure appropriate legal services to support the transfer of properties to the new investment structures.
Procurement	Border to Coat is set up as a "Teckal" company meaning that it is possible to directly award investment mandates to the company in the same way as an internal department.

George Graham — **Director**

Sharon Smith — **Head of Investment Strategy**

Background Papers	
Document	**Place of Inspection**