

## **REPORT OF SERVICE DIRECTOR - FINANCE**

### **PENSION FUND PROPERTY PORTFOLIO**

#### **Purpose of the Report**

1. The main issue for the Working Party to discuss is the desired level of risk within the main property portfolio and consequently the target allocations within the different categories of assets. Discussions may be widened to cover the Fund's other property investments. The report presents background information on the Fund's property investments to inform these discussions.

#### **Information and Advice**

2. The Fund's agreed asset allocation ranges are currently:
 

Equities	55% to 75%
Property	5% to 25%
Bonds	10% to 25%
Cash	0% to 10%
3. The Fund's high level benchmarks are shown below together with the actual asset allocation of the Fund as at 30 September 2013.

**Liability Based Benchmark**      100.0%    FTSE UK Gilts IL > 5 Yrs

<b>Strategic Benchmark</b>		<b>Actual 30/09/13</b>
Equities (inc private equity)	65.0%    FTSE All World	73%
Property	15.0%    IPD annual universe	12%
Bonds	17.5%    FTSE UK Gilt All Stock	13%
Cash	2.5%    LIBID 7 Day	2%
	<b>100.0%</b>	

4. The use of asset allocation ranges gives the Fund flexibility to decide on various management arrangements in order to balance risk management against the desire to outperform the strategic benchmark. According to the Statement of Investment Principles (SIP), the 'block of Bonds, Property and Cash is aimed at lowering overall risk (at the cost of anticipated lower return)'. The triennial valuation assumes that returns from property lie between those from equities and gilts and the long term assumption at the latest valuation is for returns of 6% pa.

5. A paper is attached from Aberdeen Asset Management, '*What can property offer an institutional investor?*', which gives an overview of the characteristics, risks and returns available from property investing.
6. At 30 September 2013, the total exposure of the Fund to property was £409 million which is slightly below the strategic benchmark. The breakdown of the current exposure is shown below.

	£ millions	% of Fund
UK commercial property	281.4	
UK strategic land	11.4	
<b>Aberdeen Portfolio</b>	<b>292.8</b>	<b>8.3%</b>
Alpha UK Real Estate Fund	0.6	
Keills Property Trust	26.8	
Schroders UK Property Fund	4.1	
<b>UK Pooled</b>	<b>31.5</b>	<b>0.9%</b>
Aberdeen Dynamic European Property Fund of Funds	34.6	
Standard Life European Property Growth Fund	43.9	
Standard Life Global Real Estate IT	5.9	
<b>Overseas Pooled</b>	<b>84.4</b>	<b>2.4%</b>

7. The Fund has a significant portfolio of directly held UK commercial property which has been managed by Aberdeen Asset Management (albeit through a number of name changes and corporate ownerships) since 1990. This is a non-discretionary mandate, meaning that all decisions regarding the properties held (and potential purchases) are made by the Fund (on the basis of advice provided by Aberdeen) rather than by the manager.
8. The portfolio has traditionally favoured higher yielding properties requiring relatively intensive asset management. Returns have suffered since 2007 and Aberdeen have gradually been improving the quality of assets by recommending sales of more secondary assets and purchases of assets with longer, more durable income streams. This is in line with their investment approach outlined in the second attached paper from Aberdeen.
9. In 2009, Aberdeen were asked to look for opportunities to purchase strategic land for possible residential property use. To date, two direct holdings have been acquired and these are progressing through the planning process. In addition, the Fund has committed £15 million to the Barwood fund in which agreements are made with landowners to promote their land through the planning process. It is not envisaged that the Fund will take on construction risk, rather aiming to sell the land if planning consent is achieved.
10. The Alpha UK and Schroders funds were originally bought to gain property exposure for the separate (and much smaller) Admitted Bodies Fund. As with all non-prime property, performance of these funds has suffered over the last 5 years. The Keills Property Trust is a venture set up by the Fund's previous property manager and again has suffered recently. The trust is now focusing on acquiring properties where rentals are linked to inflation.
11. The overseas funds are largely focused on Europe and performance has been mixed. The Aberdeen Dynamic Fund of Funds has been the subject of much discussion recently and will be approaching the end of its life in the next 18 months to 2 years. This will result in the return of capital from the investment.

12. The main issue for the Working Party to discuss is the desired level of risk within the main property portfolio and consequently the target allocations within the different categories of assets. Aberdeen make recommendations within their report but also outline the possible impacts of adopting different targets.
13. It is also important to discuss the level of cash available for further investment by Aberdeen. Proceeds of property sales are assumed to be available for further purchases but this is at the discretion of the Fund. It is not recommended to reduce the allocation to Aberdeen but clarity over funds available for investment is needed. This should also include the strategic land initiative.
14. There has also been recent discussion of 'local' property investments and it was suggested at the last Investments Sub-Committee that this could be discussed at the Working Party.
15. Finally, it would be useful to consider the Fund's position as regards other property investment. The Fund is currently underweight its strategic benchmark allocation to property but this position has come about more from relative movements in valuations of different asset classes than from an active decision of the Fund.
16. It is therefore suggested that the Working Party makes recommendations on:
  - a. The desired level of risk and target allocations within the Fund's main property portfolio
  - b. The level of cash available to Aberdeen for additional investment
  - c. Whether to consider local property investments
  - d. Whether to make additional investments in property.

## **Statutory and Policy Implications**

17. This report has been compiled after consideration of implications in respect of finance, the public sector equality duty, human resources, crime and disorder, human rights, the safeguarding of children, sustainability and the environment and those using the service and where such implications are material they are described below. Appropriate consultation has been undertaken and advice sought on these issues as required.

## **RECOMMENDATION/S**

1. That the Working Party makes recommendations on:
  - a. The desired level of risk and target allocations within the Fund's main property portfolio
  - b. The level of cash available to Aberdeen for additional investment
  - c. Whether to consider local property investments
  - d. Whether to make additional investments in property.

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