

**24 June 2021**

**Agenda Item: 9**

## **REPORT OF THE SERVICE DIRECTOR FOR FINANCE, INFRASTRUCTURE & IMPROVEMENT**

### **FUND VALUATION AND PERFORMANCE**

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

1. To consider a reduction in the allocation to the UK to 35% of listed equities.
2. To report on the total value and performance of the Pension Fund to 31 March 2021.

#### **Information and Advice**

3. The Independent Adviser recommended reducing the UK equity allocation to 35% of listed equity holdings at the Working Party in January. After the strategic asset allocation changes already agreed have taken place the Pension Fund will have 40.7% of its listed equities invested in the UK (based on March quarter end valuations).
4. This compares to a 4% UK weighting in the global Developed Markets index. The downside of holding such a large UK weighting is the risk, as has happened in recent years, of sustained underperformance compared to global equities. However it is also true that UK equities are a better match for the Fund's liabilities, reducing currency risk in particular. This relatively small adjustment to 35% would reduce the Fund's risk relative to the Global Market and increase diversification whilst still maintaining a large proportion of investments in the UK.
5. The impact of this adjustment would be relatively small and would be largely realised when making other investments to implement the Strategic Asset Allocation. It would initially result in the Schroders benchmark changing to 44% UK and the Core Index reducing to about 35% UK. Although the target allocation to the UK within Schroders (excluding Small Cap) and the Core Index portfolios is each 50% currently, market movements and the value of equity investments held through LGPS Central, Schroders Global Small Cap and in the Specialist portfolio mean the UK holdings are a smaller proportion of total equities in the Fund.
6. When first discussed it was felt that the timing was not ideal to make this change and the discussion was deferred to the committee meeting on 15<sup>th</sup> July. The UK market has somewhat recovered since January, and with the 15<sup>th</sup> July meeting cancelled, this decision is brought to today's meeting for consideration.
7. Additionally, this report is to inform the Nottinghamshire Pension Fund Committee of the value of the Pension Fund at the end of the latest quarter and give information on the performance of the Fund. Some information relating to this report is not for publication by virtue of paragraph

3 of Schedule 12A of the Local Government Act 1972. Having regard to the circumstances, on balance the public interest in disclosing the information does not outweigh the reason for exemption because divulging the information would significantly damage the Council's commercial position in relation to the Pension Fund. The exempt information is set out in the exempt appendices.

8. The table below shows a summary of the total value of the investment assets of the Fund as at 31 March 2021 in comparison with the benchmark, together with the comparative position 3 and 12 months previously. The benchmark is a long-term target which the fund will move towards over the next year.

	Latest Quarter		Long term	Previous Quarter		Previous Year	
	31 March 2021		Benchmark	31 December 2020		31 March 2020	
	£m	%		£m	%	£m	%
Growth	3,953	64.8%	60%	3,802	63.7%	2,891	57.7%
Income & inflation protection	954	15.6%	23%	957	16.0%	1,059	21.1%
Income only	588	9.6%	10%	596	10.0%	544	10.9%
Inflation only	295	4.8%	5%	233	3.9%	187	3.7%
Liquidity	313	5.1%	2%	381	6.4%	328	6.5%
	<b>6,102</b>	<b>100.0%</b>	<b>100%</b>	<b>5,968</b>	<b>100%</b>	<b>5,009</b>	<b>100%</b>

9. Within Income & inflation protection are investments in Infrastructure assets amounting to £330.1m or 5.4% of the fund. Including infrastructure commitments made but not drawn down gives a total amount of 6.0% of the fund. There is a long term target for investments in infrastructure to be 8% of the fund.

10. The table below shows the detailed breakdown by portfolio of the Fund as at 31 March 2021 together with the total value of each portfolio at the previous quarter end.

	Core Index		Schroders		LGPS Central		Kames S		Aberdeen		Specialist		Total	
	£m	%	£m	%	£m	%	£m	%	£m	%	£m	%	£m	%
<b>UK Bonds</b>														
Gilts					205.0	29%	0.0	0%					205.0	3%
Corporate Bonds							102.8	100%					102.8	2%
					<b>205.0</b>	<b>29%</b>	<b>102.8</b>	<b>100%</b>					<b>307.8</b>	<b>5%</b>
<b>Overseas Bonds</b>														
Corporate Bonds					315.5	44%	0.0	0%					315.5	5%
					<b>315.5</b>	<b>44%</b>	<b>0.0</b>	<b>0%</b>					<b>315.5</b>	<b>5%</b>
<b>Inflation Linked</b>											295.3	20%	295.3	5%
<b>UK Equities</b>	560.1	39%	902.8	49%	9.6	1%					30.4	2%	1,502.9	25%
<b>Overseas Equities</b>														
North America	333.3	23%	516.8	28%							0.8	0%	850.9	14%
Europe	210.8	15%	127.4	7%							152.7	10%	490.9	8%
Japan	124.2	9%	81.5	4%							114.1	8%	319.8	5%
Pacific	126.3	9%	57.0	3%									183.3	3%
Emerging Markets	85.9	6%	87.5	5%	116.1	16%					0.0	0%	289.5	5%
Global	0.0	0%	34.4	2%	37.7	5%					0.0	0%	72.1	1%
	<b>880.5</b>	<b>61%</b>	<b>904.6</b>	<b>49%</b>	<b>153.8</b>	<b>22%</b>					<b>267.6</b>	<b>18%</b>	<b>2,206.5</b>	<b>36%</b>
<b>Private Equity</b>					9.9	1%					233.4	15%	243.3	4%

<b>Infrastructure</b>										330.1	22%	330.1	<b>5%</b>
<b>Credit</b>										48.2	3%	67.4	<b>1%</b>
<b>Property</b>													
UK Commercial										325.5	67%	325.5	5%
UK Commercial - Local										21.1	4%	21.1	0%
UK Strategic Land										3.9	1%	3.9	0%
Pooled - UK										29.0	6%	163.6	3%
Pooled - Overseas										108.5	22%	109.4	2%
										<b>488.0</b>		<b>135.5</b>	9%
												<b>623.5</b>	<b>10%</b>
<b>Cash/Currency</b>	4.8	0%	33.1	2%	0.0	0%	0.0	0%	0.0	172.1	11%	210.0	<b>3%</b>
<b>Total</b>	<u>1,445.4</u>	24%	<u>1,840.5</u>	30%	<u>713.0</u>	12%	<u>102.8</u>	2%	<u>488.0</u>	8%	<u>1,512.6</u>	25%	<u>6,102.3</u>
Previous Qtr	1,390.4	23%	1,725.7	29%	710.0	12%	117.3	2%	498.6	8%	1,525.8	26%	5,967.8

11. The Fund investments have increased by £134.5 million (2.3%) since the previous quarter as the market has continued to recover. Fund investments have increased by £1,093.3 million (21.8%) over the last 12 months. Valuations at 31 March 2020 were seriously affected by the market impact of the Covid-19 pandemic.

12. The table below shows the unaudited Fund Account for 2020/21 with the full year figures for 2019/20.

<b>Summary Fund Account</b>	<b>Full Year 2020/21 £000</b>	<b>Full Year 2019/20 £000</b>
Employer contributions	(201,395)	(137,261)
Member contributions	(49,638)	(47,906)
Transfers in from other pension funds	(5,580)	(9,655)
Pensions	179,425	171,375
Commutation of pensions and lump sums	31,607	35,699
Lump sum death benefits	5,237	5,050
Payments to and on account of leavers	13,086	13,657
<b>Net (additions)/withdrawals from dealings with members</b>	<b>(27,258)</b>	<b>30,959</b>
<b>Administration Expenses</b>	<b>2,692</b>	<b>2,176</b>
<b>Oversight &amp; governance expenses</b>	<b>1,804</b>	<b>1,460</b>
Investment Income	(84,822)	(130,410)
Profits & losses on disposals & changes in value	(988,631)	483,224
Taxes on income	172	247
Investment management expenses	4,370	4,995
<b>Net Returns on Investments</b>	<b>(1,073,281)</b>	<b>358,056</b>
<b>Net (increase)/decrease in net assets</b>	<b>(1,091,672)</b>	<b>392,651</b>

### Sustainable investments and fossil fuels

13. The Pension Fund has been asked to publish figures showing the Fund's direct and indirect holdings of fossil fuel companies together with the Fund's investments in Sustainable equities and renewable energy.

14. This data is published together with detailed caveats below. It is anticipated that these figures will show a gradual increase in investment in Sustainable equities and renewable energy. It is

further anticipated that investments in fossil fuels will decrease as a proportion of the Fund over time. However fossil fuel holdings will vary from quarter to quarter in Schrodgers (direct) portfolio as investments are made based on Schrodgers assessments of market opportunities. Valuations will also change from quarter to quarter in both categories due to changes in share prices which are highly correlated to the oil price. Consequently this trend will be much less smooth.

	Latest Quarter		Previous Quarter		Previous Year	
	31 March 2021		31 December 2020		31 March 2020	
	£m	% of Fund	£m	%	£m	%
Schrodgers Fossil fuel	56.4	0.92%	46.8	0.79%	53.2	1.06%
Other Fossil fuel	78.6	1.29%	67.6	1.14%	50.0	1.00%
Total Fossil fuel	135.0	2.21%	114.4	1.94%	103.2	2.06%
Sustainable & Renewable	160.3	2.63%	158.7	2.69%	141.5	2.82%

15. In the most recent quarter the value of Fossil Fuel investments increased in absolute terms and as a proportion of the fund in both the Schrodgers portfolio and elsewhere in the fund. Schrodgers increased their sector holdings in the quarter and delivered a gain of £3.48m on these holdings.
16. Schrodgers hold a number of Oil and Gas companies within the Active Equity portfolio. Sustainability forms part of their criteria in assessing companies for investment. For example one of their holdings, Neste has a strong line-up of low carbon energy products, including recycled biofuels. European countries are introducing tighter blending requirements for sustainable aviation fuel, of which Neste is the largest European producer.
17. The 'Other Fossil fuel' category is almost entirely the Energy sector in our passive portfolio and will reflect the share of the index relating to Energy. It increased because of the increase in share prices of oil and gas companies in this quarter. There was no change to the amount invested in these holdings. It should be noted that the Energy sector includes any renewable energy companies within the index, and that some oil and gas producers are also involved in the production of biofuels, hydrogen, wind power and solar energy, so have a renewables element. As a result of these two factors the figure for fossil fuels is likely to be overstated, and the figure for renewables understated.
18. Equally there will be some companies such as those in the mining sector which do not fall within this category but may produce e.g. coal which would not be included in these figures.
19. For this reason, this indicator does not provide the full picture of our exposure to fossil fuels, but forms only part of our risk monitoring. However as an indicator it should show a reducing trend in exposure over time.
20. A more thorough assessment of our equity investments is provided by LGPS Central's carbon risk analysis which assesses the carbon footprint and weight in fossil fuel and coal reserves. The metric for exposure to clean technology is less informative as most of our investment in this area is through infrastructure funds which are not covered by the analysis. This analysis confirmed that our carbon footprint and fossil fuel and coal reserves are lower than the benchmark and provided a starting point against which we can monitor progress. The projection is that as we implement our long term investment strategy that these figures will reduce reflecting a reduction of risk.

21. The 'sustainable and renewable energy' investment figure contains more estimates. The figure includes five specific investments – the Renewables Infrastructure Group, Impax Environmental, and three renewable energy infrastructure investments – Capital Dynamics Clean Energy Infrastructure VIII, Green Investment Bank's Offshore Wind Fund and Langar Lane Solar Farm.
22. An estimate of the renewable energy investments within the Fund's other infrastructure funds was added to these identified investments. Not all funds identified this as a sector in their reporting so this data is incomplete. Furthermore because of the longer reporting cycle for unlisted investments the estimate was based on both valuations and percentages from earlier in the year, so this figure can only be considered indicative, but is likely to be an underestimate.
23. It can be seen that the Fund's investments in Sustainable Equities and Renewable Energy exceed those in Fossil Fuel investments. A gradual increase in the amount invested in this area has been demonstrated over the last year and this will increase as our Strategic Asset allocation is implemented.
24. Because of the way they are calculated, these numbers will only ever be indicative, but are helpful for the pension fund in identifying risk and progress.

### Core Index Portfolio

25. Below are detailed reports showing the valuation of the Core Index portfolio at the quarter end and the transactions during the quarter. The table below summarises the valuation and compares it to the portfolio benchmark (and a comparison with the previous quarter). The benchmark changed in the second quarter of 18/19 as part of a long term aim to bring our overseas developed market passive investments to be consistent with the regional allocation of the LGPS Central Overseas passive fund, as agreed at the June 2018 Pension Fund Committee. This will be a gradual change over time.

	31 March 2021			31 December 2020		
	Portfolio		B/Mark	Portfolio		
	£000	%	%	£000	%	
UK Equities	560,099	38.8%	40.0%	532,241	38.3%	
Overseas Equities:	880,637	60.9%	59.5%	853,316	61.4%	
North America	333,348	23.0%	18.0%	317,277	22.8%	
Europe	210,820	14.6%	18.0%	205,820	14.8%	
Japan	124,182	8.6%	9.0%	122,762	8.8%	
Pacific Basin	126,345	8.7%	9.0%	122,840	8.8%	
Emerging Markets	85,942	6.0%	5.5%	84,617	6.1%	
Cash	4,817	0.3%	0.5%	4,815	0.3%	
<b>Total</b>	<b>1,445,553</b>			<b>1,390,372</b>		

26. The table below summarises transactions during the quarter.

Sector	Purchases £000	Sales £000	Net Purchases £000
UK Equities	0	0	0
Overseas Equities			
North America	0	0	0
Europe	0	0	0
Japan			0
Pacific Basin			0

Emerging Markets	49,872	49,883	-11
<b>Totals</b>	<b>49,872</b>	<b>49,883</b>	<b>-11</b>

The purchases and sales in the Emerging Markets region represents a consolidation of our previous holdings. We previously invested in both LGIMs World Emerging Markets and Global Emerging Markets funds in the Emerging Markets allocation within our Core Index portfolio. During the last quarter the investment in the Global Emerging Markets fund was transitioned to the World Emerging Markets fund.

### Schroder Investment Management Portfolio

27. The table below summarises the valuation and compares it to Schroders' benchmark. The position at the end of the previous quarter is also shown.

	31 March 2021			31 December 2020		
	Portfolio		B/Mark	Portfolio		
	£000	%	%	£000	%	
UK Equities	902,850	49.1%	49.1%	866,564	50.2%	
Overseas Equities	904,563	49.1%	50.4%	840,427	48.7%	
North America	516,819	28.1%	28.4%	489,608	28.4%	
Europe	127,417	6.9%	8.1%	128,177	7.4%	
Japan	81,501	4.4%	4.6%	80,957	4.7%	
Pacific Basin	56,976	3.1%	2.9%	56,378	3.3%	
Emerging Markets	87,457	4.8%	4.5%	85,307	4.9%	
Global Small Cap	34,393	1.9%	1.9%			
Cash	33,084	1.8%	0.5%	18,726	1.1%	
<b>Total</b>	<b>1,840,497</b>			<b>1,725,717</b>		

28. The benchmark change this quarter is due to the introduction of an allocation to Global Small Cap as agreed at the last committee meeting. The benchmark will change again following a second tranche of investment in this sector in the near future.

29. The table below summarises transactions within the quarter.

Sector	Purchases	Sales	Net Purchases
	£000	£000	£000
UK Equities	87,880	88,865	-985
Overseas Equities			
North America	61,143	58,869	2,274
Europe	31,994	33,315	-1,321
Japan	4,063	3,634	429
Pacific Basin	0	2,150	-2,150
Emerging Markets	0	0	0
Global Small Cap	34,965		34,965
<b>Totals</b>	<b>220,045</b>	<b>186,833</b>	<b>33,212</b>

### LGPS Central

30. The table below summarises the valuation by asset class of investments managed by LGPS Central. The proportional holdings are also shown. However allocation to each LGPS Central fund is at the discretion of the Pension Fund in line with the overall Pension Fund approved asset allocation and as such there is no benchmark for this portfolio.

	31 March 2021		31 December 2020	
	Portfolio		Portfolio	
	£000	%	£000	%
UK Passive	9,576	1%	9,117	1%
Global equity	37,718	5%	35,970	5%
EM equity active	116,098	16%	104,888	15%
Corporate bonds	315,508	44%	328,730	46%
Gilts	205,032	29%	211,206	30%
Private Equity	9,885	1%	9,753	1%
Credit	19,205	3%	9,998	1%
Cash	46	0%	287	0%
<b>Total</b>	<b>713,068</b>		<b>709,949</b>	

31. The table below summarises transactions within the quarter.

Sector	Purchases £000	Sales £000	Net Purchases £000
<b>Bonds</b>			
Gilts	23,716	12,814	10,902
Corporate Bonds	0		0
<b>Equities</b>			
UK	0	0	0
Emerging Markets	10,000		10,000
Global	0		0
<b>Private Equity</b>	132		132
<b>Credit</b>	10,000		10,000
<b>Totals</b>	<b>43,848</b>	<b>12,814</b>	<b>31,034</b>

#### Aberdeen Standard Investments (ASI)

32. The Committee is asked to note that approval was given in the last quarter to the following, after consultation with Members where appropriate, as operational matters falling under the responsibility of the Service Director, Finance, Infrastructure & Improvement exercised by the Senior Accountant (Pensions & Treasury Management):

Date	Property	Transaction
05/01/2021	Kings Stables Road, Edinburgh	Variation of lease
26/01/2021	Land at Dowding Way, Turnbridge Wells Kent	Rent review
28/01/2021	Land at Dowding Way, Turnbridge Wells Kent	Sale of property
24/02/2021	Units 2A and 2B Bagshot Retail Park, Surrey	Deed of Variation of Contract
24/02/2021	Unit C2 Castlewood Business Park, South Normanton	Licence for Alterations
05/03/2021	Ground Floor Office, Castle Link, North Bar, Banbury	Lease extension
17/03/2021	Unit 1 Brooke Park, Handforth	Deed of variation
18/03/2021	Christchurch Industrial Estate, Harrow	Retrospective Licence to Alter
22/03/2021	North Bar Street/Bolton Road, Banbury	Sale of property
22/03/2021	34-36 Bridlesmith Gate, Nottingham	Supplemental Deed of Guarantee
22/03/2021	Land at Carrington Farm, North Road, Tollesbury, Essex	Promotion Agreement

### Specialist Portfolio

33. Below are tables showing the composition and the valuation of the Specialist portfolio at the quarter end and the transactions during the quarter. The table below summarises the valuation at quarter end. The position at the end of the previous quarter is also shown.

	31 March 2021		31 December 2020	
	£000	%	£000	%
Private Equity	233,400	17.4%	226,500	17.6%
Infrastructure	330,100	24.6%	323,500	25.2%
Credit	48,200	3.6%	45,600	3.5%
Property Funds	135,500	10.1%	134,400	10.4%
Aegon DGF	295,300	22.0%	232,600	18.1%
Equity Funds	298,000	22.2%	323,600	25.2%
<b>Total</b>	<b>1,340,500</b>		<b>1,286,200</b>	

34. The table below summarises transactions within the quarter.

Sector	Purchases £000	Sales £000	Net Purchases £000
Private Equity	-1,079	1,848	-2,927
Infrastructure	10,840		10,840
Credit			0
Property Funds	-309	0	-309
Aegon DGF	65,000		65,000
Equity Funds		29,031	-29,031
<b>Totals</b>	<b>74,452</b>	<b>30,879</b>	<b>43,573</b>

35. There were increased investments in listed infrastructure and the Aegon Diversified Growth Fund (DGF) to achieve the strategic asset allocation targets agreed in March. The equity fund sale related to a smaller companies fund which has been reinvested through Schroders into a Global Small Cap strategy.

### Responsible Investment Activity

36. The Pension Fund believes that Responsible Investment is supportive of risk-adjusted returns over the long term. As a long-term investor, the Fund seeks to invest in assets with sustainable business models across all asset classes.

37. During the quarter the Fund's investment managers have continued with their usual stewardship activities through considered voting of shares and engaging with investee company management as part of the investment process. Quarterly reports on Responsible Investment issues have been received from Legal and General, Schroders and LGPS Central. Full reports and other responsible investment information can be found on the Pension Fund website here <https://www.nottspf.org.uk/about-the-fund/responsible-investment>.

38. Hermes EOS has exercised the Fund's voting responsibilities as our Proxy voting service. A quarterly report on voting activity can be found on our website here <https://www.nottspf.org.uk/about-the-fund/investments>.



39. LAPFF (Local Authority Pension Fund Forum) have engaged with a number of companies during the quarter (principally National Grid, BHP, HSBC, Centrica, Compass Group and Heidelberg Cement). More information can be found in their quarterly engagement report which can be accessed on the Fund's (or on LAPFF's) website. An officer attended the LAPFF business meeting on 27<sup>th</sup> January 2021. This was reported to committee in the April 2021 meeting.
40. Responsible investment considerations run through everything done by the Fund and there have been many specific actions taken during the quarter. Officers attended the PLSA (Pensions & Lifetime Savings Association) Investment conference which featured a number of sessions on responsible investment and climate risk. A number of officer meetings have been held to develop the LGPS Central Infrastructure Fund which will include some investment in renewable energy generation. Other meetings and a workshop discussed the development of a Sustainable Equities Fund. Officers attended the All-Party Parliamentary Group (APPG) Inquiry relating to Responsible Investment for a Just Transition. The Climate Strategy was approved by Committee in March. LGPS Central attended the Pension Fund Committee Working Party in January to provide some training on Climate Change Issues.

## **Statutory and Policy Implications**

41. 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**

- 1) It is recommended that Committee approve a reduction in the allocation to the UK to 35% of listed equities.
- 2) That members consider whether there are any actions they require in relation to the issues contained within the report.

**Tamsin Rabbitts**

**Senior Accountant – Pensions & Treasury Management**

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## **Constitutional Comments**

42. This is an updating information report and the Nottinghamshire Pension Fund Committee is the correct body for considering that information and any further action which members may wish to take in light of that information.

## **Financial Comments (TMR 24/05/2021)**

43. There are no direct financial implications arising from this report.