Open Agenda

Environment and Community Engagement Scrutiny Commission

Thursday 12 January 2023
7.00 pm
Ground Floor Meeting Room G02C - 160 Tooley Street, London SE1 2QH

Supplemental Agenda

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Item No.	Title	Page No.
6.	**Pension Fund divestment progress** Officers have provided a report which they will present on Pension Fund divestment progress and strategy in light of the 2016 decision to divest and more recent commitment to 'Make the council's pension fund zero carbon by 2030'. The following are enclosed: • Summary of Carbon Footprint journey • Carbon reduction graph with notes • Investment strategy statement • Southwark Pension Fund Investment Strategy to Achieve Net Zero Carbon Exposure by 2030	1 - 39
10.	**3ci** Steve Turner, Director, 3Ci will present.	40 - 57

Contact

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Date: 6 January 2023

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The following 3Ci reports are enclosed:

- Our Pathway Towards Net Zero Investment and Growth
- Unlock Private Investment for Net Zero – A Practical Guide for Local Authorities

More can be found here: 3Ci.org.uk

Southwark Pension Fund: the Journey to Net Zero Carbon Emissions

Southwark Pension Fund was one of the first London funds to commit publicly to reducing its exposure to fossil fuels over time. It is now one of London's most progressive funds, leading the way towards net zero carbon emissions in its investments.

Southwark Pension Fund is one of 89 local authority funds across the country, 32 of which sit within Greater London. There has been a political drive across a number of years to introduce greater pooling across the industry, where a number of funds will centrally group their funds in order to achieve greater efficiencies. Southwark sits as part of the London Collective Investment Vehicle (London CIV). Although pension funds have the option to invest with the pool, responsibility of decision-making sits with the individual funds and should be based within their investment strategy and policies. Each fund is responsible for its own strategy and its ability to cultivate sufficient assets to meet its primary responsibility of being able to pay pension payments as they fall due. Funds are permitted to have secondary goals such as investing in such a way to have positive environmental impact, provided these secondary goals do not negatively infringe on their primary responsibility.

Early Days of the Southwark Strategy

Historically, the Pensions Advisory Panel (PAP) have been mindful of wider council commitments to meet carbon neutrality by 2030. Following a staff survey in 2015, it was ascertained that one of many member concerns was the environmental impact of the pension fund's investments. This formed the basis for the decision to update the investment strategy to align the pension fund with this wider target of 2030. Following the assessment of a clear investment case, a commitment was made in December 2016 to reduce the Fund's exposure to fossil fuels. In March 2017, this commitment was incorporated into the Fund's Investment Strategy Statement and a revised investment strategy was launched: 'Moving toward a reduced fossil fuel exposure" which set out actions that would be taken in the short, medium and long term. It outlined the objective to eliminate exposure to fossil fuels over time, with the fund reducing exposure to fossil fuel companies in a risk-controlled way. The investment strategy statement outlines the principles within which the investment strategy can be implemented. This includes details of how the fund is structured in order to maintain diversification in assets to mitigate investment risks and protect and maintain fund value, regardless of market conditions, in order to satisfy its primary objective of meeting pensions payments into the long-term. As part of this strategy, the fund committed to ensuring that the whole of the fund was being considered, rather than selective categories and to establish best practice processes to monitor and measure the carbon footprint of the fund.

At the time of the 2017 statement, there was acute awareness of the limited number of low-to-no carbon products available in the investment market and the impact this may have on the speed with which carbon reduction could be achieved. As focus on pooling of funds grew, it became increasingly apparent that the future direction of travel for pooling arrangements and subsumption of individual funds by pools could potentially compromise the independent strategies of funds to achieve their own carbon goals. The fund continues to monitor the product opportunities available through the London CIV, but products that match the fund's urgency in terms of carbon targets are yet to be found.

Carbon Emission Measurement of a Diversified Fund

One of the key areas of focus in the early stages of the fund's journey to net zero was to find a reliable method of measuring the entire fund's carbon emissions, rather than being selective in its approach to measuring asset classes. The fund measures the carbon footprint of a number of its assets through a third-party provider, in order to ensure independence in sourcing the data and to mitigate potential optimism bias that may be present were investment managers to offer this information themselves. Officers of the fund are in frequent communication with this third-party provider to ensure accuracy of output and clarity in methodology.

Any assets which have emissions which cannot be accurately measured are given proxy emissions values using available information. It is important to note that officers of the fund are acting with prudence where assessing proxy values. Proxies will only be reduced where there is clear information indicating a reduction, in order to ensure the fund is not overstating its progress. There are ongoing communications between the fund and its external fund managers with a view to obtaining comprehensive information that would reduce or eliminate the need for proxies.

A further level of prudence is added through measurement of the fund's net zero assets. The fund has holdings in a number of net-zero asset classes, primarily through sustainable infrastructure. However, the magnitude of their offsetting cannot be accurately ascertained at this time. In order to support the reliability of total fund measurement, these assets are classed as zero carbon, rather than reducing the overall carbon emissions of the fund. Progress towards accurate measurement of this offsetting is ongoing and officers of the fund continue to engage with fund managers to achieve this.

March 2017 to December 2021: Carbon Footprint Highlights
Between 2017 and 2021, the fund focused on the short-term goals of the 2017 investment strategy statement. This included movement of passive equity funds into low carbon specific passive equity funds, removal of carbon investments from active equity managers and investment into new zero-carbon infrastructure products, such as windfarms. Across this period, the fund continued to lobby the market for new green products and standardisation of measurement processes of the carbon footprint to support benchmarking across the sector.

As a result between September 2017 and March 2021, the Fund's carbon footprint reduced by 38.3%, whilst maintaining strong investment performance. This demonstrated that investment performance can be maintained alongside reducing carbon exposure. Given this reassurance, the decision was made to move to the next stage, and in December 2021 the investment strategy was relaunched as an 'Investment Strategy to Achieve Net Carbon Exposure by 2030'. This set out updated actions to be taken in the short, medium and long term.

The net zero carbon commitment by 2030 by Southwark Council has set the Fund ahead of the majority of LGPS funds. Although reduction in carbon exposure in the Fund's investments takes the forefront of the fund's goals, the fund is approaching the task cautiously and in a way that will maintain appropriate returns on investment while managing risk. Not only will this ensure contributions remain affordable for both the Council and members of the fund, it is also key to meeting the fund's primary purpose which is to continue to be able to meet payments to pensioners as they fall due.

December 2021 onwards: a Continued Journey
Since the release of the initial strategy in 2017, the fund has been monitoring the carbon footprint of the entire investment portfolio and has achieved a reduction of 55.5% in carbon emissions at the end of September 2022, compared with those at March 2017. This has been achieved through changes to the 'low-hanging fruit' of the fund; the areas that can be easily affected to substantially reduce the overall footprint such as the movement of passive equities into alternative low-carbon equity funds. Changes past this point will require the fund to work through a number of iterations of investments to 2030 in order to achieve its net zero ambitions and progress is likely to slow in its pace.

Since 2017, the fund has moved around £1,162million of cash through capital drawdowns, transfers and divestments in aid of reaching net zero, with an additional £565million expected by the end of 2023-24, for a total movement of £1,726million. This total movement

represents 86.6% of the fund's total value as at 30th September 2022. These movements are summarised by asset class below.

Asset Group	Commitment/ Market Value (£m)	2017/18	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	Total (£m)
		£m	£m	£m	£m	£m	£m	£m	
Active Equity	245.7	2			4				6
Passive Equity	742.4		300	130		458	155	*155*	1,198
Absolute Return Bonds	130.8							*130.8*	130.8
Diversified Growth Fund	174.9						53.2	*121.7*	174.9
ESG Allocation - Alternatives	143.9					81.5	8.3		89.8
Sustainable Infrastructure	153.0			32	10.6	42.4	41.9		126.9
Total Movement		2	300	162	14.6	581.9	258.4	407.5	**1,726.4**

Looking to the Future

The next major step on the journey to net zero is a refreshed Investment Strategy as part of the fund's triennial valuation cycle. This revised investment strategy was approved by the PAP in December 2022 and the changes will be incorporated into an updated Investment Strategy Statement which will be tabled at the March 2023 PAP meeting for agreement.

A key change in this update is a revised strategic asset allocation. This allocation sets out what the optimum structure of the fund is in terms of investment in different asset classes such as equities and property. The central change for this iteration of the strategy is reallocation of diversified growth funds and absolute return bonds, which collectively represent 15% of the overall fund. Both of these asset classes are in the 'legacy' category of the fund's carbon categorisations and are historically some of the worst performers in the fund for carbon emissions. Of this 15%, 5% will be reallocated to the fund's existing allocation to low-carbon equity funds and 10% to a suitable low-carbon multi-asset credit fund, once available. Full divestment from the diversified growth fund is anticipated to occur across 2023/24 and the selection process for the new product is in early stages.

The fund also intends to transfer current holdings within the LGIM Low Carbon equity fund into an alternative equity fund that holds stronger carbon emission credentials. Given that the total value of the holdings in this equity fund currently sits at £310million, it is anticipated this will have a substantial positive impact on the fund's carbon reduction. This is expected to take place in two tranches, in order to monitor the impact this movement has on fund performance. The first tranche should complete by June 2023 and the second by the end of the financial year.

As the fund grows in terms of value and number of assets, it also looks to expand on its staff resources in order to manage the increased workload as a result. Not only will this help the fund achieve greater efficiencies, it further signifies Southwark Council's dedication to reaching net zero.

Obstacles to Achievement of Net Zero

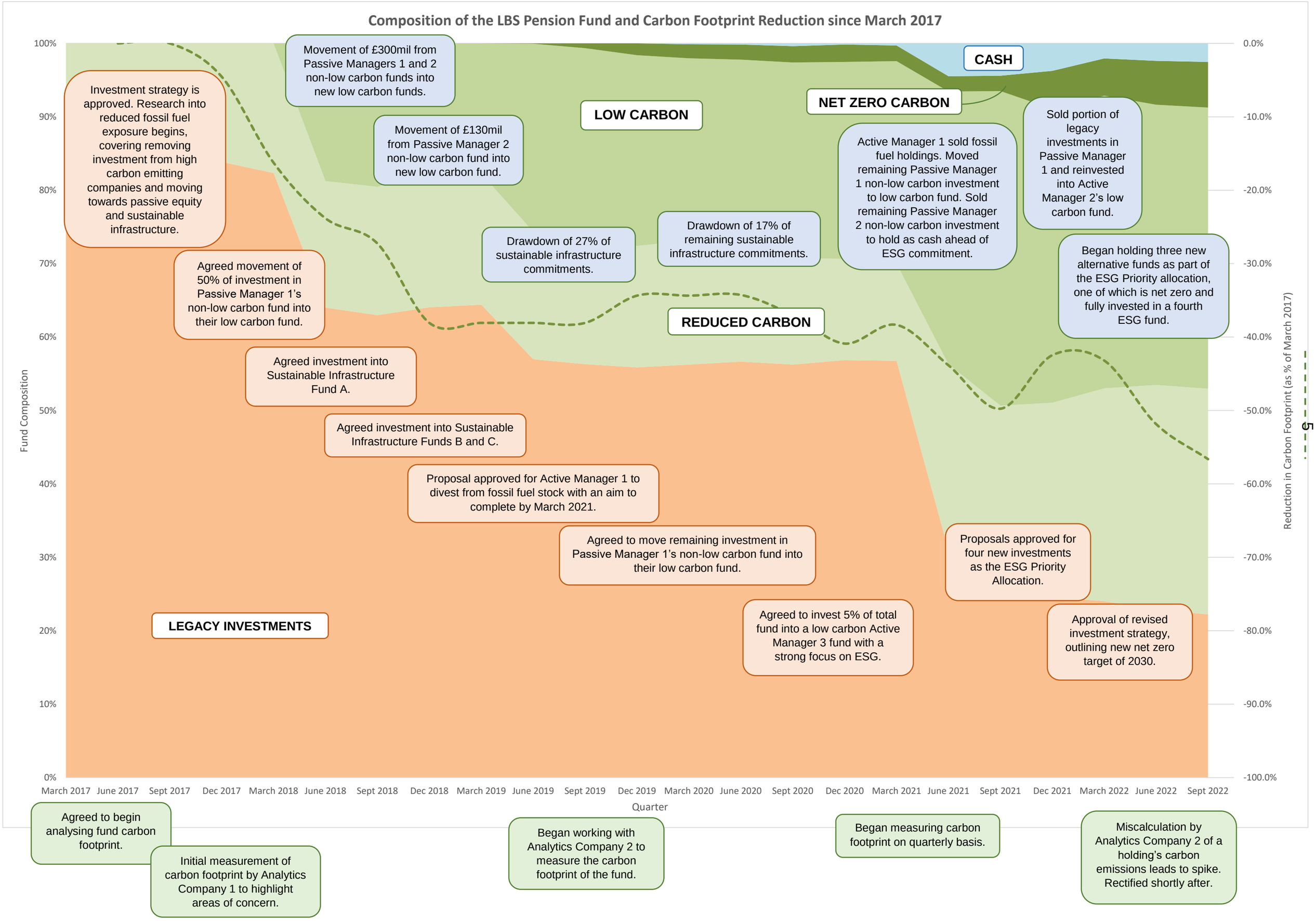
The fundamental limitation to the fund achieving net zero by 2030 is that its primary responsibility is to ensure it maintains an adequate level of liquidity and its ability to meet pension payments over time. Although the fund has seen positive performance returns in recent years, moving into greener investment has not come without financial implications in the short term. The exclusion of investments in companies exposed to fossil fuel risks has

reduced short term returns for the Fund, especially given this is a sector that has achieved strong returns in the past year and continues to do so.

Reduced investment performance could also have an impact on scheme employers. As part of the triennial actuarial valuation, employer contribution rates are calculated based on the assets of the fund and its ability to meet the expected pensions payments. Reduced investment returns will require scheme employers to pay higher contribution rates to maintain adequate funding. If reduced performance is seen across the LGPS as a whole, this may also lead to increased employee contribution rates.

Specific market risks and factors need to be addressed through the fund's investment strategy, with a prominent risk being that of inflation. Unfortunately, a number of the assets that can be employed by the fund to mitigate this risk are those that historically show poor performance for carbon emissions. A prime example of this is index-linked gilts, which currently represent 10% of the fund. Until there is a suitable alternative in the market, the fund will need to retain some of its assets which show higher carbon emissions.

The market for low-to-no carbon products is an obstacle within itself. The fund's progress to net zero can only move as quickly as the market itself does. Investment can only be made in products that demonstrate strong carbon reduction credentials and a strong investment case that meets the Fund's risk and return requirements. This limits the products available in an already scarce market. This issue is compounded by poor outcomes from the latest COP events and increased competition amongst investors to gain access to the few suitable products currently in the market.


Composition of the LBS Pension Fund and Carbon Footprint Reduction since March 2017
Fund Composition
Reduction in Carbon Footprint (as % of March 2017)
Quarter
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
0.0%
-10.0%
-20.0%
-30.0%
-40.0%
-50.0%
-60.0%
-70.0%
-80.0%
-90.0%
-100.0%
March 2017
June 2017
Sept 2017
Dec 2017
March 2018
June 2018
Sept 2018
Dec 2018
March 2019
June 2019
Sept 2019
Dec 2019
March 2020
June 2020
Sept 2020
Dec 2020
March 2021
June 2021
Sept 2021
Dec 2021
March 2022
June 2022
Sept 2022
CASH
NET ZERO CARBON
LOW CARBON
REDUCED CARBON
LEGACY INVESTMENTS
Investment strategy is approved. Research into reduced fossil fuel exposure begins, covering removing investment from high carbon emitting companies and moving towards passive equity and sustainable infrastructure.
Movement of £300mil from Passive Managers 1 and 2 non-low carbon funds into new low carbon funds.
Movement of £130mil from Passive Manager 2 non-low carbon fund into new low carbon fund.
Drawdown of 27% of sustainable infrastructure commitments.
Drawdown of 17% of remaining sustainable infrastructure commitments.
Active Manager 1 sold fossil fuel holdings. Moved remaining Passive Manager 1 non-low carbon investment to low carbon fund. Sold remaining Passive Manager 2 non-low carbon investment to hold as cash ahead of ESG commitment.
Sold portion of legacy investments in Passive Manager 1 and reinvested into Active Manager 2's low carbon fund.
Began holding three new alternative funds as part of the ESG Priority allocation, one of which is net zero and fully invested in a fourth ESG fund.
Agreed movement of 50% of investment in Passive Manager 1's non-low carbon fund into their low carbon fund.
Agreed investment into Sustainable Infrastructure Fund A.
Agreed investment into Sustainable Infrastructure Funds B and C.
Proposal approved for Active Manager 1 to divest from fossil fuel stock with an aim to complete by March 2021.
Agreed to move remaining investment in Passive Manager 1's non-low carbon fund into their low carbon fund.
Agreed to invest 5% of total fund into a low carbon Active Manager 3 fund with a strong focus on ESG.
Proposals approved for four new investments as the ESG Priority Allocation.
Approval of revised investment strategy, outlining new net zero target of 2030.
Agreed to begin analysing fund carbon footprint.
Initial measurement of carbon footprint by Analytics Company 1 to highlight areas of concern.
Began working with Analytics Company 2 to measure the carbon footprint of the fund.
Began measuring carbon footprint on quarterly basis.
Miscalculation by Analytics Company 2 of a holding's carbon emissions leads to spike. Rectified shortly after.

Southwark Council
southwark.gov.uk

Investment Strategy Statement

London Borough of Southwark Pension Fund

1. Introduction

The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 Regulation 7 requires administering authorities to formulate and to publish a statement of their investment strategy (ISS), in accordance with guidance issued from time to time by the Secretary of State.

This ISS has been designed to be a living document and is an important governance tool for the London Borough of Southwark Pension Fund (the Fund). This document sets out the investment strategy of the Fund, provides transparency in relation to how the Fund investments are managed, outlines the Fund's approach to managing risk, how environmental, social and governance issues are taken into account and the approach with regard to pooling of investments. This document replaces the Fund's Statement of Investment Principles.

This statement will be reviewed by the Pensions Advisory Panel annually, or more frequently should any significant change occur, with any resulting recommendations made to the Strategic Director of Finance and Governance.

Southwark Council is the administering authority for the Southwark Local Government Pension Fund and bears ultimate responsibility for the funding of member pensions. The management and strategic direction of the Fund, whilst separate from the council, will always take into consideration the council's long term objectives.

In this regard the Fund's investment principles are aligned with the council's values as defined in the Borough Plan, in particular, the value of "spending money as if it were from our own pocket."

https://moderngov.southwark.gov.uk/documents/s92006/Appendix%20A%20Southwarks%20Borough%20Plan%202020.pdf

The pension fund has its own climate strategy and goals which are consistent with council targets to become carbon neutral by 2030. This is ahead of the UK government's commitment to achieve net zero by 2050.

The Fund is fully committed to collaboration with other local authority partners and in 2015 invested in the London Collective Investment Vehicle (CIV). The London CIV is a collaborative venture between local authorities to deliver benefits of investment scale and efficiency to the

participating Funds. The Fund will continue to support the development of the London CIV as an investment vehicle.

2. Investment objectives and principles

The Fund is an open, defined-benefit pension fund as part of the national Local Government Pension Scheme. The Scheme rules are determined at national level and cover many elements of the Fund, such as employee benefits and employee contributions. The nature of the Fund and scheme design means that payment of pensions will extend over the very long term.

In setting the investment strategy the Fund seeks to balance twin objectives: first, to achieve sufficient long-term returns for the Fund to be affordable and second, to keep the employers' contribution rate as stable as possible.

The Fund will seek to operate a long term, sustainable strategy; one which does not rely upon the pursuit of short term returns or adherence to asset management trends, but utilises a well structured asset and fund manager investment allocation to target long term socially responsible investment performance. The Fund's uncomplicated investment structure provides significant flexibility and adaptability if required.

To achieve the twin objectives, the Fund needs to invest in a diverse range of assets which provide higher returns relative to the growth of pension liabilities whilst taking account of the volatility inherent in investment markets. The principles set out below provide high level guidance on how the Fund seeks to meet these objectives and manage the associated risks.

Governance

- The Fund seeks at all times to adopt best practice governance standards within a structured framework, compliant with regulatory requirements and with expert independent advice taken throughout the decision making process.
- The Fund will operate with transparency and be accountable for decision making to stakeholders and scrutiny bodies.
- The Fund will ensure that officers and members of the Pensions Advisory Panel and Local Pension Board have the necessary skills, expertise and resources to ensure effective and evidence based decision making regarding the Fund's investment strategy.

Investment structure and risk management

- The Fund is a long term investor and as such the Fund invests in a wide range of investment assets, which may be volatile (such as equity) or illiquid (such as property), but that over the long term can generate a sufficient return to at least meet the Fund's pension obligations.
- The Fund operates an evidence and research based approach to investment; continually utilising research and guidance from investment professionals and peers, and seeking continual development in the understanding of investment.
- The Fund recognises the importance of having the right asset allocation, but also the value of developing the most appropriate structure and appointing suitable investment managers. The Fund will take account of market movements, cycles and the economic

background in decision making, but will avoid making decisions on a purely short term basis.

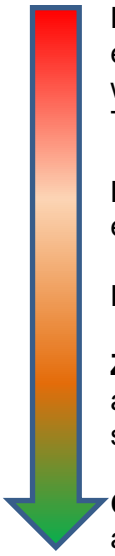
- The Fund will be comprehensive in the consideration of risks; the Fund will base assessments of risk on future pension liabilities and contributions, will consider financial and non-financial risks, diversify investment assets in an appropriate manner, but also recognise the limits of that diversification. As a long term investor the Fund understands that investment success depends significantly on the sustainable growth of the economy.
- The Fund will seek the most efficient and cost-effective solutions to achieving the Fund's objectives. This may involve active management and other services where additional costs are justified. Fees will always be considered in the context of overall performance and it is recognised that higher performance may be associated with higher fees.
- The Fund is a shareholder in the London CIV, with the Fund making regular contributions to the London CIV to assist in the development and expansion of the collaborative venture. Any future investments within the London CIV will be dependent upon the satisfactory completion of detailed due diligence and review to the same high standard that would be undertaken outside the investment pool.

Responsible investment and stewardship

- The Fund is a responsible investor; holding the belief that integrating responsible investment factors such as ESG in the investment process will protect, if not generate better returns over the long term.
- The Fund seeks to integrate responsible investment factors into the investment process across all asset classes.
- The Fund is prepared to be innovative in its investment strategy in order to cultivate positive social impact, within a framework of prudence and fiduciary duty.
- The Fund will proactively exercise responsible stewardship of assets held and act as a responsible voice in the broader investment community through platforms such as the Local Authority Pension Fund Forum.
- The Fund will collaborate with others whenever possible to share ideas and best practice, and to improve effectiveness and to reduce costs.
- The Fund considers the impacts and opportunities provided by climate change on both a Fund and wider social level, and so holds a commitment to meeting net zero carbon emissions from pension fund investment by 2030 with no direct investment in companies exposed to fossil fuels.

Categorisation of Investments

There is currently no standardised way of measuring the relative performance of different funds' carbon profiles; however, Southwark continues to work on its carbon footprint and investment classifications (see key below) to illustrate the progress being made.



NON LOW CARBON: Investment products that are not actively targeting reduced carbon emissions. Some of these may potentially have exposure to fossil fuels; however we are working to understand the extent of this and will address this in our strategy going forwards. The Fund intends to make no new investments in such products.

REDUCED CARBON: Investments either in property or in funds with specific oil and gas exclusions.

LOW CARBON: Funds specifically set up as 'low carbon' funds.

ZERO CARBON: Investments in vehicles that produce zero carbon or in some cases have a measurable offsetting impact on carbon emissions. Currently this category contains sustainable infrastructure and timberland products.

CASH: Held in the pension fund, usually pending anticipated drawdown requests or in advance of an acquisition.

The Fund will at all times monitor investments that are specifically reduced, low and zero carbon to ensure the Fund progresses towards the stated objectives of this strategy.

Within the context of achieving sustainable long-term returns, the Fund will always seek, as part of any reallocation of assets, to achieve a lower carbon footprint following the reallocation. Every new investment made will endeavour to be lower carbon than the one it is replacing.

The chart in Appendix B shows how the investment strategy has been implemented to date, with progressively greater proportions of the overall Fund invested in "greener" funds.

3. Investment strategy and the process for ensuring suitability of investments

The Fund's asset strategy, along with an overview of the role each asset plays is set out in the table below:

Asset class	Target Allocation %	Investment Style %	Maximum Allocation %	Role (s) within the strategy	Carbon Classification
Equity	45.0	Passive 30.0	60.0	Expected long term growth in capital and income in excess of inflation over the long term.	Low Carbon
		Active - Direct 10.0			Reduced Carbon
		Active – Indirect 5.0			Low Carbon
Diversified Growth	10.0	Active 10.0	20.0	Primarily for diversification from equities. Equity like returns over time with a lower level of risk.	Non low carbon
Absolute Return Fixed Income	5.0	Active 5.0	10.0	Diversified approach to fixed income investing which is not solely dependent on the direction of interest rates.	Non low carbon
Index Linked Gilts	10.0	Passive 10.0	40.0	Low risk (relative to the liabilities) asset that provides inflation linked income and protection from falling interest rates.	Non low carbon
Property	20.0	Direct 14.0	30.0	Provides diversification from equities and fixed income. Generates investment income and provides some inflation protection.	Reduced Carbon
		Pooled Fund 6.0			Reduced Carbon

Sustainable Infrastructure	5.0	Limited Partnership 5.0	10.0	Asset class provides additional diversification from traditional asset classes. Generates sustainable, reliable income with significant linkage to inflation. Provides risk mitigation from declining fossil fuel usage.	Zero carbon
Bereavement Services	5.0	Limited partnership 5.0	10.0	ESG priority allocation. Focus on investments with strong ESG and, in particular, low carbon credentials.	Reduced
Timberland					Zero
Private Equity					Reduced

The above table sets out the Fund's asset allocation strategy with a target allocation to each asset class. If the actual asset allocation as at a reporting quarter end moves outside a target range for a particular asset class, (plus or minus 5% of total investment assets) the Strategic Director of Finance and Governance will review the portfolio(s) and prevailing market conditions to determine if a corrective rebalancing action is required. A breach of the target range will not automatically trigger a portfolio rebalance.

Under Regulation 7 of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016, the Fund is required to set maximum investment limits pertaining to different asset classes so that actual allocation to those asset classes will not breach this maximum limit. The limits as applied to the Fund are set out in the above table.

Appendix A shows the Fund's current investment manager appointments and mandates.

The Fund's asset allocation is reviewed on an ongoing basis and undergoes a triennial strategy review as part of the actuarial valuation process. The triennial review, which reflects updated actuarial and capital market assumptions, looks at both qualitative and quantitative analysis, covering:

- The required level of return that will mean the Fund is able to meet its future benefit obligations as they fall due.
- The level of risk that the Fund can tolerate in absolute terms, and in relation to its funding level and associated surplus/deficit.
- An analysis of the order of magnitude of the various risks facing the Fund, so that the Fund can focus upon the most significant risks.
- The desire for diversification across asset class, region, sector, and type of security.

4. Risk measurement and management

The risks inherent within the Fund are assessed both qualitatively and quantitatively as part of regular investment strategy reviews by the Strategic Director of Finance and Governance and the Pensions Advisory Panel. The Fund uses specialist external investment advisers under contract, to support these reviews and on an ongoing basis. The Fund highly values the use of specialist support in the management of performance and risk.

The table below, based on the 31 March 2019 Actuarial Valuation results and estimates, shows how a range of events could impact on the Fund:

Event	**Event movement**	**Impact on the Fund**
Fall in equity markets	25% fall in equities	£223m
Rise in inflation	1% increase in inflation	£314m
Fall in interest rates	1% fall in interest rates	£314m
Underperformance by the active managers	3% collective underperformance	£31m

The Fund's overall investment strategy is designed to mitigate much of the underlying risk through the holding of a variety of different, diverse asset classes (e.g. long term directly held property investments).

Equity risk

The largest asset risk to the Fund is in relation to its equity holdings. Should equity markets deteriorate significantly this will have a large negative impact on the Fund's assets. The Fund invests in equities in order to provide the necessary long term expected returns to help ensure that the Fund remains affordable. The Fund believes that the extra returns that are expected to be generated by equities compensate for the level of risk equities bring to the Fund. However, the Fund is aware of the need for diversification in growth assets, and the Fund's strategy reflects this via allocations to absolute return investment mandates (with an asymmetric profile) and property (with a lower correlation to equity).

Inflation

CPI inflation will increase the value of pension benefits accrued by active and deferred members of the Fund as well as increasing the value of pensions in payment. The Fund has an allocation to index linked gilts for explicit inflation protection and other investment assets, such as property and equities, in the expectation that these will achieve returns in excess of inflation over time.

Active manager risk

Active investment managers are appointed to manage a portion of the Fund's assets. This brings with it the risk of underperformance relative to the market but also brings the chance of additional returns and diversification. The additional risk is small relative to other risks. Extensive due diligence is undertaken before managers are selected and investment managers are also monitored regularly by Fund officers, the Pensions Advisory Panel, and by the Fund's investment advisors.

Liquidity risk

The Fund recognises that there is liquidity risk in holding assets that are not readily marketable and realisable. Given the long term investment horizon and the potential for an illiquidity premium in investment returns, the degree of liquidity risk within the portfolio is considered as acceptable. The Fund has a large allocation to property and is building an exposure to sustainable infrastructure, but the majority of the Fund's assets are realisable at short notice.

The table below sets out a summarised cash flow position of the Fund over the last five financial years.

	2016-17 £000	**2017-18 £000**	**2018-19 £000**	**2019-20 £000**	**2020-21 £000**
Contributions and Transfers In	55,789	54,711	58,891	65,787	69,712
Benefits and Transfers Out	(60,269)	(63,406)	(71,384)	(71,384)	(67,580)
Investment Income	14,324	15,432	15,287)	15,287	12,636

	2016-17 £000	2017-18 £000	2018-19 £000	2019-20 £000	2020-21 £000
Net Position	**9,844**	**10,054**	**10,917**	**9,690**	**14,768**

The Fund is currently cash flow positive; in that the sum of contributions received and investment income is greater than the benefits paid out to pensioners. During 2020-21 the Fund received £14.8m more in contributions and investment income than was paid out in benefits. As such the Fund is not currently exposed to unplanned and inefficient divestment of assets.

Exchange rate risk

This risk arises from investing in unhedged overseas (non GBP denominated) assets, with all pension benefits due to be paid in sterling. As a long term investor the Fund takes the view that currency volatility can be tolerated. Sterling has for many years been a depreciating currency and the Fund has benefitted significantly in return terms from not hedging this risk. The Fund's portfolio is well diversified across asset classes, geography and investment managers.

Demographic risks

The Fund is subject to a range of demographic risks, but with particular importance to the investment strategy is the possibility of a maturing Fund membership profile. This would involve a change in the ratio between active members contributing into the Fund and pensioner members drawing pension benefits from the Fund. The more mature a pension fund, the more likely it is that disinvestments would need to be made to pay benefits. The Fund is not in that situation at present as income from contributions and investments is greater than benefit payments. However, this situation is monitored regularly and formally as part of the actuarial valuation and strategy review.

Environmental, social and corporate governance policy

The Fund is a long term investor that aims to deliver a truly sustainable pension fund; ensuring that it is affordable, delivers financially to meet the objectives of the Fund employers, and is invested responsibly.

The fiduciary duty of the Fund is to act in the best long term interests of Fund members. To do so properly requires the Fund to recognise that environmental, social and governance issues can impact on the Fund's financial performance and that they should be taken into account in funding and investment strategies, and throughout the funding and investment decision making process.

The Fund will seek to incorporate ESG considerations at all stages in the investment process; from the overall asset allocation, to individual investment selections, and continued engagement and responsible stewardship of Fund assets.

The responsible investment objectives of the Fund are promoted through membership of the Local Authority Pension Fund Forum (LAPFF). As a LAPFF member the Fund allies itself with 89 other shareholders with combined assets of over £300 billion to influence key areas of responsible investment interest.

Fund engagement is crucial in relation to improving standards of corporate governance, which over the long term is expected to enhance investment returns. Details of the Fund's approach are set out in section 6 as well as the approach for the implementation of moving towards a zero carbon commitment as Appendix D.

The Fund's key responsible investment principles are set out below:

- Apply long term thinking to deliver long term sustainable returns.
- Seek sustainable returns from well governed and sustainable assets.
- Apply a robust approach to effective stewardship.
- Engagement through voting, meetings, and the LAPFF is a valuable tool to influence organisations in areas of responsible investment interest.
- Ensure that responsible investment is a core competency and skill to support decision making.
- Seek to innovate, demonstrate and promote responsible investment leadership and ESG best practice.
- Apply evidence based decision making in the implementation of responsible investment.
- Achieve improvements in ESG through effective partnerships with the London CIV and LAPFF.
- Share ideas and best practice to achieve wider and more valuable responsible investment outcomes.
- Be transparent and accountable in all Fund activities.
- Consider the costs of responsible investment decisions alongside fiduciary responsibilities.
- To continue with a structured, measured process of reducing with an aim of eliminating investments in fossil fuels.

Environmental, social and governance risks

The Fund may consider investments that have an explicit focus on delivering wider social and environmental impacts provided there is no risk of significant financial detriment to the Fund.

The Fund recognises the growing financial risks associated with investment in traditional energy sources and is fully committed to the achievement of carbon neutrality. The Fund commits to transferring any current investments in these traditional energy sources in a way that is both structured and affordable and also meets the Fund's fiduciary duties.

The Fund is committed to a process to achieve a neutral carbon footprint by 2030. This will be accomplished through a phased divestment and transfer of assets into reduced, low and zero carbon products.

Appendix D outlines the approach by which the Fund will achieve this objective, how the risks and other considerations associated with such a commitment will be managed and how the divestment will be incorporated into the asset allocation strategy for the Fund.

5. Approach to asset pooling

The Fund is a shareholder of the London Collective Investment Vehicle (CIV). The London CIV was created in 2015 and continues to progress the opening of a range of sub-funds for potential investment. As part of any future changes to investment strategy, the Fund will look first to the availability of appropriate investment products within the London CIV.

The transition of any assets into the pool will follow the normal due diligence process with consideration of: transition costs, fit with overall strategy, fees (direct and indirect), reporting arrangements, ESG requirements and, most importantly, expectations for future performance.

The Fund currently pays a contribution to London CIV for passive investments. This amounts to approximately £50,000 per annum. This fee arose from collective fee arrangements with the CIV, although these are not assets under management of the London CIV (value as at 30 June 2021 £1.07 billion, approximately 55% of the Fund).

The Fund has a target allocation of 20% of the assets to illiquid property and the cost of exiting these strategies early in favour of a CIV alternative would have a significant negative financial impact on the Fund.

6. Policy of the exercise of rights (including voting rights) attaching to investments

The Fund follows the principles of the UK Stewardship Code and exercises the voting rights attached to its investments wherever it is possible and cost effective to do so.

The aim is to promote and support good corporate governance principles and best practice. Voting rights should be exercised in accordance with the best financial interests of both the beneficiaries and contributors to the Fund. Environmental, social and ethical considerations may be taken into account when exercising votes where this acts in these parties' best interests.

Fund managers have been instructed to vote in accordance with their house policies and practices, whilst also taking into account the Combined Code on Corporate Governance. Where practical, managers should vote in line with the council's priority themes.

Fund managers report in advance of all voting rights they intend to exercise on behalf of the Fund. They provide details of their house view and on how they intend to vote. They ensure that this is consistent with the council's key themes and also with the LAPFF principles.
Fund managers' views are compared with the voting recommendations of LAPFF. Where the fund managers' house views are not consistent with those of LAPFF, the fund manager is instructed by the Fund to vote in line with the recommendations of the LAPFF.

Fund managers provide a quarterly report on corporate governance activity. This lists all votes which have been exercised and all engagement with companies which has taken place. It allows for checks to be carried out in order to ensure all the Fund's voting rights have been exercised in accordance with policy.

Myners Principles

The Government introduced a code in October 2001 based on the results of HM Treasury's review of institutional investment in the UK, carried out by Paul Myners. This code set out ten principles that were intended to improve the investment management of pension funds. These were updated in October 2008 and previously LGPS administering authorities were required to prepare, publish and maintain statements of compliance against a set of six principles within the Statement of Investment Principles. Although not specifically required by the Regulations the Fund sees the Myners Principles as a relevant governance tool and will continue to report on compliance.

The Fund is fully compliant with the six principles and Appendix C sets out the compliance statement.

Advice Taken

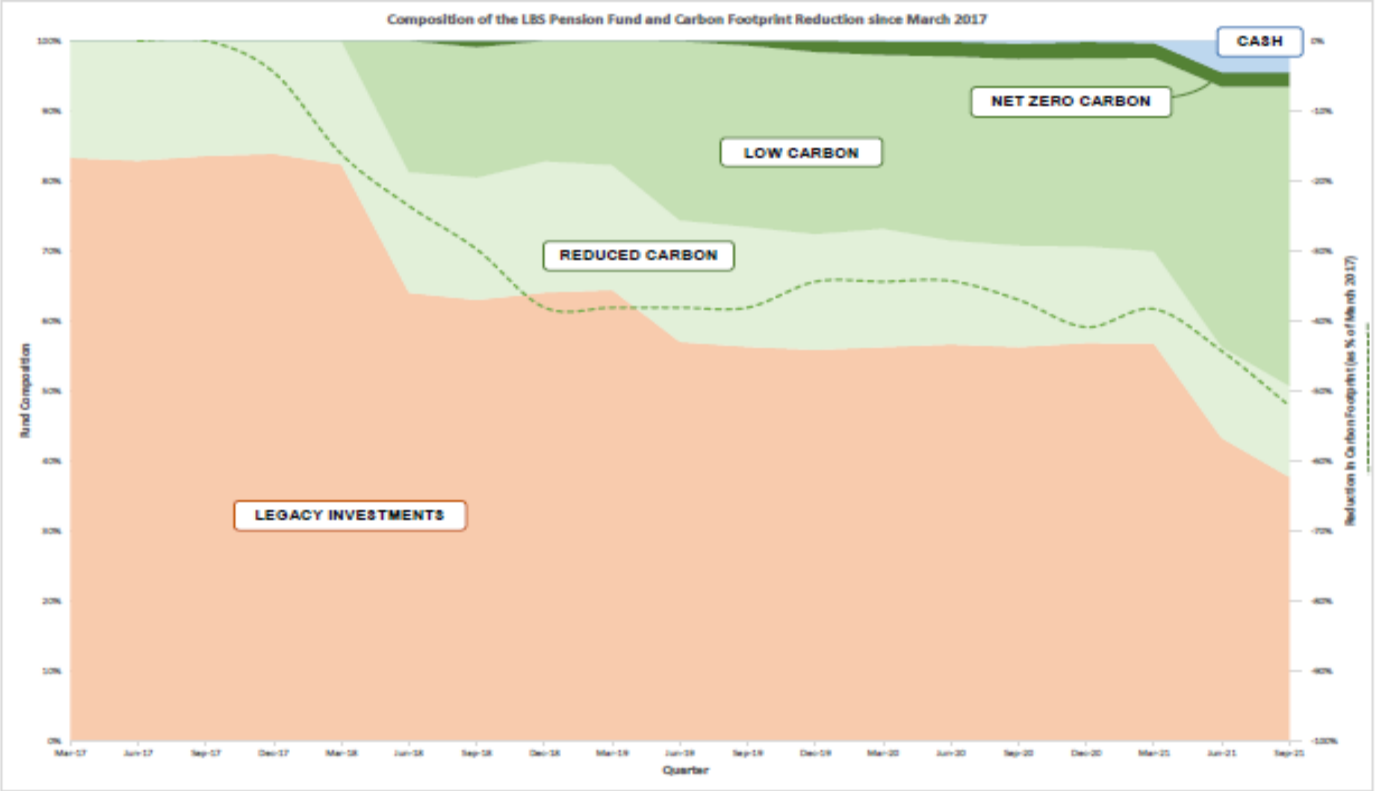
In creating this statement, the Fund has taken advice from its investment consultant, independent adviser and has sought the views of the Local Pension Board. Also, in relation to each of the constituent parts, such as the asset allocation and risk mitigation, advice has been taken from its investment consultant and scheme actuary Aon.

Appendix A – Current investment managers and mandates.

Manager	Mandate	Benchmark	Benchmark Weight (%)	Outperformance target (% p.a.)	Carbon Classification
BlackRock	Low carbon passive Global Equities	MSCI World Low Carbon Target Reduced Fossil Fuel Select Net Index	15.0	-	Low Carbon
BlackRock	Index Linked Gilts	FTSE UK Gilts Index-Linked over 5 Years Index	5.0	-	Non low carbon
BlackRock	Dynamic Diversified Growth Fund	LIBOR	10.0	+3.0% net of fees	Non low carbon
BlackRock	Absolute Return Bonds	LIBOR	5.0	+4.0% net of fees	Non low carbon
BlackRock	Sustainable Infrastructure	10% p.a. absolute return	1.5	-	Zero carbon
Legal & General	Low carbon passive Global Equities	MSCI World Low Carbon Target	15.0	-	Low carbon
Legal & General	Index Linked Gilts	FTSE Index-Linked Over 5 Years	5.0	-	Non low carbon
Newton	Global Equity	FTSE All World	10.0	+3.0% net of fees	Reduced carbon
Comgest	Active Emerging Market Equities	MSCI Emerging Markets – Net Return	5.0	-	Low carbon
Nuveen	Core Property	7.0% p.a. absolute return	14.0		Reduced carbon

Frogmore	Opportunistic Property	16.5% p.a. absolute return	1.5	-	Reduced carbon
Brockton	Opportunistic Property	15.0% p.a. absolute return	1.5	-	Reduced carbon
Invesco	PRS Property	8.5% p.a. absolute return	1.5	-	Reduced carbon
M&G	PRS Property	8.0% p.a. absolute return	1.5	-	Reduced carbon
Glennmont	Sustainable Infrastructure	10% p.a. absolute return	2.0	-	Zero carbon
Temporis	Sustainable Infrastructure	10% p.a. absolute return	1.5	-	Zero carbon
Temporis	Sustainable Infrastructure	11-12% p.a. absolute return	1.0	-	Zero carbon
Blackstone	Private Equity	12-14% p.a. absolute return	2.5	-	Reduced carbon
Darwin	Bereavement Services	6-8% p.a. absolute return	1.0	-	Reduced carbon
BTG Pactual	Timberland	12-14% p.a. absolute return	1.5	-	Zero carbon

Appendix B – Carbon Profile Allocation over Time



Appendix C

Myners Principles – Assessment of Compliance

1. Effective Decision-Making

Principle

Administering authorities should ensure that:

- Decisions are taken by persons or organisations with the skills, knowledge, advice and resources necessary to make them effectively and monitor their implementation; and

- Those persons or organisations have sufficient expertise to be able to evaluate and challenge the advice they receive and manage conflicts of interest.

State of Compliance

The Fund is currently **fully compliant** with this principle:

- The Pensions Advisory Panel is supported by suitably qualified officers and external advisors. All members of the Panel are offered training on appropriate topics.

2. Clear Objectives

Principle

An overall investment objective(s) should be set out for the fund that takes account of the scheme's liabilities, the potential impact on local tax payers, the strength of the covenant for non-local authority employers and the attitude to risk of both the administering authority and scheme employers and these should be clearly communicated to advisors and investment managers.

State of Compliance

The Fund is currently **fully compliant** with this principle:

- The Fund's objectives are set out in the Investment Strategy Statement and the Funding Strategy Statement. The objective, benchmark and risk parameters are clearly stated in the Investment Management Agreements with each investment manager.

- Covenants of all scheme employers are reviewed on an ongoing basis.

3. Risk and Liabilities

Principle

- In setting and reviewing their investment strategy, administering authorities should take account of the form and structure of liabilities.

- These include the implications for local tax payers, the strength of the covenant for participating employers, the risk of their default and longevity risk.

State of Compliance

The Fund is currently **fully compliant** with this principle:

- The asset allocation strategy is reviewed every three years. Aon is commissioned to carry out an asset liability study which models the risk/reward characteristics of different investment strategies.

- The study follows the triennial actuarial valuation and the form and structure of liabilities are fully taken into account.

4. Performance Assessment

Principle

- Arrangements should be in place for the formal measurement of performance of the investments, investment managers and advisors.

- Administering authorities should also periodically make a formal assessment of their own effectiveness as a decision making body and report on this to scheme members.

State of Compliance

The Fund is currently **fully compliant** with this principle:

- The Pensions Advisory Panel monitors the performance of the investment managers and the suitability of the investment strategy on a regular basis.

- Performance measurement is provided by JP Morgan and Aon.

- Assessment of the effectiveness of the administering authority is reflected through the effectiveness of the decision making in the investment returns achieved. Further, with the establishment of the Local Pensions Board, scrutiny of the Pensions Advisory Panel is now being undertaken.

- A procurement exercise was carried out in 2020-21 which resulted in the appointment of Aon as the fund's investment advisors. They were appointed through the National

LGPS Frameworks and as such are subject to ongoing review at the framework level. Feedback is provided to the framework on an annual basis.

5. Responsible Ownership

Principle

Administering authorities should:

- Adopt, or ensure their investment managers adopt, the Institutional Shareholders' Committee Statement of Principles on the responsibilities of shareholders and agents.
- Include a statement of their policy on responsible ownership in the statement of investment principles.
- Report periodically to scheme members on the discharge of such responsibilities.

State of Compliance

The Fund is currently **fully compliant** with this principle:

- The Fund has adopted the investment managers' policies on activism and each has adopted the Institutional Shareholders' Committee Statement of Principles. All investment managers adopt a policy of engagement with companies.
- The Fund's policy on responsible ownership is set out in its Investment Strategy Statement.
- Investment managers report on the exercise of voting rights and this is monitored by officers and the Pensions Advisory Panel to ensure consistency with the Fund's policy.
- The pension fund is a member of the LAPFF, the UK's leading collaborative shareholder engagement group.
- Responsible ownership is periodically reported to the Pensions Advisory Panel and states how active fund managers are discharging these responsibilities.
- A section on responsible ownership is included in the Pension Fund Annual Report and a member survey has been completed. These ensure that members are both provided with the relevant information and are able to input their views into the responsible ownership process going forward.

6. Transparency and Reporting

Principle

Administering authorities should:

- Act in a transparent manner, communicating with stakeholders on issues relating to their management of investment, its governance and risks, including performance against stated objectives.

- Provide regular communication to scheme members in the form they consider most appropriate.

State of Compliance

The Fund is currently **fully compliant** with this principle:

- Documents relating to the Pension Fund are published on the pension fund website.

- The annual report sets out the arrangements during the year for the management of investment, governance and risks and other relevant information.

- Members can also request information directly from the council.

- The Pension Advisory Panel meeting papers are published on the council's website.

Investment Strategy Statement: Appendix D

Southwark Pension Fund Investment Strategy to Achieve Net Zero Carbon Exposure by 2030

Introduction

The London Borough of Southwark Pension Fund is an open, defined-benefit pension fund as part of the national Local Government Pension Scheme. The nature of the Fund and scheme design means that payment of pensions will extend over the very long term.

In setting the investment strategy, the Fund seeks to balance twin objectives: first, to achieve sufficient long-term returns for the Fund to be affordable and second, to keep the employer contribution rate as stable as possible. These objectives must now be considered in the context of the global climate emergency and the need to reduce exposure to carbon investments, a key thrust to this strategy.

In this respect, the Fund seeks to operate a long term, sustainable strategy; one which does not rely upon the pursuit of short term returns but utilises a well-structured asset and fund manager investment allocation to target long term socially responsible, sustainable investment performance. The Fund avoids unnecessary complexity within its investment structure, appointing best in class managers within an asset class to achieve the strategic asset allocation. Having stronger relationships with a smaller number of managers provides significant flexibility and adaptability if required, but this will be challenged as the fund strives to reduce exposure to fossil fuels.

To achieve the twin objectives while reducing carbon exposure, the Fund needs to invest in a diverse range of assets, which provide higher returns relative to the growth of pension liabilities whilst taking account of the volatility inherent in investment markets. This will require additional resources, support and advice in order to deliver the positive outcomes being targeted. It will also require increasingly sophisticated management reporting for control and monitoring of performance.

As a long-term investor, with significant investment assets and pension liabilities the Fund must be comprehensive in the consideration and mitigation of risks that the portfolio faces. The Fund will base assessments of risk on future pension liabilities and contributions, will consider financial and non-financial risks, diversify investment assets in an appropriate manner, but also recognise the limits of that diversification.

The Net Zero Challenge

A developing risk to investment and to the Southwark fund is from exposure to fossil fuels. Extraction and combustion of fossil fuels generate significant carbon dioxide (CO_2) output. There is a growing scientific consensus[1] that continued CO_2 production will have a detrimental impact upon the earth's climate.

The Fund, through its diversified portfolio of investments, is exposed to assets where a portion of the market value is derived from current or future extraction and production of fossil fuels. Global and local regulatory restrictions on fossil fuel extraction and usage, in addition to changing consumer trends, may degrade the viability of fossil fuel extraction and usage. The value of investments in companies that derive much of their revenue or value from these resources would be at risk.

Recent Background

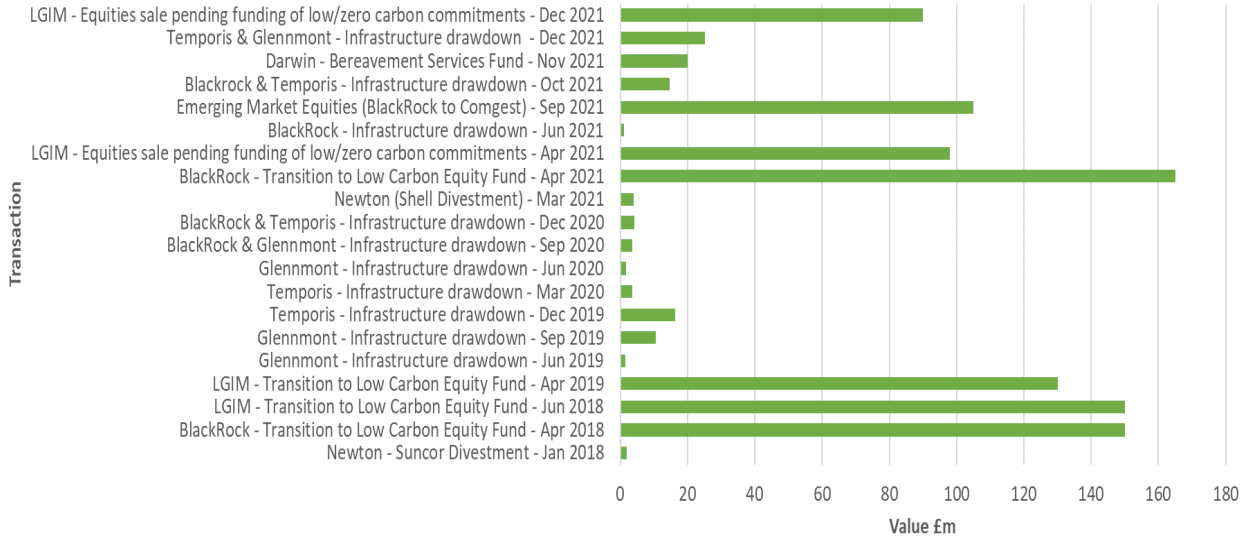
On 13 December 2016, after due consideration of the long term risk to the Fund; the Fund announced that investments in fossil fuel companies would be cut over the long term. This commitment was incorporated into the Investment Strategy Statement for the Fund published in March 2017 and updated in December 2021. Southwark is one of the first LGPS Funds to

[1] IPCC report, 'code red' for human driven global heating, warns UN chief / / UN News

make such a commitment and places the Fund at the forefront of sustainable fossil fuel aware investment.

The Fund recognises the growing financial risks associated with investment in traditional energy sources and is fully committed to transferring any current investments in these traditional energy sources in a way that is both structured and affordable and also meets the Fund's fiduciary duties.

The previous investment strategy committed to a reduction in exposure to fossil fuel generated significant CO_2 output. It was adopted in 2017 and has acted to counteract the risk to the Fund of investment exposure to fossil fuels, in line with other Fund responsibilities. In the period between 2017 and the adoption of the new strategy, the Fund's carbon exposure has reduced by 50%. When the previous strategy was agreed we set out a short, medium and long-term plan. Over the last four years significant progress has been made in transitioning investments exposed to fossil fuels to products with lower carbon exposure, as set out in the chart below:



Progress by Asset Class

The availability of suitable investment products, which meet the Fund's requirements, has influenced progress made within each asset class the Fund is invested in. This can be demonstrated by the fact that 100% of the Fund's holdings in equities had been transferred to low or reduced carbon investments by September 2021. In comparison, the Fund's defensive allocation, (15%) which includes investments in absolute return bonds and index linked gilts, remains in non-low carbon investments due to the lack of availability of suitable replacements. The progress to date by asset class is set out in detail below.

Equities

The Fund's holdings in passive developed market equities have been transitioned to passive low carbon equity funds. Emerging market passive equities have been switched to a new emerging market active equity strategic asset allocation. Investment has been made in the Comgest Global Emerging Markets Plus Fund, which demonstrates strong ESG credentials whilst maintaining performance targets. The Fund's active equities portfolio has divested from

fossil fuel investments and a restriction has been placed on the portfolio preventing further investments in these companies or their industry peers.

The above changes have resulted in the Fund's 45% strategic allocation to equities now being entirely in low or reduced carbon holdings, whilst maintaining exposure to this asset class in a manner that continues to achieve the required level of risk and return.

New ESG Priority Allocation

A strategic allocation of 5% to alternative investments has been agreed. This allocation has both low carbon and strong ESG credentials. Commitments to three new investments have been approved within this allocation, with the majority expected to be invested by the end of March 2022. Commitments have been made with Blackstone Capital Holdings (private equity); Darwin Alternative Investment Management (bereavement services); and BTG Pactual Timberland Investment Group.

New Allocation to Sustainable Infrastructure

Following the agreement to allocate 5% of the Fund to this asset class, commitments have been made to investments in four funds that specifically include investments in solar and wind power technologies identified by the fund managers.

Measurement of Progress

During this time, it has been possible to test performance against our commitment through the use of carbon foot printing. We have developed our approach and made ongoing improvements. Further work is required as the market develops and there are improvements in the availability and accuracy of the measurement of carbon intensity data.

The Fund has increased in value from £1.5bn in September 2017 to over £1.9bn in March 2021. Performance has remained strong in the short to medium term with returns at March 2021 as follows: 1 year 24.4%, 3 years 9.6%, and 5 years 10.4%. The one-year return out-performed the average local authority return of 22.8% and the Fund has achieved top quartile performance in the longer term when compared to other local authorities.

These strong performance results give confidence in moving forward with a more definite plan to take the Fund to 2030. The Fund has reduced its carbon footprint by 50% during this time whilst maintaining investment performance. Looking forward there remains a conviction that strong investment performance can be delivered alongside reducing carbon exposure, and it is appropriate to move to the next stage of making further progress towards a net zero carbon commitment by 2030.

This document outlines how the Fund will approach this divestment, how the risks and other considerations associated with such a commitment will be managed and how the divestment will be incorporated into the asset allocation strategy for the Fund.

Transition to Net Zero Carbon Principles:

The overall approach of the Fund to incorporating wider environmental, social and governance issues (ESG) is set out in more detail within the Investment Strategy Statement.

This applies throughout the investment process from the initial investment to ongoing engagement and responsible stewardship of Fund assets.

This document will specifically address the Fund's principles for the transition to net zero carbon: The four key principles for divestment are set out below:

- Climate related risks and opportunities will be incorporated into the overall asset allocation strategy
- The commitment to reduction in fossil fuel investment is more than a long-term risk mitigation strategy.
- Divestment is not risk free.
- Engagement and local authority partnerships - LCIV

Principle 1: Incorporation into asset allocation strategy

The primary purpose of the Fund is to meet the pension benefits for the members of the Fund. Every three years the Fund undergoes an actuarial valuation, which estimates the value of pensions due to be paid to members. The result of which allows the Fund to review the asset and investment strategy in order to establish the most appropriate mix of assets to best achieve the required level of net of fees investment return on an appropriate risk adjusted basis, whilst ensuring diversity of assets, sufficient liquidity and appropriate governance of the investments.

The Fund will seek to fully integrate fossil fuel risk and opportunities into the investment strategy review process, from overarching asset allocation to individual investment choices. All investments will be considered through the lens of fossil fuel risk, but that any investment cannot be separated from the overall investment objectives for the Fund and must be subject to a full business case in consideration of the overall portfolio as well as fees and transition costs.

Principle 2: More than a long-term risk mitigation strategy

The Fund has a fiduciary duty to all the employers within the Fund and to the scheme members, and as such must manage the investment assets effectively with an investment time horizon in line with the liabilities for the Fund and have due regard to the investment risk inherent within the portfolio.

The Fund recognises the risk that fossil fuel investment places upon the Fund for future investment and as such, this document largely involves the desire to mitigate risk.

However, purely focussing upon those investments that are negatively exposed to the decline in profitability and viability of fossil fuel extraction and usage excludes a key consideration for the Fund; identifying those investments that are positioned to gain from such a transition.

The Fund therefore will proactively seek to identify suitable investments that fit within the overall asset allocation strategy and will be the beneficiaries from a low carbon regulatory and investment environment. The Fund will target both a downside risk mitigation strategy and a desire to invest in positive ‘green’ focussed assets.

Principle 3: Divestment is not risk free – Potential for negative implications

It is imperative that, as set out in Principle 2, the Fund must seek to incorporate fossil fuel considerations into the overarching investment strategy rather than seeking to separately implement fossil fuel risk mitigation approaches.

The Fund has long held a large portion of equity investments as passive (investments that are held in the same proportion as that of the market as a whole) with a current target allocation of 30%. This approach acknowledges the challenges and typically higher costs involved in seeking to predict future investment winners and losers. The inclusion of a fossil fuel risk mitigation strategy within this leads to a risk that in the short term the Fund may be negatively exposed to overall market returns if fossil fuel based investments outperform the wider market. Global usage of fossil fuels is still predicted to comprise a significant portion of global energy

usage in years to come and as such, the Fund must be cognisant of the potential investment returns forgone should fossil fuel usage decline at a rate slower than the market has priced in.

There are additional management expenses within equity investment mandates that have some element of fossil fuel exclusion. As such the Fund must be confident that the additional risk from holding a portion of the Fund that is exposed to fossil fuels must be considered to be greater than the additional burden of higher management fees and any associated costs of transitioning assets from one mandate to another. The Fund works with its advisers and asset managers to ensure that there is no expected financial detriment associated with asset allocation shifts made to low carbon alternatives.

The measurement and assessment of which investments are most exposed to fossil fuels is not straightforward. Some companies may hold fossil fuel reserves or operations which are more damaging to the environment as a result of greater CO_2 output but that might be paradoxically less exposed to changing regulatory environment due to lower extraction costs. Companies not directly involved in the production or extraction of fossil fuel may derive significant portions of their revenue from fossil fuel companies. The Fund must ensure that any assessment of exposure to fossil fuels risk is sophisticated, and that investments are not distorted by inaccurate data.

Principle 4: Engagement and Local Authority Partnerships - LCIV

There is growing appreciation of the growing risks and opportunities that pension funds face from the transition away from traditional fossil fuel usage, including among Local Government Pension Funds. Where appropriate, it is important that the Fund works with other Local Authority partners to share knowledge and best practice as well as utilising collective assets to push for the most effective and efficient implementation of reduced fossil fuel strategies.

The Fund will work with local authority partners as well as the LCIV, the pooled investment vehicle of which the Fund is a shareholder and active supporter, in the application of this commitment. The Fund will also seek to be an active voice in the investment community for the advancement of investment outside of fossil fuels.

Timeline:

The Fund's implementation period to achieve net zero carbon is split into three main time horizons, encompassing short, medium and long-term objectives.

- The short term: one-four years (2022-2026)
- The medium term: five-seven years (2027-2029)
- The long term: year eight (2030)

Given the difficulty in predicting the global investment and technological environment in addition to Fund specific liability and investment requirements, longer-term periods will likely be subject to significant variability and uncertainty.

Short Term – From 2022 to 2026

Triennial Actuarial Valuation and Investment Strategy Review

- The short term will incorporate the results of the 2022 and 2025 triennial actuarial valuations. The Fund will publish the results of the 2022 actuarial valuation in March 2023, the results of which will be the foundation for the subsequent investment strategy review. The asset allocation review aims to ensure that the current investment allocation is appropriate to meet the required investment return to fund future pensions within a suitable risk profile. Where investment underperformance is identified or risk profile changes, either across an asset class or manager specific, any subsequent reallocation will be considered with regard to overall fossil fuel exposure.

Local Authority Collaboration and Pooling

- It is important that the Fund works together with other likeminded local authority partners, in order to develop suitable fossil fuel reduction opportunities. Collaboration will also seek to mitigate some of the fee and transition cost implications of changing investment allocation.
- The Fund will engage with the LCIV through representation by officers and members on key LCIV governance panels to push for the availability of reduced fossil fuel investment mandates within the LCIV.

Fund Managers

- Re-allocation of investments from opportunistic property as these funds reach the end of their life cycles.
- Initial review of direct property holdings, with any necessary action being taken in the medium term.
- Low carbon passive equity investments will be moved to zero carbon alternatives, subject to the availability of products. The transition of these assets will take place in a phased manner with up to 50% being transferred in the short term and the remainder in the medium term once performance of these new investments has been reviewed.
- Active equity mandate to be assessed against zero carbon target and if not achieved move to new zero carbon mandate.
- Seek alternatives to replace the holdings in the defensive allocation which currently includes index linked gilts and absolute return bonds. Replacements will be required to either be low or zero carbon, whilst providing an equivalent level of risk and serving the same purpose within the asset allocation. It is recognised that if suitable products are not available in the short term, further review of this allocation may be required in the medium to long term.
- Initial review of the Fund's diversified growth holding in terms of its continuing suitability within the strategic asset allocation, whilst also identifying suitable low or zero carbon replacements.
- Review performance of holding in the Comgest Global Emerging Markets Plus Fund in terms of both performance against benchmark and carbon emissions.

- Consolidate new mandates allocated in 2021-22. (These include Comgest Global Emerging Markets Plus Fund, Blackstone Strategic Capital Holdings II, Temporis Impact V Fund, Darwin Bereavement Services Fund; and BTG Pactual Timberland Fund).
- Assess carbon objectives in the context of the results of the 2022 and 2025 triennial actuarial valuations.
- The Fund will use this period to identify developments in low and zero carbon equity investments being brought to the market and the opportunities they present to the Fund in its journey to achieving net zero carbon.
- A formal update and refresh of the investment strategy will take place in 2026.

General

- The Fund will continue to develop and improve its approach to the measurement of its carbon footprint to ensure it is kept current and accurate. This will be a key metric in monitoring progress towards achieving net zero carbon. We will work with fund managers and data providers to establish actual data which will replace proxies. All new investment products that the Fund invests in will be required to provide the Fund with regular data on their carbon intensity.
- Develop enhanced carbon measurement for property investments and review the management and monitoring of carbon in the property allocation.
- The Fund will lobby the fund management industry for the introduction of new products that meet our objectives.
- The Fund will continue to support the work of the Local Authority Pension Fund Forum (LAPFF) as representing 90 local authority pension funds in their engagement with companies to promote best practice climate aware business activities
- Any changes to investment allocations will need to be communicated with key advisers, such as the Fund actuary, as well as the Fund's external auditors.
- The Fund will engage with the investment advisers who support the Fund in monitoring and engaging with buy-rated investment strategies held outside of the LCIV.

Medium Term – From 2027 to 2029

Triennial Actuarial Valuation and Investment Strategy Review

- The medium term will incorporate the results of the 2028 triennial actuarial valuation and will constitute a key point for major review of assets and investments to ensure that these are best placed to meet the payment of benefits to members of the scheme. Fossil fuel risks and opportunities will be incorporated in the consideration for any amendments to the asset allocation strategy.
- The carbon footprint will be re-calculated quarterly and incorporated into the overall portfolio risk assessment.

Local Authority Collaboration and Pooling

- The Fund is committed to working with the LCIV and will seek to comply with the government requirements for pooled investments. The Fund will continue to seek to exert influence over the strategic direction of the available investments within the LCIV, alongside other local authority partners, to ensure that these are appropriate for the sustainable strategy that the Fund wishes to implement. The opportunity for reduced fossil fuel or sustainable investment in multi asset mandates will likely develop as part of continued engagement between the Fund and other likeminded members of the LCIV.

Fund Managers

- Continued engagement with fund managers to ensure that fossil fuel risks and opportunities are consistently and appropriately taken into consideration throughout the decision making process.
- Review of private residential holdings within the Fund in terms of their continuing suitability within the investment strategy and their contribution to the Fund's zero carbon targets.
- Review of direct property investments to seek zero carbon options. This will be subject to availability of zero carbon investments in the commercial property sector and also the satisfactory performance of markets to avoid crystallisation of losses, thereby protecting the value of the Fund. If it is not possible to achieve zero carbon within this asset class suitable alternative asset classes, which meet the Fund's strategic requirements, will be identified as a replacement.
- Balance of low carbon passive equities will be moved to zero carbon equivalents. This will be subject to satisfactory performance of assets transferred in the short term and the availability of suitable investment products in this asset class.
- Complete the migration of the current diversified growth, index linked gilts and absolute return bond holdings into reduced and zero carbon products.
- Further review of holding in the Comgest Emerging Markets Plus Fund, with action being taken if investment performance or zero carbon targets are not being achieved.

- Formal review of the performance of the zero carbon sustainable infrastructure investments and maintenance of the pipeline of commitments to maintain the strategic allocation to this asset class. Make adjustments to holdings in this asset class if necessary.
- Review the performance and carbon emissions of the reduced carbon private equity holding with Blackstone. Make adjustments if required, subject to the availability of alternatives.
- Review the holding in the Darwin Bereavement Services Fund and consider suitable replacements if performance and carbon targets are not being achieved.

General

- The Fund will continue a policy of engaging with companies through membership of the LAPFF and the LCIV to encourage companies to adopt the highest of standards with regard to fossil fuels and energy efficiency.
- The measurement of the Fund's carbon footprint will include advanced metrics which will measure progress towards the Fund's net zero carbon targets. The use of scenario analysis will facilitate the Fund to understand where it could be by 2030 based on its current investment strategy, planned changes, and alternative investment strategies and asset allocations. This will enable action to be taken in the medium to long term, to identify holdings which cannot continue to be held in the strategic asset allocation, ensuring that the 2030 target is achieved. An assessment of the Fund's alignment with the Paris Agreement will be conducted providing temperature scores of the portfolio. This will also provide useful information for decision-making.
- The Fund will continue to lobby the fund management industry to encourage the development of new zero carbon investment products.
- A survey of scheme members will be conducted which will include scheme governance, administration and investments. The results will be considered when assessing actions to be taken over the long term.

<u>Long Term: 2030</u>

Triennial Actuarial Valuation and Investment Strategy Review

- The Fund will continue to assess the overall investment strategy as required to meet the pension benefits for members. As and when asset and manager allocations require amending, the risk of fossil fuel exposure will be incorporated into any due diligence regarding risk and reward decision making.

Local Authority Collaboration and Pooling

- In the long term, the Fund may be required to invest the majority of its assets through the LCIV, depending on government requirements for pooling of assets. The availability of suitable opportunities within the LCIV will be key for the continued reduction in fossil fuel investments as well as positioning the Fund to benefit from clean technology and low carbon industries. This will allow the Fund to invest across a variety of disparate asset classes without compromising the ambition to be a long-term sustainable investor.

Fund Managers

- All investments in the Fund will be reviewed to identify any remaining allocations which are not at least low carbon, with the majority now being zero or negative carbon. Investments that do not meet this criterion will be transitioned to suitable alternative products. As with the short and medium term, this will be subject to the ongoing availability of investment products that meet the Fund's risk and return requirements.
- Final tuning to complete carbon neutral objectives.
- Final application of negative carbon offsets from the Fund's sustainable infrastructure holdings.
- Review carbon emissions performance of private equity holding.
- The activity required at this stage will depend on progress made in earlier years towards ensuring the majority of the Fund's investments are, as a minimum, low carbon.

General

- The Fund will have fully incorporated fossil fuel risk, through regular and sophisticated monitoring and portfolio analysis into the investment decision-making process. Carbon reduction targets as part of the overall portfolio will play a key role in achieving the net zero carbon target by 2030.

Agenda Item 10

Cities Commission For Climate Investment

Our Pathway Towards Net Zero Investment and Growth

October 2022

A Connected Places Catapult Initiative

CATAPULT Connected Places

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Executive Summary

3Ci – Cities Commission for Climate Investment – was founded by Connected Places Catapult, Core Cities UK, London Councils, and supported by the UK Government's Department for Business, Energy and Industrial Strategy (BEIS) and Innovate UK. Acting in partnership with the private sector and the wider local government family, including the Scottish Cities Alliance (SCA), the M10 group of Metro Mayors and the Local Government Association (LGA), 3Ci is developing innovative financing models alongside a programme of technical assistance for cities and regions that will:

- Drive additional private investment into local Net Zero programmes at scale (approx. £200 billion for the founding partners alone);
- Build a pipeline of new projects, bringing them to the market at a high level of investment readiness;
- Boost local capacity to assemble and deliver projects, allowing them to be scaled;
- Create new financial partnerships with fund managers and banks, enabling them to invest with confidence in local Net Zero projects;
- Operate across multiple asset classes in an integrated, place-based manner including:
  - retrofit of homes and commercial properties;
  - integration of renewable energy;
  - shifts to sustainable transport;
  - circular waste management; and
  - the enhancement of green spaces and waterways.

On the ground, 3Ci initiatives bring business, finance, and local political and community leadership together to accelerate change through innovation that is fair to all and has local support. Our aim is to leave a lasting legacy not just of reduced emissions, but improved neighbourhoods alongside a major skills and jobs dividend.

The opportunity cost of not doing this work will create short and long-term systemic barriers and structures. This will mean the significant growth opportunities in terms of jobs and business growth, estimated at £825 billion[1] through a place-based approach will not be realised. In addition, £billions will be required to strengthen the resilience of our infrastructure, buildings and places to mitigate the damaging effects of climate change, estimated as an increase from 1.1% of GDP at present to 3.3% by 2050.[2]

1 *'Accelerating Net Zero Delivery'*, Innovate UK, March 2022
2 *'What will climate change cost the UK?'*, The Grantham Research Institute on Climate Change and the Environment, May 2022

"3Ci is helping to establish and create a new market for Net Zero in the UK. We recognise that one solution lies in convening partners to generate investable propositions, creating opportunities for economic growth and carbon reduction. The work which 3Ci are doing in this regard is critical."

Carl Ennis, Chief Executive, Siemens

"If we are to tackle the many challenges the climate emergency presents, it's essential we take a collaborative approach to find long term solutions. Already, we have achieved a huge amount in the short time since 3Ci's inception; identifying the scale of the financial challenge needed to meet net zero, acquiring the backing of private investors and local authorities across the UK and being a respected forum for national investors, cities and communities to learn from and feed into. Through this work, encouraged and supported by 3Ci, we are ensuring the transition to net zero is a just one that leaves no city or community behind."

Cllr Georgia Gould, Chair of London Councils and Leader, Camden Borough Council

Establishing the Market

There are three pillars that form the foundation of our work, which collectively underpin our ambition to support local authorities in securing the necessary finance required to deliver their Net Zero ambitions.

- **Innovating** new approaches and mechanisms for securing investment, testing and deploying these within the market.
- **Accelerating** the speed of collaboration between local and national government, industry and financial institutions by convening partners and promoting best practice.
- **Advocating** for changes in approach to investment across local and national government, which help secure the levels of investment needed.

To support these pillars we have established five practical focused workstreams:

1. **National Net Zero Project Pipeline**
Development of a national register of local and regionally led bankable projects, articulated to a common and combinable format, to deliver net zero outcomes.

2. **Regional Investor Events**
Series of events aimed at convening cities and local governments with investors to showcase opportunities, building mutual understanding and confidence.

3. **Local Integrated Investment Pilots**
A programme of geographically diverse pilots which test and demonstrate the delivery of integrated local investment model that aggregates different domains and sectors to optimise co-benefits and facilitate cross-investment.

4. **Dissemination of Local and Regional Innovations**
Development of a national platform to share innovations rapidly in an easily accessible and standardised format.

5. **National Technical Assistance Programme**
Creation of a development fund that invests in the necessary capacity and skills to bring projects forward for investment.

In the challenging global economic environment we currently face, the need to generate inclusive, sustainable, and long-term economic growth is imperative for the overall wellbeing of citizens and businesses. A UK-wide rollout of the 3Ci programme would bolster sustainable economic growth through additional investments in cleaner infrastructure, creating capital deepening. Furthermore, the linkages between generating additional capital deepening with new technology, innovation and the involvement in, or access to, global value chains would provide a boost to infrastructure-led growth through improvements in total factor productivity.

A Place-Based Approach to Investment

A place-based, multi-intervention, blended finance model occurs when some of the dividends from the most financially attractive assets, such as renewable energy generation schemes, are used to help fund some of the more challenging interventions like waste management decarbonisation or green infrastructure. Local authorities are key conveners and have a critical curating role to play in bringing together green investment opportunities to create a bankable package of schemes.

In 2021 the Commission created a model for delivering a multi-intervention, place-based route to decarbonisation, which can deliver an economic outcome that will attract both financial and return-driven capital as well as capital with socio-economic outcomes as its core focus. By aggregating the low carbon investment plans of the UK's largest cities – worth an estimated £206 billion – it is possible to create a more attractive and substantial proposition for investors. Through support from BEIS we have established the case for a new programme ***Net Zero Place Programme (NZPP)*** that builds on this model incorporating a series of ***Net Zero Neighbourhoods (NZNs).***

The Net Zero Place Programme is derived from considering the UK's Net Zero strategy and policy, identifying potential barriers and designing a programme that unlocks those barriers and provides opportunities and benefits. Considering this, the NZPP presents a viable and credible intervention for contributing to achieving Net Zero by 2050, at pace and scale, as a result of its unique characteristics, which include:

- **Firstly, it promotes a place-based approach to decarbonisation** that encourages community and local authority buy-in and participation.
- **Secondly, it facilitates the delivery of multiple interventions** in one place in order to scale up delivery, generate efficiencies and derive wider socio-economic benefits.
- **Thirdly, it provides a blended funding model,** which combines Government and outcome-seeking funding, with profit-seeking private investment. It also provides cost savings to the government, possibly reducing what could be a 70-80% subsidy, to around 35%, and
- **Lastly, it generates revenues** that can be used to fund the programme (repayable finance) and **removes the need for individual residents and asset owners to personally fund the significant costs of decarbonisation,** whilst providing an incentive to participate (reduced energy bills).

Close to 100 million tons of GHG emissions[3] per year could be abated across the UK under a full 3Ci programme roll-out

Figure 1 –
Net Zero Place Programme interventions

3 As per economic modeling undertaken in separate outline business case

In addition to these key characteristics, the programme has broader co-objectives that could be achieved including: providing the implementation vehicle for a 'National Energy Efficiency Roll Out Programme', supporting a just transition and growth agenda, generating improved health and quality of life outcomes, and contributing to alleviating the cost-of-living crisis through mitigating fuel poverty and increasing disposable income.

The UK Government has a Net Zero policy and strategy to achieve Net Zero by 2050, highlighting its commitment to addressing climate change impacts. Whilst the policy and strategy are in place, gaps remain in relation to actual delivery, instruments and interventions available that will foster further progress in achieving the target. This is because of barriers that exist and continue to persist, such as capacity, coordination and affordability constraints. The NZPP and its supporting governance and management structures, provide unlocking features (such as scalability, replicability and invest-ability) that serve to capture private sector finance addressing gaps around delivery, instruments and interventions.

The programme would establish a number of economic benefits to the UK, including direct carbon emissions reductions and financial benefits (energy bill savings) from building retrofit as well as indirect benefits from active travel, waste and green interventions, which contribute to better physical and mental health outcomes, among others.

It proposes numerous Net Zero Neighbourhood (NZN) demonstrators based on a set of principles, including: minimising intermediaries between funders and revenue generation; minimising risk of ownership structure; flexibility to work with authorities of different readiness and capacity; primacy of local authorities in local decision making, primacy of place-based approach, and scalability.

Based on a proxy neighbourhood of circa 1300 properties across different tenure types and socio-economic conditions, each NZN will:

- Result in energy bill savings of £59.5m overall, of which, £26.5m will accrue to the resident of the property, £20.3m to the private investor and £12.7m will go towards the asset maintenance fund and operating cost.
- Generate additional benefits of £25.7m from carbon emission savings and £12.2m from other benefits such as air quality benefits, distributional uplift and jobs.

The key constraints in implementing a scaled programme are primarily related to the economic return profile of implementing deep building retrofit, heat degasification, and distributed renewable energy generation and storage. Traditional models have highlighted that the costs of implementation are high relative to the financial saving on the energy bill of the resident. However, the NZPP addresses this in two ways:

- reducing the up front implementation costs through procurement economies, implementation economies and system design economies via a place-based approach, and
- by aggregating the non-subsidy funding component across multiple dwellings, energy savings can be valued over the investment time horizon of institutional investors (30-50 years) instead of individual homes owners (5-10 years).

As a result, the NZPP provides cost savings to the Government by reducing the required subsidy from c.80% to around 35%; it removes the need for homeowners to fund the cost of retrofit and delivers a return to institutional investors.

Accelerating Activity

3Ci works with local and national government, industry and finance partners to create the market for Net Zero investment. Our work has demonstrated that convening these partners will stimulate innovation and new approaches to financing and accelerate implementation on the ground.

Individually we seek to support the aims and objectives of our partners in delivering their Net Zero ambitions. It is our collective view, borne out of consultation with local and national government, industry and financial institutions, that the following areas of activity provide the basis for the next phase of activity and investment:

1. Further interrogation of the 3Ci programme through a **Full Business Case (FBC)** to establish the management arrangements for the successful delivery of the programme's outputs and activities.
2. Design and establish a set of **demonstrators** in a series of locations where the programme principles and blended finance model could be effectively tested.
3. Continued development of the **National Net Zero Project pipeline,** which currently includes over 900 projects from 50 local authorities. This would include, additional quality assurance work, the funding model for its ongoing development, operation and delviery, migration to an online portal and expansion to other local authorities across the UK.
4. **Knowledge development and dissemination** through a series of publications aimed at accelerating innovation and sharing good practice, establishment of an annual regional investor event programme and the creation of a 'masters programme' to develop capacity and capability within local government.
5. Commitment towards funding the establishment of a **National Technical Assistance Facility,** which in the first case would build on scoping work being undertaken by 3Ci but is required to understand the capabilities and capacity required, management and operational arrangements and the mechanism for funding it.

About 3Ci

The work of 3Ci is overseen by an Advisory Board which is chaired by Professor Greg Clark CBE.

Professor Greg Clark CBE: Chair, Connected Places Catapult, Chair, 3Ci

Mayor Marvin Rees: Mayor of Bristol; Chair of Core Cities UK

Mayor Sadiq Khan: Mayor of London; member of M10 Combined Authority Mayors

Mayor Philip Glanville: Mayor of Hackney

Keith Bottomley: Deputy Policy Chairman, City of London Corporation

Lucy Yu: Chief Executive, Centre for Net Zero

Cllr Susan Aitken: Leader of Glasgow City Council

Cllr John Merry: Deputy Mayor of Salford; Chair of Key Cities Group

Cllr Kevin Bentley: Leader Essex County Council; Chair, LGA People and Places Board

The Board is supported by an Executive team based at the Connected Places Catapult

Steve Turner, Director
Zoe Jennings, Head of Climate Investment
Paulius Mackela, Climate Investment Manager
Mariana Bui Beganton, Strategic Programmes Manager
Anita Glover, Marketing and Communications Manager
Darren Pangbourne, Programme Manager
Helena Downey, Governance and Secretariat Officer
Chris Murray, Strategic Engagement Manager
Shelley Nania, International Lead

3Ci Cities Commission For Climate Investment

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Proudly supported by:

Department for Business, Energy & Industrial Strategy

Please get in touch

For more information or to get involved please contact us at:

3Ci.org.uk

Proudly supported by:

UKRI Innovate UK

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Cities Commission For Climate Investment

Impact Acceleration Report 1

Unlock Private Investment for Net Zero – A Practical Guide for Local Authorities

October 2022

A Connected Places Catapult Initiative

CATAPULT Connected Places

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By the end of reading this guide you will:

- Have a set of tools to identify capability gaps
- Know some practical ways to bridge those gaps
- Know about the different ways 3Ci might be able to support you into the future
- Ultimately, make progress towards unlocking private sector investment for your Net Zero initiatives.

We want to support you to unlock the long-term finance you need to achieve Net Zero.

We are here to Help

3Ci seeks to leverage the distributed and combined scale of cities to mobilise finance and drive investment into low and Net Zero carbon projects across the UK.

3Ci was founded by the Connected Places Catapult, London Councils and Core Cities UK. We are creating a wider partnership, including UK Government, Innovate UK, Metro Mayors, Combined Authorities, Scottish and Key Cities, Counties and Districts and a growing league of private investors, financiers, advisors, developers and built environment technology professionals.

As part of this programme, 3Ci commissioned TPXimpact to explore local authority capability to draw in investment for Net Zero.

This guidance provides you with some of the findings. Page 8 shares some wider recommendations on what more 3Ci can do to support development of capability.

To learn more about 3Ci, contact: **3Ci.org.uk**

You are ...

Working in a local authority, and you are thinking about how you meet Net Zero targets, improve the lives of your residents, and contribute to creating resilient communities.

You want to ...

- improve the viability of Net Zero initiatives
- unlock private sector investment
- innovate inclusively
- develop sustainably

and to do this you need to ...

- develop the business case to invest in upskilling, new capabilities and resource mobilisation.

In Context

In this guide we're focusing on some new approaches to funding Net Zero projects, but we know it is just one part of a bigger programme.

There are other ways to fund Net Zero

This guide focuses on private investment, particularly using blended financing models.

If you are interested in exploring different types of financing models in parallel sectors, check out the HUB-IN Business & Financing Models Guide. This guide focuses on funding heritage-led regeneration.

Connected Places Catapult's Place Leadership Programme

Alongside partnering in 3Ci, Connected Places Catapult has a Place Leadership Programme which creates partnerships to bridge the gap between buyers, suppliers, innovators and industry, helping place leaders and their partners to implement new solutions which enable clean, innovation-led levelling up.

What does Good look like?

We want to develop a replicable model for the design, funding and delivery of Net Zero projects that secures private sector investment. This approach is **place-based, portfolio-driven** and draws on **blended-finance.**

Here are six aspects of the 3Ci model for local authorities to unlocking investment that TPX impact identified as most relevant.

Local authority initiated – We use our statutory levers and our resources to mobilise our own organisation and others behind our Net Zero ambition.

Align with the wider system – We consider the system we operate within. We know our local suppliers and contributing third party organisations. We facilitate these groups to work together to deliver on one Net Zero ambition.

Place-based – We deeply understand our place, and are responsive to the community, geography and local needs in our portfolio design.

We implement at neighbourhood level.

Community as partners – We engage our communities as partners, ensuring what we deliver is done with them, not to them.

Portfolio driven – We increase profitability of collective interventions by organising Net Zero projects into portfolios, whilst reducing financial overheads and increasing social and environmental outcomes.

Blended finance – We blend a range of financial sources to fund our Net Zero portfolios.

We standardise tools and templates to de-risk projects portfolios and attract private investment.

Barriers and Implications for Local Authorities

In researching this report with councils and local authorities, one of the things we learned is that most councils are not currently set up to apply this model to their existing Net Zero projects. Moving to this model to develop portfolio and place-based Net Zero neighbourhood programmes, will will require changes to how councils both work and plan.

The barriers to implanting the model broadly align to three themes, with a set of corresponding implications:

Mindset

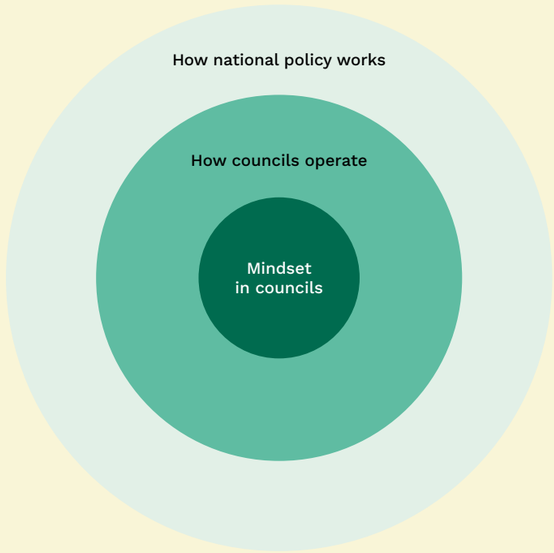
There are cultural and mindset shifts that will be required by councils in order to implement the model and embed it within their way of working.

How councils operate

Councils are organisations with financial and legislative limitations. These limitations may prevent or hinder a council from implementing models to unlock private finance. Some of these limitations will be in the control of a local authority, others will be shaped by national policy.

How national policy works

National policy is not currently set up to support this model, and some pieces of national policy will prevent or hinder a council from working in this way.



This report does not consider national policy.

What Capabilities are Needed to Unlock Private Sector Investment?

We found ten distinct capabilities that are required to unlock private sector investment for Net Zero (the 3Ci model).

Seven of the capabilities are well developed in support of Net Zero, but may need reframing in the context of identifying and securing project, programme and portfolio finance.

The remaining three are less well developed both in relation to Net Zero and to securing investment.

32Policy and strategy
Ability 1 nslate national and local policy into actionable strategies that align the climate, environmental, social and economic outcomes the council is aiming to achieve with the available Net Zero interventions.

2 Project identification and qualification
Ability to identify and prioritise the types of Net Zero interventions that are suitable to a place, aligned to strategy & policy and establish their feasibility in order to deliver carbon, environmental and social outcomes.

3 Supply management and procurement
Knowledge and understanding of the different Net Zero suppliers available in the local, national and international market. The ability to compare strengths and drawbacks of these suppliers and then work effectively with them over the delivery period.

4 Scenario modelling
Ability to develop models that can test the profitability and impact (environmental, economic, social and health) of different Net Zero portfolio scenarios. Models should be able to account for variables such as homeowner uptake, supplier costs, finance requirements etc.

5 Portfolio development
Ability to combine Net Zero interventions into a portfolio, understanding the financial modeling to create an investable proposition, which will lead to desired outcomes and deliver ROI for investors.

6 Investor engagement
Ability to understand the needs of, and risks involved with, different investors, perform due diligence and effectively negotiating investment deals and contracts with them.

7 Project delivery
The skills to deliver several capital transformation projects, or to project manage the delivery of a range of suppliers delivering multiple projects in parallel on our behalf.

8 Community engagement
Structures, skills and capacity in place for collaborative working between the council and communities at a street / neighbourhood level, which enables these communities to meaningfully shape, and on occasion, drive decision making related to their place.

9 Net Zero reporting
Data, systems, and skills to be able to continuously capture data against carbon, environmental, economic, social and health metrics and report/monitor this in a consistent way within neighbourhoods and across wider places.

10 Neighbourhood upkeep
The ability to upkeep Net Zero interventions in a neighbourhood to ensure continued effectiveness, either through continuous supplier management or as a service delivered by the council.

Six Steps to Building Capability

To properly embed the model, we believe that 3Ci should provide some central support. There are, however, six steps that councils could take to implement the 3Ci model independently. In the next few pages, we're going to go through recommendations of how you can start to achieve this.

1. **Identify your role**
Consider the role that your authority is best placed to play. See next slide. Do your strategies and action plans align to that?

2. **Score yourself**
Use the capability descriptions in this document to score yourself against each capability and understand where gaps might exist. See the annex to this document.

3. **Bridge the gap**
Not all capabilities have to come from the council, they may be held by others in your local ecosystem. What investment can you make, or partnerships can you build to fill those capability gaps?

4. **Find a first opportunity**
Review your climate action plans, and critically assess which of these opportunities may have a potential revenue stream. Prepare a prospectus that outlines the opportunity.

5. **Begin the conversation**
Investors may be willing to engage with you before you have every level of detail worked out. Reach out to some with a high-level prospectus. Work with these investors to develop the offer.

6. **Learn and build**
Take your learnings from these conversations. Use it to identify further investment opportunities, start to think about aggregating opportunities together.

Step One

1

What role do you want to play?

Councils vary in terms of their statutory duties, capabilities, assets, resources, and the communities they serve. These variables influence the ability of a council to unlock private sector investment (the 3Ci model). This model has been produced on the assumption that a council will own the end-to-end responsibility for its delivery. However, if they cannot perform some of these functions, there are several other roles they can play if they want to initiate a 3Ci model. These roles are not mutually exclusive, and a council can play any number of combinations.

Alternative roles

The asset owner
An authority which has core assets it can contribute to the 3Ci model. These may come in the form of council estate, social housing, infrastructure or land. These assets can form part of the areas of transformation in the 3Ci model.

The broker
An authority which holds a range of relationships, possibly with investors, suppliers, businesses or the community. The council can use these relationships to bring together the necessary parties to broker a 3Ci model.

The enabler
An authority which has mature capabilities in analysis and/or has mechanisms or frameworks it can bring to bear such as procurement or project identification processes. Capabilities such as these can be used to enable planning of a 3Ci model, and support delivery.

The deliverer
A delivery authority might deliver the 3Ci model itself, or procure others to do so on its behalf. It takes responsibility for delivery because it holds statutory responsibility on planning. It may or may not own the relevant assets, but it leads the way on carrying out the work.

What capabilities do you need to deliver these roles?

The role that a council chooses to play will determine the capabilities that they require. The below outlines how capabilities in the framework align against these different roles.

Baseline capabilities to initiate the model

Regardless of the role a council chooses to play, all councils initiating the 3Ci model will need the ability to create Net Zero strategies aligned to place and to identify and qualify projects. Without these capabilities, a council cannot initiate the model.

- 01. Policy and strategy
- 02. Project identification and qualification

Capabilities against roles

The below outlines the capabilities a council requires to play a particular role. Importantly, all capabilities are required to deliver the model. Therefore, where a council takes on a particular role, it must consider where the other capabilities will be delivered from.

The asset owner
Asset Owners do not necessarily have to have skills outside of owning assets and procuring services:

- 03. Supply management and procurement

The broker
The broker is likely to have novel capabilities that other councils can leverage including:

- 04. Scenario modelling
- 05. Portfolio development
- 09. Net Zero reporting

The enabler
The enabler is responsible for bringing people to the table, as such will require:

- 06. Investor engagement
- 08. Community engagement

The deliverer
The deliverer is responsible for delivery of Net Zero interventions in a place, their upkeep and reporting. Capabilities include:

- 03. Supply management and procurement
- 07. Project delivery
- 10. Neighbourhood upkeep
- 09 Net Zero reporting

Step Two

Self-assess your capabilities

Identify the:

Capabilities you already have and are using in the Net Zero context.

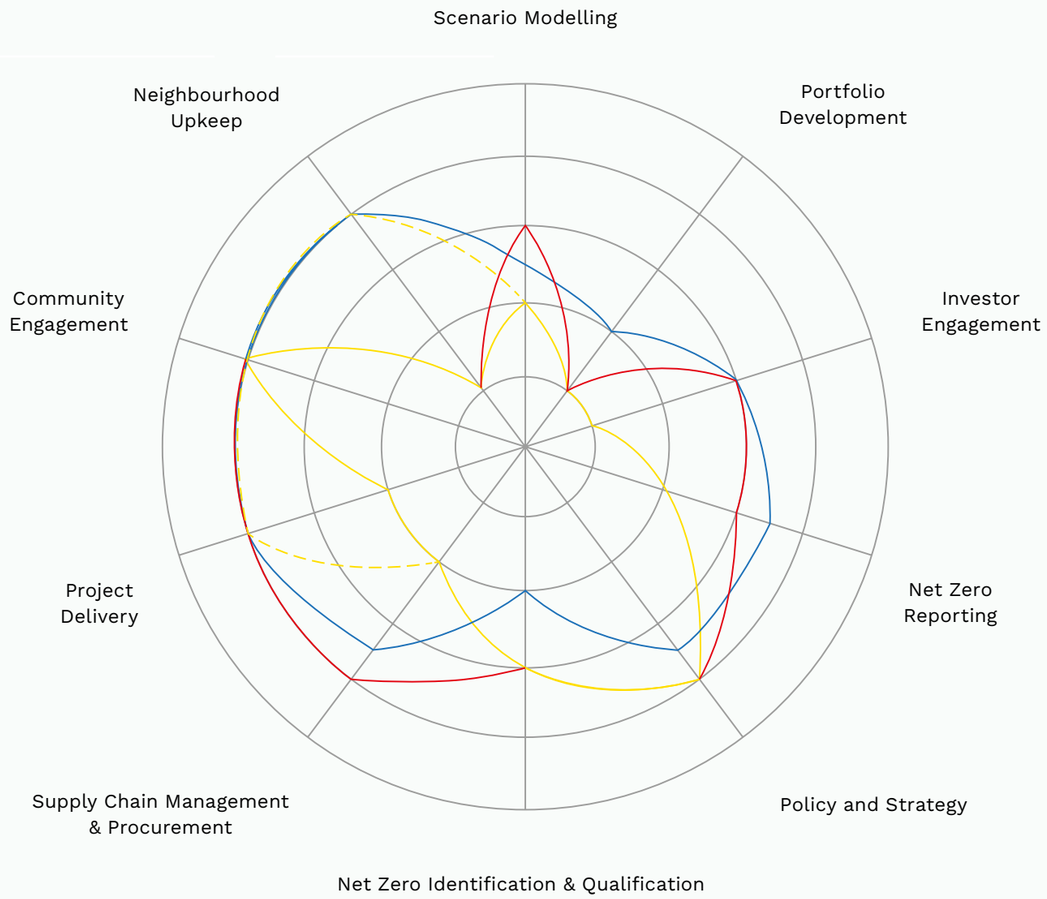
Capabilities that you are using in other areas that you can reframe in the context of the 3Ci model.

New capabilities which you need to develop.

Turn to the appendix for more details on each capability.

You can do your own capability assessment by scoring your organisation on a spectrum from:

emerging capability **(1)** – developing capability **(2)** – maturing capability **(3)** – thriving capability **(4)** – exceptional capability **(5)**



Policy and strategy
As a local authority, how well can you translate data and policy into actionable strategies that align climate interventions to Net Zero targets?
To reframe – these strategies now need to be adapted to integrate place based approaches to delivery.

Project identification and qualification
Do you have governance around project qualification? How much do you struggle to know what to prioritise according to carbon impact?
To reframe – you need to advance your modelling capabilities to decide where to focus the sourcing of private sector investment.

Supply chain management and procurement
How advanced are your procurement mechanisms and do you have working relationships with local and national suppliers and contractors?.
To reframe – you now need to play a convening role, bringing different organisations together to deliver a single approach.

Project delivery
How experienced are you in delivering Net Zero interventions, especially and largely on your own estates?
To reframe – you need to build capability to deliver across a larger portfolio of interventions, particularly retrofit.

Investor engagement
How well do you engage investors in your Net Zero work, and have you generated private sector investment in your Net Zero projects?

Community engagement
How experienced are you in actively engaging communities around Net Zero?
To reframe – you now need to think of scale of engagement, and how to engage residents as partners shaping your approach to unlocking finance.

Neighbourhood upkeep
How experienced are you in the upkeep of Net Zero interventions? Is this largely done with the support of external contractors?
To reframe – you need to embed upkeep as an essential part of project development and across multiple interventions and asset owners.

Net Zero reporting
How well can you can track carbon data across larger geographies and how experienced are you reporting on emissions for your own estate?
To reframe – you now need to think about how you can embed neighbourhood level reporting across related environmental, social and health outcomes.

Scenario modelling
How well can you model and assess different investment scenarios according to type of interventions?

Portfolio development
How well can you develop investment portfolios/ prospectuses for your Net Zero propositions?

Step Three

Bridge the gap

Once you have identified the gaps in your own capability, start to identify opportunities to reframe or reuse the skills and capabilities you already have in other parts of your organisation, and start to look for ways you can plug the gaps where those capabilities don't currently exist.

Not all capabilities have to come from you as the local authority. Capabilities may be held by others in your local ecosystem.

Ask yourself:

- What investment can you make, or partnerships can you build to fill those capability gaps?
- How can you map the capabilities that exist outside of your organisation?
- How can you make a case for building partnerships and convening your ecosystem?

Try a stakeholder mapping exercise to review relevant stakeholders – if you are acting as the 'brokerer' for example, identify who in your region the enabler might be.

Once you've mapped your stakeholders and reviewed actions, re-do the capability assessment – identify what's changed and who else you might need to bring in.

Step Four, Five and Six

Make things happen

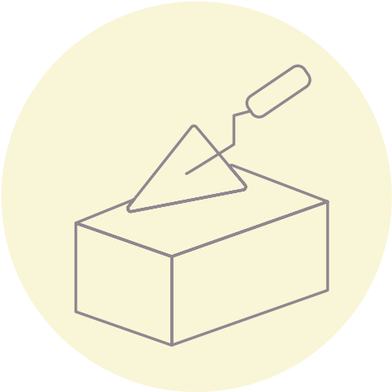
Find a first opportunity
Review your climate action plans, and critically assess which of these opportunities may have a potential revenue stream. Prepare a prospectus that outlines the opportunity.

Begin the conversation
Investors may be willing to engage with you before you have every level of detail worked out. Reach out to some with a high-level prospectus. Work with these investors to develop the offer. It's always helpful to start by investigating investors' ways of working, motivations and expectations.

Learn and build
Take your learnings from these conversations. Use it to identify further investment opportunities, start to think about aggregating opportunities together.

A City Council Scenario

Meet Bilsbury City Council



The scenario

Bilsbury is an urban city council that forms part of a wider Combined Authority. The city has high population density, is the 6th most populous city in the UK and has pockets of both wealth and relative poverty within the city.

As a city council, Bilsbury has a large estate with a mix of libraries, social housing, community centres and council buildings. The council has started work itself to decarbonise its buildings in line with its Net Zero strategy, but is yet to fully go to Net Zero. It also has plans to influence decarbonisation of the wider city but does not have the money to deliver it.

The council has a wide range of statutory duties. It is responsible for planning, the cities capital programme, waste, and energy. It also works within its combined authority on transport for the greater city region.

Where they add value

As a council seeking to implement the model, Bilsbury brings the following to the table:

- ample assets that it contributes to the model
- history of delivering Net Zero projects and the capacity internally to deliver them
- control over waste, energy and planning to increase the attractiveness of the proposition
- procurement frameworks in place with suppliers and contractors that can deliver Net Zero interventions and upkeep the estate.

Roles they can take in the model

Given the above, Bilsbury is in a very good position to take on the Asset Owner and Deliverer roles in the model.

What else they need to do

Bilsbury does not currently have the full capability to implement the model. It lacks scenario modelling and investor engagement capabilities. To pursue the NZN approach, the council will need to draw on others in the system. They could do this by:

- engaging in a partnership with their Combined Authority which may have these capabilities at hand
- engage with other local organisations including universities that may have more advanced modelling capabilities
- procure some of this capability from a consultancy or a contractor while gradually building out the capability in house
- work with residents, businesses and others to bring other assets into the NZN

Shifting to a Net Zero Model

Meet Grently County Council

The scenario

Grently is a county council. It has both urban and rural areas within its boundaries.

As a county council, Grently owns none of its own housing stock which is run and managed by district councils. It has a handful of council buildings, but its estate is modest.

Grently declared a climate emergency in 2019, and has since developed a climate capability team. This team largely focuses on engaging the local community, including businesses and parishes, to influence their response to the climate emergency. Because of this, they have quite strong ties to local communities.

Grently have also developed some relations with investors from previous pieces of work where they have tried to attract investment into the county.

Where they add value

As a council seeking to implement the model, Grently brings the following to the table:

- strong community ties and a history of engaging these groups on climate change. This gives an ability to bring different asset owners (particularly home-owners) to the table
- some capability in scenario modelling and portfolio development
- ability to align the district councils on vision and priorities
- strong relations with investors that could be leveraged to fund the model.

What else they need to do

As a county council, Grently does not have strong capability in developing or delivering big capital or Net Zero projects. As such, it will rely on partners for the delivery of projects.

If Grently chooses to implement this model without building out these capabilities, they could:

- partner with their district councils who likely have a wider estate and more history delivering Net Zero projects or capital works
- engage contractors who can own and run the full delivery of Net Zero projects within portfolios that they deliver.

Looking to the Future

This report outlines some of the ways you can start building the capability to unlock private finance independently. 3Ci has the tools and skills to help you with this process.

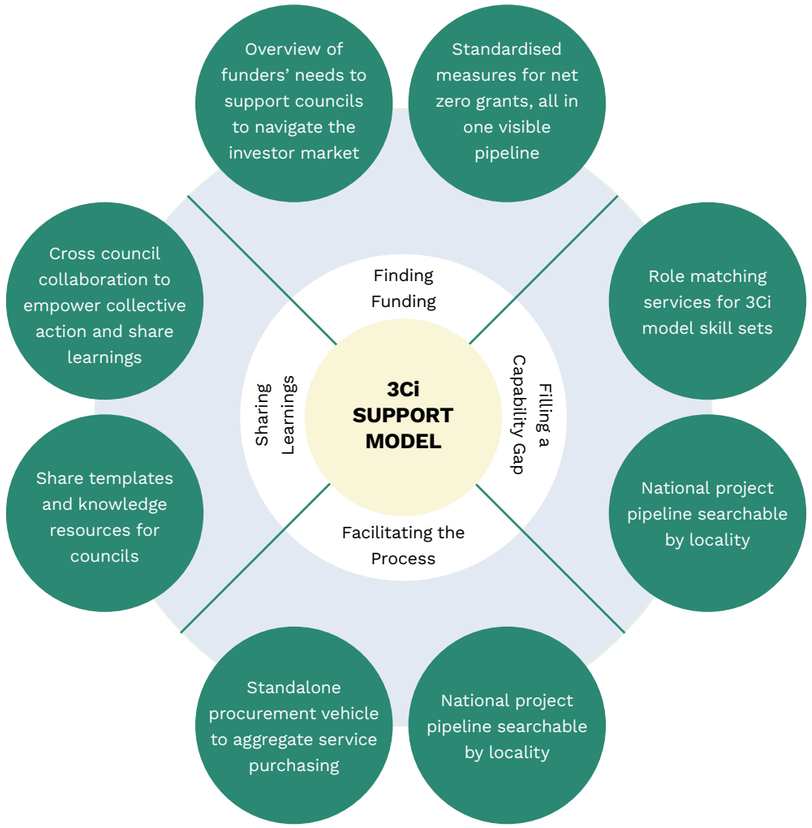
We are developing an outcome-driven model and can help your local authority in the following ways;

Finding funding – 3Ci could support you to identify public and private funding opportunities for your Net Zero portfolios.

Filling a capability gap – 3Ci could establish targeted ways to address some of the capability gaps that you experience.

Facilitating the process – 3Ci could deliver part of the process on behalf of you, where this makes sense.

Sharing learnings – As the model is implemented and iterated, 3Ci could facilitate learning across local authority experiences.



To learn more about 3Ci and our upcoming opportunities to trial the model check out:

3Ci.org.uk

Contact: **contact@3ci.org.uk**

Interested in similar tools to help you innovate in places?

Check out:

- **Net Zero Navigator** – A tool to support local authorities plan Net Zero programmes
- **The Net Zero Go Knowledge Library** by the Energy Systems Catapult
- **HUB-IN** – tools for heritage-led regeneration
- **Hubs of Innovation** – a practical guide to key issues in innovation locations

3Ci Cities Commission For Climate Investment

CATAPULT Connected Places

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Please get in touch

For more information or to get involved please contact us at:

3Ci.org.uk

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Environment and Community Engagement Scrutiny Commission

MUNICIPAL YEAR 2022-23

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NOTE: Original held by Scrutiny Team; all amendments/queries to Julie Timbrell Tel: 020 7525 0514

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