Item No. 7.	Classification: Open	Date: 27 September 2023	Meeting Name: Pensions Advisory Panel
Report title:		Asset Allocation and Net Zero Strategy Update – June 2023	
From:		Senior Finance Manager, Treasury and Pensions	

Recommendations

1. The pensions advisory panel is asked to:

   a) Note the Fund's asset allocation at 30 June 2023, overall performance and other matters considered by the officers and advisers of the Fund during the quarter and post quarter end.
   b) Note recent progress in the implementation of the net-zero carbon strategy, as set out in this report.

Background

2. Decision making for the Southwark Pension Fund is a bipartite mutual responsibility between the Strategic Director of Finance (S151 officer) and the Pensions Advisory Panel (PAP). London Borough of Southwark, as administering authority for the Southwark Pension Fund, has delegated responsibility for the management and decision making for the Fund to the S151 officer. All Fund investment decision making, ongoing investment monitoring and risk management by the S151 officer must be made with regard to advice received from PAP.

3. Additional oversight of the decision-making process is provided via the Local Pension Board.

Pension Fund Investments – June Quarter 2023

Position Statement at 30 June 2023

4. The market value of the Fund increased during the quarter from £2,015.0.m to £2,053.6 m, an increase of £38.6m (+1.9%).

5. The value of the major asset classes at 30 June 2023 compared to 31 March 2023 is as follows:

	31 March		30 June	
	£m	%	£m	%
Low carbon passive equities	668,006	33.2	699,239	34.1
Active Emerging Market equities	93,431	4.6	91,762	4.5
Active global equities	262,806	13.0	266,911	13.0
Total Global Equities	1,024,243	50.8	1,057,912	51.5
Total Diversified Growth	141,523	7.0	100,085	4.9
Total Absolute Return Bonds	133,397	6.6	128,956	6.3
Total Index Linked Gilts	152,894	7.6	140,996	6.9
Total Core Property	197,339	9.8	198,690	9.7
Total ESG Priority	324,464	16.1	382,444	18.6
Total Cash & Cash Equivalents	41,155	2.0	44,508	2.2
Total Fund	2,015,015	100.0	2,053,591	100.0

6. The following table shows the breakdown of the market valuation as at 30 June 2023 by asset class/manager and compares the totals with the target asset allocation, which was agreed by PAP in December 2022:

	Manager(s)	TOTAL FUND £000	Actual %	Target %	(Under) Overweight
Low carbon passive equity	Blackrock LGIM	352,397 346,842 **699,239**	17.2 16.9	17.5 17.5	-0.3 -0.6 (-0.9)
Active Emerging Market equity	Comgest	91,762	4.5	5.0	-0.5
Active global equity	Newton	266,911	13.0	10.0	+3.0
Total Global Equity		**1,057,912**	**51.5**	**50.0**	**+1.5**
Total Diversified Growth	Blackrock	**100,085**	**4.9**	**0.0**	**+4.9**
Total Absolute Return Bonds	Blackrock	**128,956**	**6.3**	**0.0**	**+6.3**
Total Multi-Asset Credit	Robeco	**0**	**0.0**	**10.0**	**-10.0**
Total Index Linked Gilts	Blackrock LGIM	82,048 58,948 **140,996**	**4.0** **2.9**	**5.0** **5.0**	**-1.0** **-2.1**
Total Core Property	Nuveen	**198,690**	**9.7**	**14.0**	**-4.3**
Total ESG Priority	See table below (Para 17)	**382,444**	**18.6**	**16.0**	**+2.6**
Total Cash & Cash Equivalents	LGIM Newton Nuveen	33,207 6,954 4,347	1.6 0.3 0.2	0.0 0.0 0.0	1.6 0.3 1.2

		44,508	**2.1**		**+3.1**
Total Fund		**2,053,591**	**100.0**		

7. The Fund's Strategic Asset Allocation (SAA) has tolerance, within specific ranges, for deviation from the target allocation for each manager/asset class. All allocations are within the maximum permitted by the SAA. The key overweight positions outside of these tolerance ranges shown above are in Diversified Growth and Absolute Return Bonds (+4.9% and +6.3% respectively). In contrast, the key underweight is in Multi-Asset Credit (-10%).

8. Aside from changes due to market movements, compared to last quarter the main changes in the asset allocation weightings are seen in:

   - a reduction in the overweight to the Diversified Growth Fund (from +7.0 to +4.9) due to a redemption of £30m to fund the new allocation to the Darwin Leisure Development Fund.
   - an increase in the overweight to ESG priority funds from +0.1 to +2.6 compared to the 16% target. This was partly due to the allocation to Darwin Leisure Development Fund mentioned above.

9. Members of PAP will be aware that the decision to introduce the allocation to Multi-Asset Credit (MAC) was made in December 2022. At the special PAP meeting of 9 March 2023 it was agreed to allocate £100m of the MAC allocation to Robeco. Following a detailed legal review and due diligence process, and considering market liquidity, the investment was made on 6 September 2023.

10. Officers and advisers will continue to evaluate opportunities in Multi-Asset Credit with the aim of being fully funded by the end of 2023-2024. The source of funding will be the Absolute Return Bond fund managed by Blackrock.

11. There is also a significant underweight in the core property mandate run by Nuveen (-4.3%, excluding cash) It should be noted, however, that there is a 20% overall target allocation to property, which includes ESG priority allocations to Invesco, M&G, Frogmore, Darwin and Brockton Capital . As at 30 June, the total actual property allocation was 16.6% with another 0.2% held in cash by Nuveen ahead of making new investments.

Fund Manager Activity – listed assets

12. During the quarter there were no mandates terminated although, as mentioned above, notice was given to Blackrock re: the need to exit the Diversified Growth and Absolute Return Bond funds to finance the allocation to Multi-Asset Credit.

13. As advised at the PAP meeting of 17 July, there were changes to the Newton mandate during the quarter to 30 June. Newton is now using a proprietary Net Zero score and projected emissions pathways to construct a portfolio consisting only of companies it assesses to have the best emission reduction plans.

14. The portfolio “go live” date was 30 April with the total number of stocks reducing from 42 to 40 and the post-transition WACI (Weighted Average Carbon Intensity) reduced by 20.8% on Day 1 (marginally ahead of expectation).

15. On 6 March 2023 the PAP agreed to implement a new cash management framework, which ensures that the Fund has access to sufficiently liquid assets to meet predicted cash flow requirements and the flexibility to meet additional cash flow needs. Also, the cash flow policy seeks to minimise the level of cash balances held to maximise investment returns.

16. During the quarter the operational changes to implement the new cash management framework were implemented. This involved amending the LGIM Investment Management Agreement to permit investment in the LGIM Sterling Liquidity Fund. Allocations were also made to new Money Market Funds run by Northern Trust and Blackrock. These were funded by full redemption of the Blackrock liquidity fund.

17. There were no other changes to the listed asset portfolios during the quarter.

Fund Manager Activity – ESG Priority allocations

18. The below table breaks down the ESG priority holdings showing the valuation of underlying funds as at 30 June 2023:

Manager	Fund	Market Value £m
Invesco	UK Residential Fund	33.183
M&G	UK Residential Property Fund	43.784
Frogmore	Frogmore Real Estate Fund III	6.574
Brockton	Brockton Capital Fund III	6.837
Glennmont	Glennmont Clean Energy Fund Europe III	28.346
Temporis	Operational Renewable Energy Renewable Energy Impact Strategy	64.724 30.273 16.709
Blackrock	Global Renewable Power Infrastructure	19.206
Darwin	Bereavement Services Fund Leisure Development Fund	21.764 29.496
Blackstone	Strategic Capital Holdings II	46.859
BTG Pactual	Core US Timberland	34.688
TOTAL		**382.444**

19. It should be noted that a number of the above funds are fully committed (e.g. Darwin funds), whereas others will be drawing down cash to invest over the coming months and years (e.g. Blackstone). Some of the older funds are starting

to return capital which can be considered for reinvestment to ensure that the ESG priority allocation is maintained.

20. During the quarter a £30m commitment was made to the Darwin Leisure Development Fund, which is fully drawn down. An additional commitment of £15m was made to the Invesco UK Residential Property Fund, of which £10m was drawn down with the remainder to be drawn in October. These commitments were funded from cash.

Investment Performance Results for the Period

21. The following table shows the total fund returns for the quarter and for longer-term assessment periods:

	Quarter	Year to 30 June	3 Years to 30 June p.a.	10 Years to 30 June p.a.
Fund	2.3	4.1	6.0	8.5
Benchmark[1]	0.4	5.0	6.4	8.9
Relative	+2.0	-0.9	-0.4	-0.4

[1] The benchmark figures are subject to change given outstanding queries with JP Morgan (custodian)

22. The Fund made a return of 2.3% in the quarter, ahead of the benchmark return of 0.4%. The total fund return for the year to the end of June 2023 was 4.1%, which was below the benchmark return of 5.0%. Over 3 years, the Fund returned 6.0% p.a. compared to a benchmark return of 6.4% p.a., a difference of -0.4% p.a. An annualised return of 8.5% over 10 years means that the Fund has exceeded, by some margin, the 2013 actuarial valuation's average discount rate of 5.4%.

23. Further information on the performance of underlying managers will be provided during the adviser update (Item 8).

Post quarter end events

24. On 6 September a £100m allocation to Robeco's Climate Global credit fund, part of the Fund's new allocation to Multi-Asset Credit, was made. This was funded by full redemption from the Blackrock Dynamic Diversified Growth fund and partial redemption (£12m) from the Blackrock Absolute Return Bond fund.

25. Following consultation with Aon, on 9 August an additional commitment of £6m was made to the Temporis Impact Strategy V – this is to enable the fund manager to commit to an attractive transaction in battery storage (thus diversifying the Fund's holdings).

26. In mid-August the s151 officer agreed to vote in favour of an extension to the fund life of the Nuveen UK Retail Warehouse fund, to 30 June 2024. This was to enable the manager to take more time to sell the remaining assets in the fund when it is likely that valuations will be more favourable. The vote was passed unanimously.

27. Nuveen has recently advised that the 16 Colonial Way (a Watford Industrial Unit) asset has been independently verified as having an EPC A+ rating, which makes it LBS pensions fund’s first Net Zero holding in the direct property portfolio.

28. Officers had performance review meetings with Newton (global equity), Comgest (emerging market equity) and Glennmont (renewable infrastructure). An oral update on any matters arising will be given at this PAP meeting.

29. The London CIV announced that Jason Fletcher (the Chief Investment Officer) has decided to leave to pursue new opportunities. He will be leaving at the end of October 2023 and individual investment team heads will report to Dean Bowden, the Chief Executive, until a replacement is found.

30. On 7 September the S151 officer and the Senior Finance Manager, Treasury and Pensions had an introductory meeting with Dean Bowden, the new CEO of the London CIV. An oral update on any matters arising will be given at this PAP meeting.

LGPS Pooling Consultation

31. On 11 July a Government consultation on the future of LGPS pooling was issued. The key areas covered by the consultation are:

    a. A proposal for funds to transfer all listed assets to their pools by 31 March 2025.
    b. The potential for the number of pools to be reduced over time if they do not reach scale (c £50bn).
    c. The potential for pools to play a more active role in underlying funds’ investment decisions, including giving advice to funds.
    d. The need for a training policy to be introduced for committee members.
    e. Improvements in the consistency of data produced by funds.
    f. Regulations to be issued that require funds to produce a plan on how they will invest up to 5% of assets in projects that support levelling up in the UK.
    g. The government’s ambition that funds will invest up to 10% in private equity (up from the current target of 5%).

32. Officers have participated in a number of roundtables and events whereby they have had the opportunity to compare notes with other funds, including the London Boroughs. Having considered both cross-fund issues and those specific to LBSPF, a draft consultation response will be shared before submitting a response ahead of the 2 October deadline. Further information can be found in Item 10 on this meeting’s agenda.

Further Areas of Progress

33. Further potential opportunities with new and existing managers in asset classes such as sustainable infrastructure, property, and wider alternatives, are being pursued by officers in conjunction with Aon. The PAP will be updated on progress in these areas at future meetings.

Community, Equalities (including socio-economic) and Health Impacts

Community Impact Statement

34. There are no immediate implications arising.

Equalities (including socio-economic) Impact Statement

35. There are no immediate implications arising.

Health Impact Statement

36. There are no immediate implications arising.

Climate Change Implications

37. There are no immediate implications arising.

Resource Implications

38. There are no immediate implications arising.

Legal Implications

39. There are no immediate implications arising

Consultation

40. There are no immediate implications arising.

Financial Implications

41. There are no immediate implications arising.

AUDIT TRAIL

<table>
<tr><td>Lead Officer</td><td colspan="2">Clive Palfreyman, Strategic Director, Finance</td></tr>
<tr><td>Report Author</td><td colspan="2">Caroline Watson, Senior Finance Manager, Treasury and Pensions</td></tr>
<tr><td>Version</td><td colspan="2">Final</td></tr>
<tr><td>Dated</td><td colspan="2">15 September 2023</td></tr>
<tr><td>Key Decision?</td><td colspan="2">No</td></tr>
<tr><td colspan="3">CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER</td></tr>
<tr><td>Officer Title</td><td>Comments Sought</td><td>Comments Included</td></tr>
<tr><td>Assistant Chief Executive - Governance and Assurance</td><td>No</td><td>No</td></tr>
<tr><td>Strategic Director, Finance</td><td>No</td><td>No</td></tr>
<tr><td>Cabinet Member</td><td>No</td><td>No</td></tr>
<tr><td colspan="2">Date final report sent to Constitutional Team</td><td>18 September 2023</td></tr>
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