Item No. 9.	Classification: Open	Date: 26 February 2024	Meeting Name: Pensions Advisory Panel
Report title:		Asset Allocation and Net Zero Strategy Update – December 2023	
From:		Senior Finance Manager, Treasury and Pensions	

Recommendation

1. The Pensions Advisory Panel is asked to note the Fund's asset allocation at 31 December 2023, overall performance and other matters considered by the officers and advisers of the Fund during the six months to the end of December and post quarter end.

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 – December Quarter 2023

Position Statement at 31 December 2023

4. The market value of the Fund increased during the quarter from £2,057.9m to £2,165.9m, an increase of £108m (+5.2%). In contrast, in the previous quarter the market value of the Fund increased by £4.3m.

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

	30 June		**30 September**		**31 December**	
	£m	%	£m	%	£m	%
Low carbon passive equities	699.239	34.0	702.903	34.2	745.500	34.4
Active Emerging Market equities	91.762	4.5	91.012	4.4	93.903	4.3

	30 June		30 September		31 December	
Active global equities	266.911	13.0	256.615	12.5	277.634	12.8
Total Global Equities	**1,057.912**	**51.5**	**1,050.529**	**51.0**	**1,117.037**	**51.6**
Total Diversified Growth	**100.085**	**4.9**	**0.0**	**0.0**	**0.0**	**0.0**
Total Multi-Asset Credit	**-**	**-**	**98.576**	**4.8**	**105.756**	**4.9**
Total Absolute Return Bonds	**128.956**	**6.3**	**120.335**	**5.8**	**108.709**	**5.0**
Total Index Linked Gilts	**140.966**	**6.9**	**132.102**	**6.4**	**156.791**	**7.2**
Total Property	**318.564**	**15.5**	**322.521**	**15.7**	**322.392**	**14.9**
Total ESG Priority	**262.570**	**12.8**	**274.016**	**13.2**	**278.241**	**12.8**
Total Cash & Cash Equivalents	**44.508**	**2.2**	**34.199**	**2.9**	**76.952**	**3.6**
Total Fund	**2,053.591**	**100.0**	**2,057.902**	**100.0**	**2,165.880**	**100.0**

6. The following table shows the breakdown of the market valuation as at 31 December 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	372,209 373,291	17.2 17.2	17.5 17.5	-0.3 -0.3 -0.6
Active Emerging Market equity	Comgest	93.903	4.3	5.0	-0.7
Active global equity	Newton	277,634	12.8	10.0	+2.8
Total Global Equity			**51.5**	**50.0**	**+1.5**
Total Diversified Growth*	Blackrock	**0.0**	**0.0**	**0.0**	0.0
Total Absolute Return Bonds	Blackrock	**108,708**	**5.0**	**0.0**	+5.0
Total Multi-Asset Credit	Robeco	**105,756**	**4.9**	**10.0**	-5.1
Total Index Linked Gilts	Blackrock LGIM	**95,784** **61,007**	**4.4** **2.8**	**5.0** **5.0**	**-0.6** **-2.2**
Total Property	See table below (Para 10)	**322,393**	**14.9**	**20.0**	-5.1
Total ESG Priority	See table below (Para 18)	**278,241**	**12.8**	**10.0**	+2.8
Total Cash & Cash Equivalents	LGIM Northern Trust Blackrock Newton Nuveen	**7,425** **29,763** **10,441** **7,621** **21,702**	**0.3** **1.4** **0.5** **0.4** **1.0**	0.0 0.0 0.0 0.0 0.0	+0.3 +1.4 +0.5 +0.4 +1.0 **+3.6**

	Manager(s)	TOTAL FUND £000	Actual %	Target %	(Under) Overweight
Total Fund		**2,165,880**	**100.0**		
30 September		2,057,902			
30 June		2,053.591			

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 are in Absolute Return Bonds (+5.0%) and ESG Priority Funds (+2.8%). In contrast, the key underweights are in Multi-Asset Credit (-5.1%) and Property (-5.1% excluding cash held by Nuveen).

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

- A reduction in the overweight to the Diversified Growth Fund (from +4.9%) due to a full redemption to fund the new allocation to the Robeco Global Climate Credits Fund in September 2023. Consequently, the underweight to Multi-Asset Credit (MAC) has reduced from -10% to -5.1%.

- A reduction in the overweight to the Absolute Return Bond Fund (from +6.3% at the end of June to +5.0% at the December) due to a partial redemption to fund the new allocation to the Robeco Fund as above.

- An increase in the overweight to cash (from +2.2% to +3.6%). The majority of this increase is due to an increase in the cash held by Nuveen ahead of property purchases.

9. A report on progress to appoint additional manager(s) to run the allocation to Multi-Asset Credit (with a view to being fully funded by the end of 2023-2024) is to be considered under Item 12 of this meeting. The source of funding will be the Absolute Return Bond fund managed by Blackrock.

Fund Manager Activity – public market assets

10. As mentioned in Para 7, 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.

Fund Manager Activity – property

11. The table below breaks down the property holdings showing the valuation of the direct and indirect fund holdings as at 31 December 2023:

Manager	**Description**	**Market Value £m**	**Actual %**	**Target %**
Nuveen	Direct property UK Retail Warehouse Fund	191.175 2.003	8.9	14.0
Invesco	UK Residential Fund	47.803	2.2	1.5
M&G	UK Residential Property Fund	42.723	2.0	1.5
Darwin	Leisure Development Fund	25.068	1.2	0.5
Frogmore	Frogmore Real Estate Fund III	6.765	0.3	1.2
Brockton	Brockton Capital Fund III	6.856	0.3	1.3
Total Property		**322.393**	**14.9**	**20.0**
Last quarter		**322.521**	**15.7**	**20.0**

12. The table shows that there is a significant underweight in the core property mandate run by Nuveen (-5.1%, excluding cash). However, it should be noted that Nuveen have permission to draw down cash, which is held within the Pension Fund's cash balances, as and when appropriate investment opportunities arise.

13. The overall target allocation to property is 20%, which includes ESG priority allocations to Invesco, M&G, Frogmore, Darwin (Leisure Development Fund) and Brockton Capital. As at 31 December, the total actual property allocation was 14.9%, with another 1.0% held in cash by Nuveen ahead of making new investments (Para 16).

14. At the start of the September quarter there was an outstanding commitment of £15m to the Invesco UK Residential Property Fund. During the September quarter a capital call of £10m was drawn down, with the remaining commitment being funded in October. The commitments were both funded from cash.

15. In August the Section 151 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.

16. Nuveen 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.

17. In December Nuveen advised that offers had been made on a number of properties on behalf of the Fund. The purchase of one of the properties was to be funded through cash held by Nuveen, together with £13.4m of cash held within the Pension Fund's cash balances. This was transferred to Nuveen in mid-December. However, due to a last minute query on some of the legal documentation, completion on the property did not happen until January. Hence Nuveen was holding a higher cash balance than had been expected (£21.7m compared to £6.6m at the 30 September). This was placed on deposit with a money market fund, earning interest of 5.5%, ahead of the rescheduled January

completion date. Following the quarter end, an additional £6m of cash was transferred to Nuveen to fund a further property purchase.

18. Darwin advised that there had been a significant decrease in the Net Asset Value of the Leisure Development Fund during September. This was driven by a change in the way that the assets are valued reflecting, amongst other things, an increase in the cost of borrowing. The impact on LBS PF is that the valuation of the Fund's holding reduced by £4.5m (15%) since fully funding in the June quarter. It should be noted, however, that Darwin has maintained the valuation methodology for a number of years and that this may change should market conditions be favourable.

Fund Manager Activity – ESG Priority allocations (ex-property)

19. The below table breaks down the ESG priority holdings (excluding property) showing the valuation of underlying funds as at 31 December 2023 against the original commitments:

Manager	**Fund**	**Commitment**	**Market Value £m**
Glennmont	Glennmont Clean Energy Fund III	€35m	30.102
Temporis	Operational Renewable Energy Renewable Energy Impact Strategy	£33.3m £30.6m £31.0m	65.711 31.621 21.781
Blackrock	Global Renewable Power Infrastructure	$40m	24.258
Darwin	Bereavement Services Fund	£20m	22.450
Blackstone	Strategic Capital Holdings II	$110m	47.855
BTG Pactual	Core US Timberland	$40m	34.463
TOTAL			**278.241**
Last Quarter			**274.016**

20. It should be noted that a number of the above funds are fully committed (e.g. Darwin Bereavement Fund), 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. This is covered in some detail at Item 10 of this meeting.

21. The following table shows the private market cash transactions (excluding property) for the September and December quarters:

	Net Drawdowns		Net Distributions	
	September	December	September	December
Blackstone	£5.9m		£5.1m	£0.6m
Glennmont	£1.8m		£0.2m	£0.5m
Temporis Impact Fund (TIF)	£0.8m	£4.3m	£0.2m	-
Temporis Operational Renewable Energy Strategy (TORES)				£3.3m
Temporis Renewable Energy (TREF)				£1.1m
Total impact on LBSPF cash balances	**-£8.5m**	**-£4.3m**	**+£5.5m**	**+£5.5m**

Investment Performance Results for the Period

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

	Quarter to 31 December	Year to 31 December	3 Years to 31 December p.a.	10 Years to 31 December p.a.
Fund	5.9	10.5	5.0	8.5
Benchmark[1]	5.8	11.4	6.3	9.2
Relative	+0.1	-0.9	-1.3	-0.7

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

23. The Fund made a return of 5.9% in the quarter, marginally ahead of the benchmark return of +5.8%. The total fund return for the year to the end of December 2023 was 10.5%, which was below the benchmark return of 11.4%. Over 3 years, the Fund returned 5.0% p.a. compared to a benchmark return of 6.3% p.a., a difference of -1.3% p.a. An annualised return of 8.5% over 10 years means that the Fund has exceeded, by some margin, the 2022 actuarial valuation's assumed investment returns of 4.05% p.a..

24. Further information on the performance of underlying managers will be provided during the adviser update (Item 11).

Manager meetings

25. Officers had update meetings with Glennmont (sustainable infrastructure), Newton (global equity), Nuveen (core property), Frogmore (property) and LCIV. An oral update on any matters arising will be given at this PAP meeting.

LGPS Next Steps on Investments Consultation – Government Response

26. As discussed at the PAP meeting of 27 September, officers submitted a response to the LGPS pooling consultation following circulation of the submission to members of PAP.

27. The consultation closed on 2 October 2023 and, having considered 152 submissions, the government issued a response on 22nd November 2023. A summary of the government response can be found at Appendix 1 of this report.

28. The key areas of interest to PAP are that government is progressing proposals (that were set out in the consultation) to accelerate and expand pooling, and increase investment in levelling up and private equity.

Further Areas of Progress

29. 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

30. There are no immediate implications arising.

Equalities (including socio-economic) Impact Statement

31. There are no immediate implications arising.

Health Impact Statement

32. There are no immediate implications arising.

Climate Change Implications

33. There are no immediate implications arising.

Resource Implications

34. There are no immediate implications arising.

Legal Implications

35. There are no immediate implications arising

Consultation

36. There are no immediate implications arising.

Financial Implications

37. There are no immediate implications arising.

AUDIT TRAIL

Lead Officer	Clive Palfreyman, Strategic Director of Finance	
Report Author	Tracey Milner, Pensions Investments Manager, Treasury and Pensions	
Version	Final	
Dated	14 February 2024	
Key Decision?	No	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	**Comments Sought**	**Comments Included**
Assistant Chief Executive - Governance and Assurance	No	No
Strategic Director, Finance	No	No
Cabinet Member	No	No
Date final report sent to Constitutional Team		16 February 2024

Lead Officer	Clive Palfreyman, Strategic Director of Finance
Report Author	Tracey Milner, Pensions Investments Manager, Treasury and Pensions
Version	Final
Dated	14 February 2024
Key Decision?	N/A

CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	**Comments Sought**	Comments Included
Director of Law and Democracy	N/A	N/A
Strategic Director of Finance	N/A	N/A
List other officers here		
Cabinet Member	N/A	N/A
Date final report sent to Constitutional Team		

APPENDIX 1 – LGPS Next Steps on Investments Consultation – Government Response

Introduction

1. The Government has issued a response to the LGPS consultation which closed on 2 October 2023. Given the 2025 deadline for the transfer of assets is being maintained, it is hoped that guidance will be issued soon to enable funds to identify the steps they will need to take to fully comply with the requirements.

2. The key points from the consultation response are set out below:

Pooling

- 2025 stays as the pooling transition deadline for transition of liquid assets to the pool on a comply or explain basis.

- The Government Actuary's Department estimate that the LGPS could reach around £950 billion in assets in 2040, the government is therefore looking towards a smaller number of pools with assets under management averaging £200 billion.

- Revised guidance will include a preferred model of pooling which is expected to be adopted over time based on "characteristics and outcomes" rather than prescribed structures. Inter-pool collaboration will be encouraged.

- Investment in other pools should only be done via a Fund's existing pool.

- Greater transparency on reporting to be developed in conjunction with the Scheme Advisory Board (SAB).

Levelling Up

- Government keen to maintain a broad definition of levelling up but UK wide.

- Where scale for local investment is an issue funds may wish to continue to invest outside the pool.

- Five percent investment in levelling up remains an ambition, but recognises it is not a separate asset class.

Private Equity

- On private equity the Government remains committed to unlocking capital to support growth businesses. However, "investment in the UK is particularly welcome but it is not proposed to restrict this ambition to investments in private equity in the UK".

- Ten percent investment in private equity remains an ambition and would not be mandated (need to still take into account fiduciary duty). Ten percent does relate to private equity, but funds can also include other investments in private markets outside of this where appropriate on risk/return grounds.

- Pools to be encouraged to strengthen partnerships with British Business Bank to support opportunities in venture capital and growth equity.

CMA Objective Setting for Advisers

- LGPS regulations will be amended to require objective setting for all advisers including consultants, pools and independent advisers when providing advice on investments, investment strategy statements, strategic asset allocation and manager selection.

Governance and Other

- Requirement to formally publish a training policy for the pensions advisory panel and to report on training undertaken.

- LGPS definition of investments amendment to be made in regulations.

- Guidance to be issued to increase consistency of reporting on asset allocation in annual reports, working with the Scheme Advisory Board.