

Item No.:	Classification: open	Date: 06/08/2015
To	Strategic Director of Finance and Corporate Services	
Report title	Combined Gateway 1 and 2 – approval of procurement strategy and contract award: Pension Fund Investment Management Services	
Ward(s) or groups affected	All	
From	Caroline Watson, Pension Fund Investment Manager	

RECOMMENDATIONS

1. That the strategic director of finance and corporate services confirms his prior approval to the procurement strategy outlined in this report for the appointment of Investment Management Services
2. That the strategic director of finance and corporate services confirms his prior approval to the award of the investment management services contract to the following companies with estimated fees set out as follows:
 - Brockton Capital £1,575,000
 - Frogmore Real Estate Partners £2,250,000
 - Invesco Asset Management £540,000
 - M&G Investments £800,000

The estimated total value of the four contracts is £5,165,000 and the investment periods of each provider are set out in the closed version of the report

3. That the strategic director of finance and corporate services notes that a formal review of the open ended contracts awarded to Invesco Asset Management and M&G Investments will take place after four years and formal approval will be sought for these investments going forward.

BACKGROUND INFORMATION

4. The London Borough of Southwark Pension Fund (Fund) has a strategic allocation to property of 20% of total fund assets. The current allocation to this asset class is underweight due to the relatively strong performance of equity markets. The total value of Southwark's pension fund at 31 March 2015 was £1.25 billion.
5. Following a review of the Fund's property portfolio it was recommended by the Pensions Advisory Panel to increase the Fund's property allocation back towards its strategic weighting of 20%. This requires an additional allocation of approximately £65 million.
6. In addition to the Fund's core property investment with TIAA Henderson Real Estate, the Pensions Advisory Panel has considered ways in which to achieve the increased allocation. Specific opportunities have arisen in opportunistic property and the private residential sector that would be particularly attractive to the Fund. Access to these opportunities would be through specialist pooled funds. At the

current time, the pension fund's investment advisers, Aon Hewitt, have advised that a small number of opportunities can only be accessed within a short timeframe at discounted fee rates.

7. At the 21 April 2015 meeting of the Pensions Advisory Panel, a recommendation was made, and subsequently approved by the strategic director of finance and corporate services, to commence a tender process as recommended by Aon Hewitt.
8. Following the presentation stage of the tender process on 10 June 2015, the chair of the Pensions Advisory Panel made a recommendation to the strategic director of finance and corporate services to award contracts as set out in paragraph 25 of this report. This recommendation was approved by the strategic director of finance and corporate services.
9. As the investment will be directly into pooled funds, there is no requirement to follow a procurement process under the Public Contracts Regulations (2015). Under the LGPS regulations proper advice must be sought and this has been provided by Aon Hewitt.
10. Legal advice has been received from Sackers regarding the exemptions referred to in paragraph 9 above. They have confirmed that it is not necessary to follow a statutory procurement process and that there are two possible arguments to support this conclusion:
 - (i) an investment decision should not be characterised as a contract for the supply of services or goods – the decision is an investment decision which is arguably completely out of the scope of the regulations; or
 - (ii) if the regulations do apply, then an investment decision of this sort falls into the exemption for “financial services in connection with the issue, purchase, sale or transfer of securities” under Regulation 10(e).

KEY ISSUES FOR CONSIDERATION

11. Each fund's end date varies as does the opportunities for redemption of investments. This is due to the illiquid nature of property investments and frequent redemptions would have a negative impact on the overall performance of the fund and therefore other investors. The durations of each fund varies from 4 to 7 years, the levels of fee reflects the nature of the investments (i.e. opportunistic property investment attracts higher fees than investment in the private residential sector).
12. The total contract cost has been estimated based on a number of assumptions, due to the limited amount of information available at the commencement of the contracts: two of the four funds are open ended and therefore the estimated value was calculated following the definition from Contract Standing Orders regarding estimating contract values for an undetermined period which is in accordance with regulation 6 (19b) of the PCR2015. Following this definition the contract durations were assumed to be 4 years, for the purpose of calculating total contract costs. However it is expected that the investment could be for a longer duration.

- Brockton Capital 17 July 2015
- Frogmore Real Estate Partners 17 July 2015
- Invesco Asset Management to be advised

21. Fees are expected to be above the EU procurement threshold over the life of the investments but there will be no Investment Management Agreement in place. This is because all the suggested funds are pooled. This means the Fund will be purchasing units alongside other investors and will not own the underlying property investments. The value of units will be determined by the value of the underlying investments.

22. Once an investment is made, it will be retained until either the Fund redeems or capital is returned by the funds to investors.

Procurement project plan

23. This is a key decision and as stated in paragraphs 9 and 10, it has not followed the usual CSO procurement route. Because access to the pooled funds is time limited and there are exemptions to the EU procurement regulations, the plan is to award the contracts as soon as possible.

Activity	Complete by
Recommendation from Pensions Advisory Panel and approval by Strategic Director of finance and corporate services re procurement strategy	21/04/2015
Completion of Tender Documents	26/05/2015
Invitation to Tender sent to providers	27/05/2015
Closing date for return of tenders	02/06/2015
Completion of evaluation of tenders	04/06/2015
Property manager presentations to Pensions Advisory Panel	10/06/2015
Completion of scoring & recommendation made by Pensions Advisory Panel to award	10/06/2015
Approval of recommendation made by Pensions Advisory Panel to award - strategic director of finance & corporate services	11/06/2015
Completion of external review of contracts	24/06/2015
Contract Award – M&G	30/06/2015
Contract Award – Frogmore	07/07/2015
CCRB Review Combined Gateway 1 & 2	09/07/2015
Contract Award – Brockton Capital	14/07/2015
Contract Award – Invesco Asset Management	To be confirmed
Contract Start	Varies
Add to contract register	July 15
Forward Plan	August 15

Activity	Complete by
Notification of Forthcoming Decision	05/08/2015
Approval of Combined Gateway 1 and 2	w/e 14/08/2015
End of scrutiny call-in period and notification of implementation of Gateway decision	31/08/2015
Contract Completion Date	Varies – see paragraph 11

Description of procurement outcomes

24. This procurement will achieve the implementation of the Fund's strategic allocation to property of 20% ensuring the required diversification of the fund's investments and protecting against the predicted lower performance in equity markets in the next year.
25. The total amount to be invested, of £65 million, will be allocated across the 4 investment managers based on scores awarded during the procurement process.

This will become public information in annual report etc, but again, commercial sensitivity of fees? Therefore used summarised information?

Tender Process

26. As explained in paragraphs 9 and 10, this did not follow an EU procurement process.
27. Stage 1 Invitation to Submit a Quotation. This was sent to the four investment managers identified by Aon Hewitt. Following the scoring of stage 1, all four managers were taken forward to stage 2 and provided a presentation to the Pensions Advisory Panel.
28. The tender process was designed to clarify the two different types of investments (opportunistic and private residential property) and their suitability for fund investment and also to be fully flexible such that the Pensions Advisory Panel may choose not to allocate to either sector or choose to fully allocate to a single fund. From the assessment of both stages, it was concluded that the four managers should all be appointed, with the amounts detailed in paragraph 25 above being awarded for investment with each.
29. All four funds have already been assessed by Aon Hewitt and passed the due diligence and quality factor. The evaluation was therefore focused on the suitability of the investment for the Fund (70%) and value for money (30%).

Tender evaluation

30. The evaluation and scoring of responses to the Invitation to Submit a Quotation took place on 3 June 2015 by Aon Hewitt and was reviewed and agreed by the strategic director of finance and corporate services and Chair of the Pensions Advisory Panel on 4 June 2015.
31. Before sending out the Invitation to Submit a Quotation, weightings were set for each criterion. These are not consistent with the Council's standard price:quality weightings. As set out in the table below, the highest weighting was given to suitability and quality. The investments being considered are high risk and as such the emphasis in assessing them is on the quality of the investment strategy, personnel involved in running the funds and the ability to achieve the target returns within an acceptable level of risk. Fees are high for all funds given the specialist nature of the investments being managed, but must be considered in the context of the high target returns.
32. The two opportunistic fund managers are targeting net returns in the region of 12% to 14% per annum and the two private rented sector managers are targeting 7% - 9% per annum. This compares to the current long term UK returns assumption for core, diversified property of just over 6% per annum.

Criteria	Weighting
Assessment of Suitability	40%
Price	30%
Presentation Stage	30%
Total	100%

33. The above criteria were broken down into sub-criteria as set out in the detailed scoring as set out in the closed version of this report.
34. Questions in each of these sections were scored based on 0 to 3 and weighted accordingly:
35. The evaluation consisted of two stages. Stage one was a desktop evaluation based on an assessment of suitability (40%) and Price (30%). Stage 2 was a presentation and was assessed according to three criteria: quality of team; ability to achieve target returns; and explanation of risks within their strategy.
36. All four providers were invited to attend the stage 2 presentation. The scores for stage 1 and 2 were added together and the scoring of all four managers was at such a level it was judged appropriate to allocate to all four. Detailed scoring is set out in the closed version.

Plans for the transition from the old to the new contract

37. Each fund has different investment cycles with limited windows of opportunity to invest. At the commencement of the procurement, Aon Hewitt advised that M&G has an opportunity at the end of June 2015, with commitments for Frogmore Real Estate Partners, Brockton Capital and Invesco Asset Management all requiring to be in place by 17 July 2015. The speed of drawdown will vary by manager according to the opportunities they are able to source.

38. The investment strategy review recommended funding these new investments from passive global equities.

The funds will be drawn down in stages.

Plans for monitoring and management of the contract

39. The contracts will be monitored by the Pensions Advisory Panel and the Pensions Investments team. Performance will be reviewed quarterly to ensure the investment managers are meeting the pre agreed performance targets. Quarterly reports are received from both the Fund's investment advisers and performance measurement providers setting out detailed performance against benchmark and advising on the on going suitability of the investments held.
40. The contracts will be continually monitored by the Pensions Investments section to ensure that performance targets are met.

Identified risks for the new contract

41. The greatest risk under these contracts is the risk of each fund manager not achieving the performance target set and of the pension fund receiving back less than was originally invested.
42. This risk has been managed by ensuring detailed evaluation criteria were applied during the procurement process and due diligence was carried out by Aon Hewitt prior to putting each fund forward for consideration. As with all service providers to the Pension Fund, the fund's investment advisers will monitor the on going suitability of each manager in providing these services to the Fund. This will be reviewed by the Pensions Advisory Panel on a quarterly basis. However as noted in paragraph 11, there will be limited opportunities for redemption of investments.

Policy implications

43. The Pensions Advisory Panel is required to continually review the effectiveness of its investment managers at least quarterly.

Community impact statement

44. This decision has been judged to have no or a very small impact on local people and communities

Sustainability considerations

Economic Considerations

45. The full cost of all four contracts is estimated as £5,165,000 and there will be no additional running costs. Due to the specialist nature of this market, there is little opportunity for local economic benefit.

Social Considerations

46. All personnel working on these contracts will be paid above the London Living Wage.

Environmental Considerations

47. All information for the duration of this contract will be exchanged electronically in order to minimise the need for paper records. As far as is practicable, meetings and clarifications will take place electronically or over the phone.

Staffing implications

48. As this procurement is for the replacement of existing investment management services, there will be no changes to staffing requirements on the appointment of the four new providers. There are no TUPE implications on the letting of these contracts.

Financial implications

49. All fees arising from both the procurement and the letting of these contracts will be met by the Pension Fund.
50. This is an on going service to the pension fund and as such the fund is accustomed to incurring such costs. Fees for these services are subject to the continual scrutiny of the Pensions Advisory Panel and the strategic director of finance and corporate services in his S.151 role as the responsible officer for the Fund.

Legal implications

51. See concurrent from the Director of Legal Services.

SUPPLEMENTARY ADVICE FROM OTHER OFFICERS

Head of Procurement

52. This report is seeking to formalise the previous procurement strategy decision and award of the contract for the pension fund investment management services.
53. The reason for prior approval and the need to formalise this decision is that the pension fund's investment advisers, advised of the investment opportunities open and the limited time frame these opportunities could be accessed at discounted rates. A decision to immediately carry out the necessary process to enter into an investment commitment was made at a meeting of the pension's advisory panel.
54. The pension fund's investment advisers identified four potential providers with the ability and expertise to conduct the required functions. A process was then followed to assess the potential provider's suitability. The process

that was followed is set out within the tender evaluation section of the report and it was concluded that it was appropriate to allocate to all four providers.

55. The report sets out the contract management and monitoring arrangements that are in place to ensure that pre-agreed performance targets are met.

Director of Legal Services

56. The Director of Legal Services notes the contents of this report which seeks the approval of the Strategic Director of Finance and Corporate Services to the procurement strategy and the contract award of a contract for Pension Fund Investment Management Services to the 4 firms referred to in recommendation 2.
57. This is a contract for services to which the Public Contracts Regulations 2015 do not apply.
58. Under CSO 5.4 there is a requirement to take all reasonable steps to obtain five tenders following a publicly competitive tendering process. In exceptional circumstances the procedures need not be followed and these are set out in the report.
59. Under Financial Standing Order 1 (g) all pension scheme decisions are the responsibility of the chief finance officer acting on the advice of the Pensions Advisory Panel. Paragraph 7 shows that the procurement route taken is in accordance with the Pensions Advisory Panel recommendation.
60. This is a key decision.
61. CSO 2.3 provides that a contract may only be awarded if the expenditure has been included in approved revenue or capital estimates or has been otherwise approved by, or on behalf of the Council. Paragraphs 51 and 52 of this Report confirm how the proposed contract will be funded.
62. Advice should be sought from Legal Services in relation to the documentation that is to be used to put in place the contracts.

Strategic Director of Finance and Corporate Services (F&CS15/004)

63. The strategic director of finance and corporate services notes the recommendations in this report for the procurement strategy and contract award for the appointment of Investment Management Services to the Pensions Fund.
64. The commitment to invest commences 17 July 2015 and the investment periods of each provider are shown in the closed version of the report. All fees arising from both the procurement and the letting of these contracts will be met by the Pension Fund.

FOR DELEGATED APPROVAL

Under the powers delegated to me in accordance with the Council's Contract Standing Orders, I authorise action in accordance with the recommendation(s) contained in the above report.

Signature  Date 14.8.15

Designation STRATEGIC DIRECTOR OF FINANCE AND CORPORATE SERVICES

BACKGROUND DOCUMENTS

Background documents	Held At	Contact
Pensions Advisory Panel Minutes	Pensions Investments, 160 Tooley Street	Caroline Watson x54379
Councillor Colley & Duncan Whitfield emails confirming recommendation & approval to appoint	Pensions Investments, 160 Tooley Street	Caroline Watson x54379

APPENDICES

No	Title

AUDIT TRAIL

Lead Officer	Chris O'Brien	
Report Author	Caroline Watson	
Version	Final	
Dated	6/8/15	
Key Decision?	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	Comments Sought	Comments included
Head of Procurement	Yes	Yes
Director of Legal Services	Yes	Yes
Strategic Director of Finance and Corporate Services	Yes	Yes
Head of Specialist Housing Services	No	No
Cabinet Member	No	No
Contract Review Boards		
Departmental Contract Review Board	No	No
Corporate Contract Review Board	Yes	Yes
Cabinet	No	No
Date final report sent to Constitutional/Community Council/Scrutiny Team	N/A	

