

**PENSIONS COMMITTEE**  
**19 MARCH 2018**

**ALTERNATIVES INVESTMENT**

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**Recommendations**

1. The Interim Chief Financial Officer recommends that:
  - a) the commitment of £25m to Hermes Fund II be approved, following the appropriate due diligence undertaken by Bfinance and sign off by the Pensions Committee Chairman; and
  - b) A £65m allocation to a new corporate private debt mandate with EQT and associated amendment to the Fund's Investment Strategy Statement be approved.

**Background**

2. In December 2016, the Committee approved the move to a new strategic asset allocation for the Fund as part of the Fund's strategic asset allocation review. (Minute no. 65 refers) The aim of the asset allocation change is to achieve lower volatility without reducing total returns to enable a closer correlation between the Fund's assets and the longer term liability profile. The new structure is summarised below in table 1:

*Table 1: Summary Changes to the Strategic Asset Allocation*

By Review Year	2013		2016	
Asset Type by %	Allocation	Tolerance	Allocation	Tolerance
Equities	80	75 – 90	75	70 - 85
Bonds	10	5 – 15	10	5 – 15
Infrastructure and Property	10	5 – 10	15	5 – 15

3. In February 2017 BFinance were appointed as a specialist procurement adviser to assist with the tender for property and infrastructure pooled funds. BFinance services included portfolio design of the proposed investments in terms of style, size and geographic exposure along with analysis of proposals from interested managers and preparation of a report in order to select a short list of suitable specialists capable of managing the mandates successfully.
4. As a result of BFinance's analysis four managers were recommended for appointment by the Pension Investment Advisory Panel and then approved for appointment by the Pensions Committee: Invesco, AEW, Stonepeak and First State.

## **Infrastructure Managers**

5. The appointment of Stone Peak, a specialist U.S. infrastructure manager, and First State, a specialist European infrastructure manager, provided good diversification away from the Fund's UK focused infrastructure investments. Stonepeak and First State were recommended by BFinance, following an in depth procurement, as the highest rated managers in these regions and are expected to provide returns in line with the Fund's requirements.

## **Property and Infrastructure Commitments**

6. The Pensions Committee decision to increase the allocation to pooled property and infrastructure funds from 10% to 15% of the Fund's market value converted to a Sterling value of an additional commitment of £170m in June 2017. However due to the analysis undertaken by BFinance, modelling the drawdown profile and distribution profile of the Fund's infrastructure and property pooled funds, an additional £210m was required to meet a peak of 88% deployment in 2018/19. A £250m commitment would have been required to ensure a c. 100% deployment, and therefore 15% of the current market value of the Fund to be invested at a peak in 2018/ 19. The Committee approved a £210m commitment to allow for further deployment of capital over the next twelve to eighteen months to help increase vintage year diversification and take advantage of any market opportunities as they arose given the changing market environment.

7. Since June 2017 the market value of the Fund's assets has increased to c. £2.7bn and following further modelling undertaken by Bfinance an additional £75m was recommended to be committed to ensure c. 100% deployment of the strategic asset allocation to pooled property and infrastructure funds.

## **Fixed Income Allocation**

8. The Fund has a strategic asset allocation to fixed income assets of 10% of the total fund value. At present, the Fund's actual allocation to fixed income is c. 6% via a segregated account with JP Morgan Asset Management and as such is under-allocated by c. 4% (c. £110m) relative to the strategic asset allocation target. The c. 4% underweight position is due to the Fund's equities outperforming corporate bonds and an active decision not to rebalance the weights to these asset classes. The Fund is therefore overweight to equities due to the underweight position in corporate bonds.

9. Taking into consideration the current funding position of the Fund at c. 100% and the Committee's recent decision to implement an equity protection strategy, it was recommended and agreed that the overweight position to equities is reduced and alternative investment options are considered.

## **Bfinance analysis and recommendations**

10. At the December Committee meeting an analysis of the Fund's real assets portfolio and evaluation of market opportunities were provided by Bfinance. Bfinance recommended a further £75m allocation to infrastructure be implemented. This comprised of a £50m allocation to the overseas infrastructure funds selected in June 2017 (First State Investments and Stonepeak) which has been taken forward.

11. In addition, it was proposed that the Committee consider making a £25m allocation to the latest fund launched by Hermes Infrastructure (Hermes Infrastructure Fund II) to maintain the proportion of UK and overseas commitments to infrastructure, subject to appropriate Bfinance due diligence. The due diligence and refresh of the original infrastructure pooled fund search to include Hermes Fund II was required due to Hermes Infrastructure Fund II being a new investment with different assets and investment risks and not a top-up into an existing Infrastructure Fund in which the Fund currently invests. The due diligence report is attached as Exempt Appendix 1 and based on the findings from Bfinance this hasn't raised any concerns about investing in the core strategy. It is therefore recommended that Committee approve the £25m into the Hermes Fund II

12. Bfinance also considered the underweight position to Corporate Bonds and have assessed alternative investment options outside of Bonds given the current interest rate and market environment. Bfinance recommend that in the current market environment, corporate private debt offers an attractive risk adjusted return with strong downside protection and yield. Further details regarding corporate private debt vehicles were provided to the Committee in December.

13. In January/February 2018, BFinance undertook a portfolio design of the proposed investments in terms of style, size and geographic exposure along with analysis of proposals from interested managers and preparation of a report in order to select a short list of suitable specialists capable of managing the mandate successfully. Exempt Appendix 2 provides further details of EQT's submission.

14. As a result of BFinance's analysis, one manager was recommended for appointment by the Pension Investment Advisory Panel and approval is sought for appointment by the Pensions Committee being EQT with a commitment of £65m.

15. It is also recommended that the Funds Investment Strategy Statement be amended to include fixed income investments (change from Bonds to Fixed income) such as corporate debt vehicles as this is in line with the Funds objectives and beliefs. The new structure is summarised below in table 2. Note that this does not change the Funds strategic asset allocation of fixed income assets of 10% of the total fund value but now is proposed to include alternative options outside of bonds.

*Table 2: Summary Changes to the Strategic Asset Allocation*

By Review Year	2013		2016	
Asset Type by %	Allocation	Tolerance	Allocation	Tolerance
Equities	80	75 – 90	75	70 - 85
Fixed Income	10	5 – 15	10	5 – 15
Infrastructure and Property	10	5 – 10	15	5 – 15

16. Please note that Appendices 1 and 2 contain exempt information (on salmon pages) and should members wish to discuss the information included in these Appendices they would need to consider passing the appropriate resolution and moving into exempt session.

## **Contact Points**

### County Council Contact Points

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### Specific Contact Points for this report

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## **Supporting Information**

- Appendix 1 - BFinance report due diligence on Hermes Fund II (**Exempt information – Salmon pages**)
- Appendix 2 - EQT report recommended Fund manager for corporate private debt vehicles investment (**Exempt information – Salmon pages**)

## **Background Papers**

In the opinion of the proper officer (in this case the Interim Chief Financial Officer) the following re the background paper relating to this report:

Strategic Asset Allocation Report December 2016