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<tr><td colspan="3">REPORT OF THE GROUP DIRECTOR, FINANCE AND CORPORATE RESOURCES</td></tr>
<tr><td rowspan="2">Investment Strategy Review - Stage 2: Asset Allocation

Pensions Committee
14th January 2021</td><td>Classification
PUBLIC</td><td rowspan="2">Enclosures
Four

AGENDA ITEM NO.
9</td></tr>
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ALL</td></tr>
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1. INTRODUCTION

1.1. This report presents the Committee with detailed proposals regarding the future asset allocation for the Fund along with discussion regarding the Fund's currency hedging policy, in line with discussion at a recent workshop of the Committee. The proposals follow on from the high level strategic approach and asset liability modelling (ALM) presented at the September 2020 Committee meeting when it was agreed that the current strategy should be diversified further into income-generating assets.

1.2. This report also introduces the current work being undertaken by the London Collective Investment Vehicle (LCIV) in respect of a mandate for renewable infrastructure and seeks approval in principle to a 5% allocation to this mandate, pending the outcome of due diligence by Hymans, the Funds Investment Advisers.

2. RECOMMENDATIONS

2.1. The Committee is recommended to:

- Approve the reduction of its current equity allocation by 3% with proceeds invested in the BlackRock Short Bond Fund, pending eventual investment in the private lending strategy as set out at Appendix 1 to this report

- Note the detailed analysis in respect of the Fund's current and proposed future asset allocation as set out at Appendix 2 to this report

- Approve the detailed recommendations set out in Appendix 3 to this report and note that if approved this will culminate in the revised asset allocation as set out in the table at page 17 of the Appendix and summarised at para 7.6 of this report

- Note the indicative timetable for the implementation of the proposed revised Investment Strategy as set out in Appendix 3.

- Direct officers as to the preferred options for currency hedging going forward, taking account of advice set out in Appendices 2 and 3.

- Approve in principle a 5% allocation to a LCIV Renewable infrastructure Fund to be implemented in Q1 2021, subject to due diligence of the LCIV offering by Hymans, the Fund's Investment Advisers

3. RELATED DECISIONS

- Pensions Committee 24th June 2020 – Investment Strategy Review Timetable and ISS Update
- Pensions Committee 30th September 2020 - Invest Strategy Review Stage 1: Setting High Level Investment Strategy

4. COMMENTS OF THE GROUP DIRECTOR, FINANCE AND CORPORATE RESOURCES

4.1. This paper sets out a number of recommendations in respect of the implementation of a revised Investment Strategy following the ALM presented at the last Committee meeting and a recent workshop. Specifically it makes recommendations in respect of changes to the asset allocation, representing a move away from growth to income generating asset classes.

4.2. In addition, Committee is being asked to make an in principle decision to allocate 5% of the Fund's assets to renewable infrastructure via an offering that is being developed by the LCIV, showing the Fund's continued commitment to the asset pooling initiative and furthering progress on its climate and ESG objectives.

4.3. Development of a robust investment strategy helps the Fund to take an ordered and prudent approach to the management of its assets, helping to manage the long term costs associated with the Pension Fund.

4.4. Spending time developing the investment strategy helps to ensure that the Pensions Committee are fulfilling their responsibilities as quasi Trustees of the Fund and that the Fund's investment objectives and policies are clearly set out in line with the Local Government Pensions Scheme (Management and Investment of Funds) Regulations 2016

4.5. There are no direct financial implications arising from this report.

5. COMMENTS OF THE DIRECTOR OF LEGAL AND GOVERNANCE

5.1. The Committee has responsibility for the prudent and effective stewardship of the Pension Fund and a clear fiduciary duty in the performance of its functions. Reviewing the Fund's Investment Strategy following the 2019 actuarial valuation helps to ensure that the Strategy remains appropriate given the funding position and assists the Committee in fulfilling this duty.

5.2. Regulation 7 of the 2016 Regulations requires the Administering Authority to formulate an Investment Strategy in line with guidance published by the Secretary of State. Regulation 7(2) stipulates that the authority's investment strategy must include:

(a) a requirement to invest fund money in a wide variety of investments;

(b) the authority's assessment of the suitability of particular investments and types of investments;

(c) the authority's approach to risk, including the ways in which risks are to be assessed and managed;

(d) the authority's approach to pooling investments, including the use of collective investment vehicles and shared services;

(e) the authority's policy on how social, environmental and corporate governance considerations are taken into account in the selection, non-selection, retention and realisation of investments; and

(f) the authority's policy on the exercise of the rights (including voting rights) attaching to investments.

5.3. This paper helps demonstrate that the Committee is investing in line with Regulation 7(2), by carrying out an assessment of the suitability of different types of investments and considering how some of the risks to which the Fund is exposed can be managed through setting an appropriate investment strategy.

6. INVESTMENT STRATEGY IMPLEMENTATION - REBALANCING

6.1. As set out in previous reports to the Committee, the decisions taken around investment strategy are some of the most important decisions taken by the Pensions Committee. Contributions and investment returns are the only two options available to fund benefit payments; decisions around the contribution and investment strategies are therefore some of the most significant in terms of their overall impact on the Fund. It should be noted that the high level decision making around the type of assets held has far more impact than manager selection.

6.2. Appendix 1 to this report sets out a specific recommendation to rebalance the Fund's current asset allocation in line with its current investment strategy. As a result of the decision in 2019 to make a 10% allocation to 2 private lending mandates and the implementation of this decision to date, equity holdings are currently significantly overweight. Conversely, income assets are underweight, albeit due to the way the private lending mandates are funded over an extended period.

6.3. Committee is being asked to address the overweight position in the equity mandates which will thereby ensure adequate resources are available as required to fund the remaining private lending mandate drawdowns as and when they are requested. The funds realised from the sale of equities will be held in the BlackRock Short Bond Fund, as previously agreed by the Committee, until such time as they are required to fund the private lending.

7. INVESTMENT STRATEGY DEVELOPMENT - ASSET ALLOCATION

7.1. Appendix 2 to this report sets out the detailed analysis of the current asset allocation and recommendations for a revised investment strategy across the 3 main asset classes - growth assets, income assets and protection assets. The recommendations are in line with the discussions at the recent investment strategy workshop held in November 2020.

7.2. Appendix 3 provides a more concise overview of the analysis and recommendations and will be used as the main document at the Committee meeting by the investment adviser from Hymans.

7.3. The overall summary of recommended changes to the Fund's investment strategy are set out in the table on page 17 of Appendix 3. As can be seen here, it is recommended that the implementation takes place in two phases, the first of which would refocus the equity allocation to a more global approach whilst at the same time reducing the overall allocation to growth assets in favour of income generating assets via both infrastructure and alternative credit. It is anticipated that such a move could be facilitated via future LCIV offerings, providing these are deemed suitable.

7.4. Importantly, it should be noted that these proposed changes will help to address and progress the Fund towards its previously set climate related objectives as it would represent a "greener" asset allocation. In particular the move away from the UK will help decarbonise the Fund's portfolio and the increase in active management will provide greater control over ESG priorities. At the same time the changes will increase assets held within the LCIV.

7.5. Whilst phase 2 continues with this approach, these further changes to asset allocation increase assets held within the LCIV by including more mandates that we believe will be offered by the LCIV, specifically in relation to property and fixed income.

7.6. If the recommendations included in these appendices are approved, the following changes to overall asset allocation will take place in 2 phases between 2021 and 2024.

Asset Class	Current target allocation	Phase 1 allocation	Phase 2 allocation
Growth (equities)	50.5%	40.5%	40.5%
Growth (DGFs)	12.5%	7.5%	7.5%
Total Growth	**63%**	**48%**	**48%**
Income	20%	35%	35%
Protection	17%	17%	17%
Total	**100%**	**100%**	**100%**

7.7. It is anticipated that the implementation of phase 1 would take around 12 months and phase 2 throughout the following 2 years to 2024.

8. INVESTMENT STRATEGY DEVELOPMENT - CURRENCY HEDGING

8.1. One of the areas for further consideration by the Committee alongside the decisions regarding actual asset allocation is the decision as to whether or not the Fund should hedge its currency risk arising from investment in overseas assets, and if so, then to what extent. This is covered in detail in both Appendix 2 and 3.

8.2. The current strategic target is to hedge 50% of the Fund's overseas exposure although at present it is estimated that c30% of the Fund's equity exposure is hedged.

8.3. The 50% target represented the Committee's desire at the time it was agreed to reduce the volatility of the Fund's equity allocation by the removal of currency exposure but to mitigate the costs associated with hedging by hedging 50% rather than 100% thus achieving some risk reduction at a lower cost.

8.4. A currency hedge contributes to the management of funding volatility and downside volatility in times of market stress. However, it is extremely difficult to second guess the future direction of currency markets. It is though noted that currency risk is second compared to risks associated with the Fund's other assets but analysis set out in the appendices suggests there is merit in maintaining some degree of exposure.

8.5. Discussion at the meeting will focus on two options being the removal of currency hedging altogether at the same time as the equity changes outlined above, or to reduce the target hedge to the current exposure of c 30% to be implemented via bespoke arrangements or pooled funds.

8.6. Pending the outcome of discussions in this respect at the Committee meeting, officers will bring back next steps in relation to currency hedging as part of the implementation of the agreed strategy changes.

9. INVESTMENT STRATEGY DEVELOPMENT - NEXT STEPS

9.1. It is anticipated that the revised Investment Strategy will be finalised at the next Pensions Committee meeting in March 2021. This will bring together the work from the last 2 Committees and workshops and include final recommendations on currency hedging arising from the discussion at this meeting.

9.2. The various strands of the Investment Strategy will be brought together in the final document, including the investment beliefs agreed at the previous Committee and of course the specific statement on Responsible Investment. It is recognised that further work to develop this particular area further might be required, although the beliefs agreed will be instrumental strand throughout implementation

9.3. The timetable for the implementation as summarised in Appendices 2 and 3 will be expanded to provide more granular detail as required.

10. LCIV RENEWABLE INFRASTRUCTURE FUND

10.1. Appendix 4 to this report sets out an update from the LCIV on its current procurement relating to a fund manager for its proposed Renewable Infrastructure Fund.

10.2. Officers of the Hackney Fund have been active members on the Seed Investor Group for this offering given the Committee's past decision to allocate upto 5% of the Fund's asset values to the infrastructure asset class (included in both its current investment strategy and the proposed future investment strategy).

10.3. The appendix sets out proposed details of the Fund along with a timetable for the procurement of a fund manager and launch date. If the timetable is met, the fund will potentially launch before the next meeting of the Pensions Committee and the Hackney Fund might not therefore have the opportunity to invest in the Fund before its first close. It is anticipated that the opportunity to invest after this time might not present itself for a further 2 to years.

10.4. Given the above, this report is seeking an in principle decision to approve the 5% allocation (c£75m - £80m) to the LCIV Renewable Infrastructure Fund, pending completion of satisfactory due diligence by Hymans Investment Advisers. A further verbal update will be presented to the January Committee in respect of this following a further meeting of the Seed Investor Group scheduled for the 13th January.

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Appendices
Appendix 1 - Rebalancing Recommendation
Appendix 2 - EXEMPT - Review of Investment Strategy - Recommendations
Appendix 3 - EXEMPT - Strategy Review Slides - Recommendations
Appendix 4 - EXEMPT - LCIV Renewable Infrastructure Fund Update