

Title of Report	Strategic Asset Allocation Review - High Level Decisions
For Consideration By	Pensions Committee
Meeting Date	27 April 2023
Classification	Public (including Exempt Appendix)
Ward(s) Affected	All
Group Director	Ian Williams, Group Director Finance & Corporate Resources

1. **Introduction**

- 1.1. This report presents the Pensions Committee with high level proposals for a review of the Fund's Strategic Asset Allocation, following on from the discussion paper presented at the 30th March 2023 Pensions Committee meeting. It recommends investment into 3 new asset classes to help the Fund achieve its climate targets, meet its cashflow needs and meet levelling up requirements.

2. **Recommendations**

2.1. **The Pensions Committee is recommended to:**

- **Approve the following new allocations as set out in the recommended revised strategic asset allocation presented in Appendix 1 ("Strawman 1", Pg 16):**
 - **Multi Asset Credit - 5%**
 - **Impact Property - 5%**
 - **Nature-based solutions - 5%**

The allocations are to be funded as described in in Appendix 1 ("Strawman 1", Pg 16)

3. **Related Decisions**

- 3.1. Pensions Committee 30 March 2023 - Strategic Asset Allocation Review - Introduction
- 3.2. Pensions Committee 30 January 2023 - Climate Target Setting
- 3.3. Pensions Committee 15 March 2021 - Investment Strategy Implementation Plan

- 3.4. Pensions Committee 14 January 2021 - Investment Strategy Review - Stage 2: Asset Allocation
- 3.5. Pensions Committee 30 September 2020 - Investment Strategy Review - Stage 1: Setting High Level Investment Strategy

4. **Comments of the Group Director of Finance and Corporate Resources.**

- 4.1. This paper sets out proposals to assist the Committee in developing the Fund's investment strategy. Development of a robust investment strategy helps the Committee to take an ordered and prudent approach to the management of the Fund's assets, helping to manage the long term costs associated with the Pension Fund.
- 4.2. Spending time developing the investment strategy helps to ensure that the Pensions Committee is fulfilling its fiduciary duties 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. It is emphasised that while the proposals referred to in Appendix 1 speak to the Funds ambition to get to net zero by 2040 and the targets for the LGPS to invest up to 5% of assets in 'local' investments the Pensions Committees fiduciary duties remain paramount and appropriate due diligence will need to be undertaken with regard to estimated returns before making these investments.
- 4.3. There are no immediate financial implications arising from this report.

5. **Comments of the Director of Legal, Democratic and Electoral Services**

- 5.1. The Pensions 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 2022 actuarial valuation helps to ensure that the Strategy remains appropriate given the funding position and assists the Committee in fulfilling its fiduciary 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.

5.4. There are no immediate legal implications arising from this report.

6. **Background to the report**

6.1. This report presents the Pensions Committee with high level proposals for a review of the Fund's Strategic Asset Allocation, following on from the discussion paper presented at the 30th March 2023 Pensions Committee meeting. It recommends investment into 3 new asset classes to help the Fund achieve its climate targets, meet its cashflow needs and meet levelling up requirements.

6.2. The recommendations paper presented at Appendix 1 has been prepared by Redigton, the Fund's investment consultants, on the basis of discussions with officers. This paper was first introduced at the meeting of the Pensions Committee on 30 March 2023, and has now been updated to include additional information on the asset classes recommended.

6.3. The paper sets out the strategic objectives of the Fund and assesses how the Fund is currently positioned to achieve those objectives. It highlights key areas where action may be required and proposes an updated Strategic Asset Allocation (SAA) that is expected to improve the probability of the Fund achieving its objectives.

6.4. The review follows on from the Fund's 2022 actuarial valuation, which saw an increase in the funding level to 106% from 92% at the previous valuation. There have been a number of other key changes since the last review, including:

- A significant change in the Fund's cashflow profile. Benefits outgoing are expected to increase by 10.1% from April 2023 in line with inflation linked pension increases, whilst the Council's contribution rate is set to reduce from 30% to 27% of payroll. As the Fund matures and inflation remains elevated cashflow is likely to become an increasing area of focus.
- New climate targets. The Fund's ambition is to reach net zero by 2040, and the Committee are therefore now considering ambitious new

interim targets to monitor progress and ensure the Fund remains a leader in this field.

- New levelling up requirements and expected changes to pooling guidance. The 2022 Government White Paper set out targets for the LGPS to invest up to 5% of assets in 'local' investments, whilst updated pooling guidance for LGPS funds is expected later this spring.

6.5. The first section of the discussion paper (Pgs 4-11) covers Research and Objectives, and follows on from the recent survey that the Committee and officers completed. It provides the context to setting the investment strategy by considering the impact of the key changes highlighted above as well as reviewing the Fund's risk return profile. It then formalises the Fund's objectives and aims of the strategic review in a Pension Risk Management Framework (PRMF).

6.6. The aim of the PRMF is to:

- Ensure that all key stakeholders are aligned on the same objectives;
- Frame and prioritise decisions against their contribution to achieving those objectives; and
- Monitor progress against these objectives to ensure appropriate action can be taken quickly.

6.7. The next section of the paper (Pgs 12-30) builds on the newly-formed objectives and covers Strategy. It outlines a set of proposals for changes to the Fund's SAA to help increase the probability of the Fund achieving its objectives. These proposals include suggested allocations to multi asset credit, impact property and nature based solutions.

6.8. Multi asset credit strategies invest across a range of credit asset classes including corporate bonds, leveraged loans and asset-backed securities. Managers aim to invest flexibly across the range of assets and generate returns above those of border credit markets through varying market exposure, asset class and sector selection and individual security selection.

6.9. The key aim of investing in a multi asset credit mandate would be to help manage the Fund's cashflows, as it offers good income potential and diversified exposure across a range of credit classes.

6.10. Social impact property encompasses a range of strategies including affordable housing, which look to provide net additional accommodation to those with a housing need. The majority of strategies are fully or partially government-funded schemes, with inflation-linked leases. The inflation linkage supports income growth, while long term leases offer a stable yield. This type of strategy can also offer real world social impact by helping to address housing needs.

6.11. Nature-based solutions are actions which protect, sustainably manage, or restore natural ecosystems (land-based and/or water-based) and address challenges related to climate change, human well-being, and biodiversity.

Most managers focus on investing in real assets, but listed equity and private equity products are also emerging.

- 6.12. The opportunity set within nature-based solutions is very wide; whilst the majority (>60%) of nature-based strategies have exposure to agriculture and/or forestry, other sectors include nature-based credits and conservation/restoration activities. The Fund's key aims in investing in a nature-based strategy would be to help diversify its portfolio, generate income and help manage inflation risk. A nature-based strategy could also help the Fund make a positive contribution to the world's stock of natural capital.
- 6.13. More details on the potential benefits and risks of the strategies described above are included within the individual strategy sections of Appendix 1. Pg 32 also sets out the expected impact of the recommended changes on the PRMF.
- 6.14. An overview of the proposals and their impact on the Fund's SAA if agreed can be found on Pg 13 of Appendix 1. The impact of the proposed changes is considered against the following metrics:
- Expected return
 - Value at Risk
 - Scope 1 & 2 CO₂ emissions
 - 2°C disorderly transition risk
 - Implied temperature rise
 - % in income producing assets

The overview also sets out proposals for funding the recommended allocations.

7. **Decision Making and Next Steps**

- 7.1. This paper asks the Pensions Committee to formally approve allocations to multi asset credit, impact property and nature-based solutions as outlined in Section 2. Approval of these high level recommendations would set an outline strategic asset allocation for the Fund, but would not commit the Fund to any specific product or route to implementation.
- 7.2. Once the high level asset allocation has been agreed, work can begin on identifying the most appropriate route (either direct or via the London CIV) to implementation for any agreed changes. It is anticipated that this work will take place during Q1 2023/24, with initial recommendations being brought to the June 2023 Pensions Committee.

Appendices

Appendix 1 (EXEMPT) - Strategic Asset Allocation Review

By Virtue of Paragraph(s) 3 Part 1 of schedule 12A of the Local Government Act 1972 this report and/or appendix is exempt because it contains Information relating to the financial or business affairs of any particular person (including the authority holding the information) and it is considered that the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

Background documents

None

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