Report for: **NOTE AND ACTION**
Item Number:

Contains Confidential or Exempt Information	**Yes:** *Appendix E contain exempt information by virtue of para 3 of Part 1 of schedule 12A to the Local Govt. Act 1972*
Title	Pension Fund Performance Monitoring & Update for the quarter ended 31 December 2023
Responsible Officer(s)	Emily Hill, Strategic Director Resources (Chief Finance Officer)
Authors	Bridget Uku, Finance Manager Treasury & Investments Ext: 5981 Email: ukub@ealing.gov.uk Nyce Higiro, Financial Accountant Ext: 9558 Email: higiron@ealing.gov.uk
Portfolio	Cllr Callum Anderson – Chair of the Pension Fund Panel
For Consideration By	Pension Fund Panel
Date to be Considered	21 March 2024
Keywords/Index	Pension Fund Performance, Investments, LGPS

Purpose of Report

This report informs the Pension Fund Panel (PFP) of the investment performance of the Fund Managers over the quarter to 31 December 2023.

The report also updates members on other Pension Fund (Fund) specific and Local Government Pension Scheme (LGPS) related issues that have arisen since the last PFP Meeting.

1. Recommendations

The Panel is asked to:

1.1 Note the value of the Fund Investments of £1,574.5m as at 31 December 2023, up from £1,488.1m as at 30 September 2023 (5.8% increase) (**para. 5.10**).

1.2 Note the update from Lothbury Property Trust in regard to the Fund's redemption notice for its entire investment in June 2023 (**Appendix C**).

1.3 Note the latest update on topical issues within LGPS (**para.11**).

1.4 Note update on the Council's responsible investment drive. (**Para 12**).

1.5 Note delegated authority remains with the Strategic Director Resources, as approved at the meeting on 12 December 2023, to start implementation of the Strategic Asset Allocation Changes approved. Work on implementation is currently underway (**para 10.4**).

1.6 Note that Officers collaborating with the Fund's advisors have initiated the implementation of the revised strategy, commencing with the allocation of private debt within the Fund. HSBC Senior UK Direct Lending Fund II has emerged as a potential addition to the current mix of Funds. Following a comprehensive review of the private debt allocation across all Funds, the precise investment amount to be deployed will be determined.

1.7 Members are asked to receive a presentation from executives representing the HSBC Senior UK Direct Lending Fund II (**para 13.1**)

1.8 Members are requested to acknowledge and approve the commitment of a still to be determined sum to the HSBC Senior UK Direct Lending Fund II under delegated authority with the aim of diversifying the Fund's private debt mix. This responsibility is delegated to the Strategic Director Resources for execution in collaboration with the Fund's advisors, and following consultation with the chair, vice-chair, and opposition spokesperson. **(para 13.1**)

1.9 Receive a presentation and a general update from Standard Life Long lease Property (**para.13.1**).

1.10 Note that the 2023 Pension Fund Annual General Meeting took place virtually on 21 February 2024. Officers conducted over 120 virtual one-on-one meetings with scheme members. Despite the event being oversubscribed, everything progressed smoothly.

2. Reason for Decision and Options Considered

2.1 To enable the PFP to monitor the quarterly and longer-term performance of the Fund and be informed of other issues in accordance with the requirements of the Council's Statement of Investment Principles.

2.2 The report is structured as follows:

- Section 3 - Strategic Asset Allocation Update (para 3)
- Section 4 - Overall Fund Performance against Benchmark (Table 3)
- Section 5 - Managers' Market Update
- Section 6 - Funding Update
- Section 7 - Class Action Filing
- Section 8 - Cash Management
- Section 9 - Procurement and National LGPS Framework Update
- Section 10 - LGPS and Ealing Scheme Topical Issues Update
- Section 11 - London Collective Investment Vehicle (LCIV) Update
- Section 12 - Responsible Investment Update
- Section 13 - Training and other external presentations

3. Strategic Asset Allocation

3.1 Three specialist Fund managers took full control of the Pension Fund Investments in April 2007 and only RLAM, the UK Corporate Bond Manager is still retained today. The strategic asset allocation of the Fund was first re-orientated in September 2013 following the decision to invest around 10% of assets in three pooled property funds.

3.2 In this regard, the Council appointed three property managers in September 2013, investing directly into three pooled UK commercial property manager solutions:

- Standard Life, Long Lease Fund
- Lothbury Property Fund
- Hermes Property Unit Trust

3.3 The bond and property mandates have been topped up intermittently to rebalance the Fund to its benchmark strategic asset allocation.

3.4 A number of changes outlined below have since been made to the portfolio.

3.5 In 2017, the Fund allocated 10% to return-seeking assets, split between private debt (5%) and infrastructure (5%) to capitalise on the stability offered by contractual cash flows. In March 2022, 1% of this allocation was redirected towards impact investments. While impact strategies are still evolving, they are geared toward achieving distinct environmental and social benefits, furthering the Fund's commitment to responsible investment and decarbonisation.

3.6 The PFP endorsed three strategies for the 1% impact allocation: the Henley Property Fund, the Darwin Bereavement Fund, and the Temporis Impact Fund (subject to conditions). Presently, the Henley and Darwin Bereavement Funds have been committed, following suitability reviews presented by the Fund's advisors to the PFP. The full commitment for the Darwin Fund (£5m) has been drawn down, while the Henley Fund is undergoing periodic drawdowns, with a remaining commitment of 9.1%. One of the Impact Funds was not invested in and will now be considered alongside other options as part of the Strategic Asset implementation currently underway.

3.7 The revised Strategic Asset Allocation agreed at the meeting on the 14/12/2023 is outlined below on Table 3 and the previous SAA is outlined on Table 2 As implementation has not yet been fully executed, officers are monitoring to the previous SAA for this report. Table 3 illustrates the scale of the reorientation of the Funds assets that will be required.

Table 1: Strategic Allocation

Mandate	Fund Manager	Strategic Asset Allocation
LCIV Global Equity	Baillie Gifford LGIM Blackrock	55%
UK Corporate Bonds	Royal London Asset Management (RLAM)	25%
Property Funds	Standard Life / Hermes / Lothbury	10%
Enhanced Yield*	Private Debt & Infrastructure Equity Debt	5%
Infrastructure/ Impact Investments	JP Morgan Henley Darwin BSF	5%
Cash		0%
Total		**100%**

Strategic Asset Allocation

Table 2: Current Allocation

Mandate	Fund Manager	Asset Allocation at 31 December 2023 %	Current Strategic Asset Allocation %
LCIV Global Equity	Baillie Gifford LGIM Blackrock	16.7 41.0 3.3	18.3 36.7 0.0
Total Equities		**61.0**	**55.0**
Infrastructure/ Impact Funds	JP Morgan Henley Darwin BSF	4.3	5.0
UK Corporate Bonds	Royal London Asset Management (RLAM)	21.2	25.0
Property Funds	Standard Life / Hermes / Lothbury	7.1	10.0
Private Debt	Brightwood Churchill Permira	4.1	5.0
Cash		2.3	0.0
Total		**100.0**	**100.0**

*Percentages may not add up due to rounding

Strategic Asset Allocation Review 2023/24 outcomes

3.8 At the December meeting, the PFP considered and approved recommendations emerging from the Fund's recent asset liability modelling and strategic asset allocation review conducted by the Fund's advisors Hymans. These included

- Reducing the current Equity allocation
- Increasing allocation for income assets
- Reducing allocation to property
- Revising allocation to protection assets

3.9 The table below details the Fund's current and revised asset allocation

Table 3 – Fund's Current and Revised Asset allocation

Fund Manager	Asset Class	Asset Values on 31 Dec 23 (£m)	Percentage of total assets 31 Dec 23 (%)	Approved Startegic Asset Allocation (%)	Difference
BlackRock	Passive Equity	52.6	61.1	47.0	14.1
Baillie Gifford	Global Active Equity	263.5			
LGIM	Global Passive Equity	645.5			
TBC	Private Equity	0	0	3	-3
Total Growth		**961.5**	**61.1**	**50.0**	**11.1**
JP Morgan	Infrastructure	58.2	3.7	6.0	-2.3
Aberdeen Standard	Property	32.0	7.1	9.0	-1.9
Lothbury	Property	35.6			
Hermes	Property	43.6			
Brightwood	Private Debt	6.6	4.1	5.0	-0.9
Churchill	Private Debt	21.3			
Permira	Private Debt	37.1			
Darwin	Imapct	5.1	0.6	1.0	-0.4
Henley		4.6			
TBC	Multi Asset Credit	0.0	0.0	4.0	-4.0
Total Income		**244.2**	**15.5**	**25.0**	**-9.5**
Royal London	UK IG Credit	332.1	21.1	15.0	6.1
TBC	Index Linked Gilts	0	0	10.0	-10.0
Cash	Cash	36.6	2.3	0.0	2.3
Total Protection		**368.8**	**23.4**	**25.0**	**-1.6**
Total Value		**1,574.5**	**100**	**100**	**-**

3.10 The planning and implementation of the above strategy has been delegated to the Strategic Director Resources to execute in consultation with the chair and vice chair. This will be communicated to the PFP at relevant intervals.

Private Debt Review and Top Up

3.11 The Fund's advisers carried out an interim review of the position on private debt and suggested that the Fund aim for a target allocation to its private debt managers per below. An additional £10m commitment to Permira Fund was made, with 39% drawn down so far.

Private debt manager	Proposed target allocation
Permira	50%
Churchill	25%
Brightwood	25%

The Fund has a strategic allocation of 5% to private debt and appointed three managers to operate diverse strategies.

3.12 An additional $10m commitment was made to Churchill Fund IV, with 77.6% drawn down to date.

3.13 An additional $20 million allocation to Brightwood was approved, and the onboarding process has began for part of the allocation.

3.14 An in depth review of private debt is currently underway as part of the implementation of recent SAA changes. Although the outcome of this review is expected imminently, it will not be available for this reporting cycle. Therefore, the exact allocation amount to the HSBC Senior UK Direct Lending Fund II has not yet been finalised. A summary of this Fund can be found in paragraph 13.1, while the Hymans suitability review is provided in the private and confidential Appendix E. Members are asked to acknowledge and approve an in-principle investment in the HSBC Senior Direct Lending Fund II following the presentation. Officers and the Fund's advisers will incorporate LCIV's proposed launch of a Private Debt Fund in quarter 4 of 2024 into the review process.

4. Fund Performance against Benchmarks

4.1. For the quarter ending 31 December 2023, the Fund returned 5.82% against a benchmark of 5.21% and this is summarised in the table below.

Table 3. Performance by Fund Manager this quarter

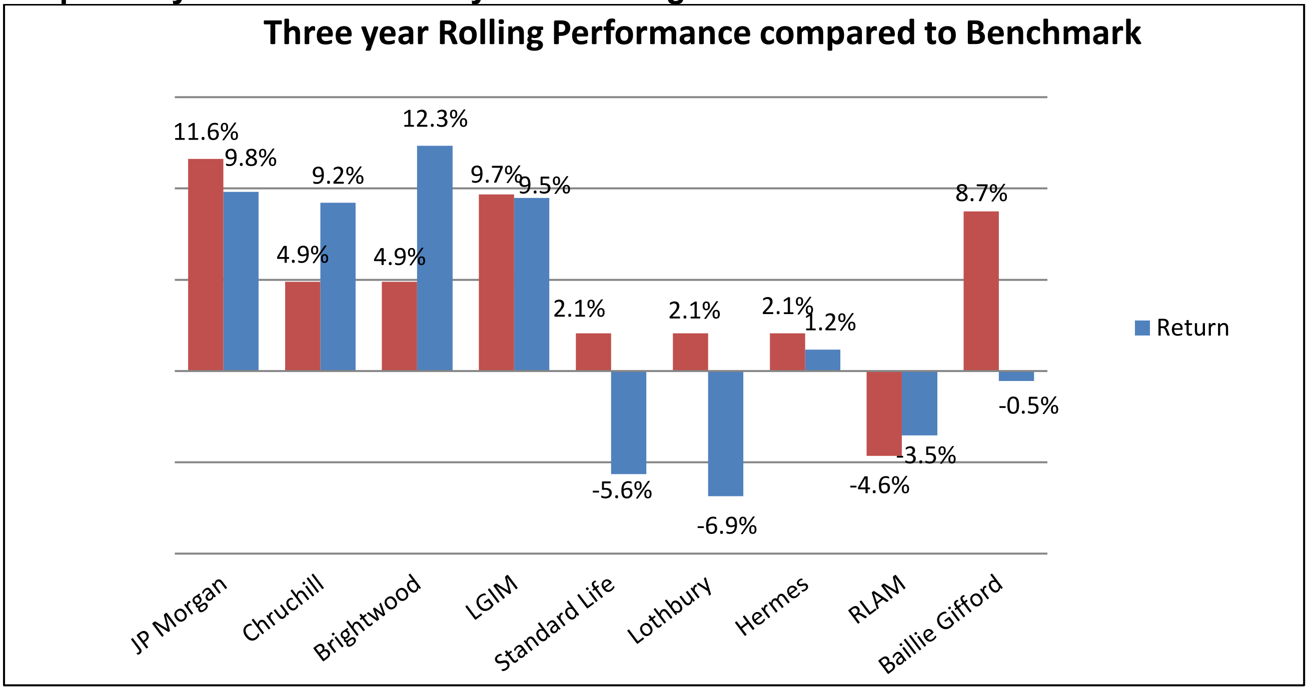
Asset Class	Fund %	Benchmark %	Relative to Benchmark* %
Global Equities			
Baillie Gifford (LCIV)	9.09	6.42	2.68▲
LGIM	6.25	6.24	0.01▲
BlackRock	7.14	6.79	0.36▲
UK Bonds			
Royal London Asset Management (RLAM)	8.17	7.39	0.79▲
Property			
Lothbury	-6.01	-1.16	-4.85▼
Standard Life	-3.96	-1.16	-2.79▼
Hermes	-2.09	-1.16	-0.93▼
Private Debt			
Churchill	-1.31	1.99	-3.30▼
Brightwood	-1.38	1.99	-3.37▼
Permira	2.39	2.00	0.39▲
Infrastructure			
JP Morgan	3.20	1.41	1.79▲
Impact Funds			
Henley	-1.45	1.59	-3.04▼
Darwin BSF	1.75	1.94	-0.19▼
Cash	-0.46	1.30	-1.77▼
Total for quarter	**5.82**	**5.21**	**0.61**▲
12 months figures	**10.77**	**11.27**	**-0.50**▼
3 years figures	**3.10**	**5.35**	**-2.26**▼
5 years figures	**5.96**	**6.92**	**-0.95**▼
Since inception	**6.57**	**7.29**	**-0.71**▼

*Relative performance is a geometric rather than arithmetic calculation
▲ Performance is above benchmark
▼ Performance is below benchmark
► Performance is same as benchmark

4.2. The Fund's composite portfolio benchmark is comprised of the most relevant indices for each asset class, weighted in accordance with the target asset allocation. The total Fund underperformance for 12 months, 3 and 5 years and since inception was -0.50%, -2.26%, -0.95% and -0.71% respectively.

4.3. The graph below shows the 3-year performance by Fund Manager compared to benchmark.

Graph 2. 3-year Performance by Fund Manager



3-year performance data for BlackRock, Darwin and Henley is not available given the duration since the Fund invested with these managers.

5 Fund Manager Performance drivers for the quarter ending 31 December 2023

5.1 Set out below is a synopsis of performance drivers, market conditions prevailing and outlook.

Market Reviews from the Fund Managers

5.2 LCIV - Baillie Gifford

The Sub-fund returned 9.1% in Q3 against 6.4% for the MSCI All Country World benchmark index thus posting a relative outperformance of +2.6%. Over the 12- month period to the end of December 2023 the Sub-fund returned 13.7%, 2.2% less than the benchmark.

In stark contrast to Q2, the Sub-fund performed strongly in the fourth quarter on the back of a market environment that favoured growth stocks once again. Evidence of this more supportive environment can be seen in the forward earnings estimates for the portfolio which have increased significantly over the last year. According to the investment manager, at the end of December 2022, the aggregate three-year forward consensus earnings forecast for the Global Alpha strategy was barely ahead of the market at 5.4% vs 5.2% (in USD). This was misaligned to the investment manager's view on the outlook for these companies. Since then, the same metric to the end of November 2023 had nearly tripled, to 15%. In contrast, the figure for the broad market, at 6%, had barely moved.

The other performance driver for the portfolio was better execution. Under the market scrutiny that the high interest environment and weak stock performance caused, several portfolio companies were forced to focus on operations, cut costs, and improve efficiencies. One notable example was Amazon where operating margins have inflected sharply, reflecting the efficiency gains now coming through from the elevated levels of investment over the last few years. The stock is the top performance contributor since the inception of the portfolio.

One area of weakness for the portfolio remains exposure to, and stock selection within China. The local economy and stock market have remained weak throughout the year due to a lacklustre economic recovery. Consequently, a large part of the weakness at individual stock level was China-related with 3 out of the 5 top detractors for the portfolio in Q3 either having direct exposure to China or an indirect exposure to the Chinese consumer: The Chinese insurer, Ping-An was the largest performance detractor at the stock level followed by Prosus (due to their exposure the Chinese technology giant Tencent) at the third place. The cosmetics company Shiseido which derives a significant portion of their revenues from China was also a large detractor

5.3 **LGIM**

Global equities rallied strongly over the third quarter, ultimately boosted by expectations that major central banks could soon cut interest rates as well as the impression that the US economy may avoid recession.

October was a challenging month; global equities continued to fall, bogged down by geopolitical fears about war in the Middle East and uncertainty over whether interest rates had peaked. In the final two months of the year, however, markets staged a blistering rally, buoyed by the prospect that the US Federal Reserve (Fed) had concluded its rate rises and was likely to cut rates in 2024.

In December, the Fed signalled that it was prepared to cut rates, potentially even before inflation is brought fully to target, which should boost economic growth and reduces the chance of a US recession. This justified the significant fall in bond yields over the previous weeks and provided a boost to risk appetite more generally.

The Fed's optimistic outlook for a 'soft landing' for the economy was backed up by US economic data suggesting that inflation was steadily falling while economic activity remained robust. US inflation fell to 3.1% for November while the US composite purchasing managers' index (PMI) rose to 51.0 in December, marking the third straight month of growth. The US economy added 199,000 jobs in November, which exceeded market expectations but nevertheless revealed a slowdown in the labour market.

European equities outperformed global equities. Eurozone inflation fell to 2.4% in November (driven by falling energy costs), close to the European Central Bank's (ECB's) 2% inflation target. Economic weakness, however, persisted, with the HCOB composite PMI remaining in contractionary territory. The combination of falling inflation and recessionary fears raised expectations that the ECB could cut rates in 2024.

UK equities underperformed, despite inflation falling to 3.9% in November, amid downbeat news on economic growth and comments from Bank of England Governor Andrew Bailey that it was "too early to be thinking about rate cuts". Emerging markets also underperformed, weighed down by China, where policy meetings offered pro-growth signals but lacked specific plans to achieve this. Credit data showed lacklustre private-sector activity, and ratings agency Moody's warned that China's A1 credit rating may be downgraded.

5.4 **BlackRock**

Global bond markets finished the year on a highly positive note, with bond yields falling notably in developed markets in December. In the US, November Consumer Price Index (CPI) inflation printed in line with expectations, with prices accelerating by 3.1% on a year-on-year (YoY) basis. In the Euro Area, November CPI also printed in line with expectations, with YoY prices rising by 2.4%.

YoY November CPI surprised to the downside in the UK, with prices accelerating by 3.9% instead of the 4.3% expected. Core inflation, which excludes more volatile food and energy prices, also surprised to the downside, with prices accelerating by 5.1% instead of 5.6% YoY. Meanwhile in Japan, November inflation printed in line with expectations, with National CPI accelerating by 2.8% YoY.

The Federal Reserve (Fed) held rates at 5.25-5.50% as expected at its December meeting, with dovish news coming from the updated statement; Summary of Economic Projections (SEP) and press conference. The statement showed new appreciation for the inflation progress in 2023, while the dot plot for the 2024 median moved down to 4.63%, suggesting 75 basis points (bps) of rate cuts next year versus 50bps previously. No Fed official expected further hikes, and five out of the seven Fed officials expected more than three cuts. Meanwhile, the November Employment Report published during the month pointed to a rebalancing labour market with moderating net job gains. Increasing labour supply supported job gains. Total nonfarm payrolls rose 199K with roughly 40-50K coming from United Auto Workers and Screen Actors Guild strikers returning to work. The unemployment rate fell back to 3.7% and the overall participation rate moved back up to 62.8%. In the Euro Area, the European Central Bank (ECB) kept the deposit, refinancing operations and marginal lending facility rates at 4.0%, 4.5% and 4.75% respectively.

There was little change to the accompanying official press release text from October, however, the central bank released its updated growth and inflation forecasts and noted that it would slow investments from its pandemic emergency purchase programme (PEPP) and finish in 2024. The ECB reduced its growth forecasts for 2023 and 2024 to 0.6% and 0.8%, respectively, and expected GDP growth of 1.5% for both 2025 and 2026. It also slightly lowered its headline inflation forecasts for 2023 to 5.4% and 2024 to 2.7%, while keeping it's 2.1% forecast for 2025 unchanged and predicting 1.9% headline inflation in 2026. The Bank of England (BoE) also revealed its monetary policy stance during the month, with the Bank maintaining the Bank Rate at 5.25%. However, the BoE also warned that there were still risks to inflation. Also in December, the Bank of Japan maintained its negative policy rate of -0.1% and its yield curve control (YCC) parameters at the December meeting.

5.5 **Royal London Asset Management (RLAM)**

The portfolio saw a positive return in the period and was ahead of the ICE BofA ML Sterling Non-Gilt Index benchmark. The main driver of positive performance was manager sector positioning, notably the underweight position in supranationals, which continued to lag the wider market having done so in the third quarter. Duration and curve

positioning were positive – we were slightly long going into the quarter and the fall in yields and strong performance from longer dated bonds therefore helped.
Stock selection effects were also helpful: we saw positive selection in insurance bonds, notably longer dated subordinated bonds from Prudential and Legal & General, but negative selection effects in structured bonds, which generally have a lower sensitivity to wider market moves, although our exposure to Thames Water was a small positive. RLAM maintained exposure to the company's operating company debt based on the attractiveness of the overall yield. They continue to believe that the sector remains attractively valued – largely based on our view that spreads in the sector overcompensate when compared to other regulated infrastructure assets such as UK electricity distribution.

Last quarter RLAM highlighted an issue with their holding in HDL, where the principal was not repaid on maturity at the end of July. We are pleased to confirm that the bond was redeemed in full in November. They believe this is a good outcome as not only did holders receive full repayment, but also accrued interest at the coupon rate since the end of July. In their view, this demonstrates the power of covenants and how these can protect investors' interests in this sort of scenario. Naturally we prefer to avoid any default, but as expressed in the initial update, the manager had confidence in their position. It should be noted that, over time, the investment in HDL has been materially beneficial – despite the default.

Economic attention over the quarter has been on inflation. At the start of the quarter investors focussed on the persistence of large price increases and central bank messaging on rates being held higher for longer. Yet, as headline inflation fell, sentiment swung dramatically towards the end of the quarter, pushing markets to price in interest rate cuts in 2024. The Federal Reserve (Fed), European Central Bank (ECB) and Bank of England (BoE) all left rates unchanged over the quarter, maintaining official rates at multi-year highs. The Fed has now held rates unchanged at its last three meetings. There has however been a significant shift in messaging, with the US central bank now indicating that it expects to cut rates by 0.75% in 2024. The ECB has similarly kept rates steady at its two most recent meetings, but central bankers in the eurozone said that no rate cuts have yet been discussed.

Although recent outperformance means that the relative attractiveness of sterling credit bonds has reduced, RLAM still favour holding them compared to UK government debt as credit spreads remain at levels that more than compensate for the credit risk. Given the potential challenges in the outlook, they remain focused on identifying companies with strong balance sheets, favouring issues with security and downside protection, and ensuring that portfolios are diversified across issuers and sectors

5.6 **Property Managers**

5.7 **Hermes**

During the second quarter of 2023, the Trust's total return to unit holders was -1.8%. Valuation write-downs on the office and leisure assets had the most significant impact, reflected in capital value growth of -3.2% compared to -1.5% for the benchmark. The Manager remains focused on income as the primary long-term driver of total returns and the Trust's income return remained slightly ahead of the benchmark over the quarter (1.0% compared to 0.9%). Over the 12-month period to the end of September

2023, the Trust delivered a total return of -11.9%, which was consistent with the benchmark weighted average. In terms of annual performance breakdown, income continued to outperform the benchmark, while the capital element was slightly behind. The Manager's focus remains on delivering sustainable long-term performance to its investors and has achieved upper quartile outperformance to its investors over the 10-year period.

The industrial sector was the main contributor to the portfolio's performance. This was due to a stabilisation of yields following a correction in the previous year, as well as a still resilient occupational market that continued to drive rental growth. The retail warehouse sector also had a positive impact on the portfolio, as it experienced renewed investor sentiment and the Manager delivered positive active management results. However, the Other/Leisure and Rest of UK office sectors were detractors to portfolio performance, as weaker investor sentiment and outward yield movement due to the rising cost of debt and increased capital requirements continued to impact these sectors. The hospitality/leisure sector also experienced weaker performance trends, which were attributed to the deteriorating economic outlook due to the cost-of-living squeeze.

In terms of positive property level contributors to portfolio performance, the industrial estate in Fordham (let to a global life science company) and the retail warehouse in Oxford (Templars Shopping Park) were the main drivers. Both properties benefited from improved investor sentiment and positive active management activity. The latter was sold at a premium to valuation during the period. On the other hand, the vacant office building with alternative hotel use consent in Westminster (Great George Street) and the office building in Maidenhead (Horizon) were the main detractors to property performance. These properties suffered from weaker investor sentiment, with yields moving up and valuation decreases over the period. The office investment in Maidenhead also experienced new vacancies within the building and the Manager will explore potential alternative uses.

5.8 **Lothbury**

The economy was broadly stable in Q3 2023, with some better news for the outlook of interest rates based on slowing inflation. The real estate transactional market, however, remained subdued. As a result, values continued to erode gradually. In many cases, the Fund’s assets experienced a worse performance than the market, as a result of them being under offer or on the market during a highly illiquid period.

The Fund’s strongest performing sector in Q3 2023 was Retail Warehouse (-3.1% in values), with its largest asset, Mile End, holding its value due to the strong business plan for future development. The smaller assets, by contrast, saw some moderate decline in value. The Fund’s single remaining foodstore, Fallowfield, lost some value. More severe were the declines experienced at the High Street assets, such as Covent Garden.

Another relatively robust sector was Industrials (-3.5%), with three of the Fund’s assets seeing values hold steady over the fourth quarter for varying reasons. This included the large multi-let estate in Manchester. One of the highest quality assets, Poyle, recorded only a modest fall. The largest price correction was at one of the development land assets in Norwich.

The strongest performing sector in Q2 2023 was Student Housing. However, this position was not maintained into Q3 2023 (-6.4%), as values fell at each of the five assets. The corrections at both Durham and St Andrews were modest, but the two London assets saw a greater change over the quarter.

One of the weakest performances was in the Office sector, which is grappling with market-wide negative sentiment (-8.7%). The more severe corrections were recorded in the larger assets, St James's Street in London and Hardman Street in Manchester. The smaller assets in London proved more resilient this quarter.

5.9 **Standard Life**

During the final quarter of 2023, the Long Lease Property Fund provided a total return of -3.96% (gross of fees) compared to a benchmark of -1.16%. Over the shorter term, the Fund is underperforming the wider real estate market; the manager's one-year performance was -12.38% (including pricing swing) against the IPD monthly Index.

As reported last quarter, there remain certain sectors within the wider index where pricing is recovering or stabilising where we have no exposure, such as multi-let industrial assets, retail warehousing and the private residential sector, which explains part of the differential in performance against the wider market. In addition, the long income market has been one of the sectors that have seen the largest relative re-pricing since September 2022; given the low yields the market was coming off, the effect of outward yield shift has had a greater proportional effect on long income assets.

Over the longer term, the manager believes that their performance will continue to be aided by the stronger tenant credit quality of the portfolio; long, inflation-linked leases; and the lack of any high street or shopping centre exposure. Performance against the MSCI peer group of similar long income funds remains strong over the longer-term metrics. While they have underperformed this over the shorter term, we believe this is largely due to differing valuation houses moving at different rates, as there are some wide disparities of performance over short-term time frames.

Summary

5.10 Set out below is the Fund's investment position as at 31 December 2023 based on valuations provided by the Fund's custodian. Fund managers and custodian's valuations can differ as valuations may have been obtained from different sources. During the quarter the Fund value increased to £1,574.5 m (£1,488.1m: 30 September 2023).

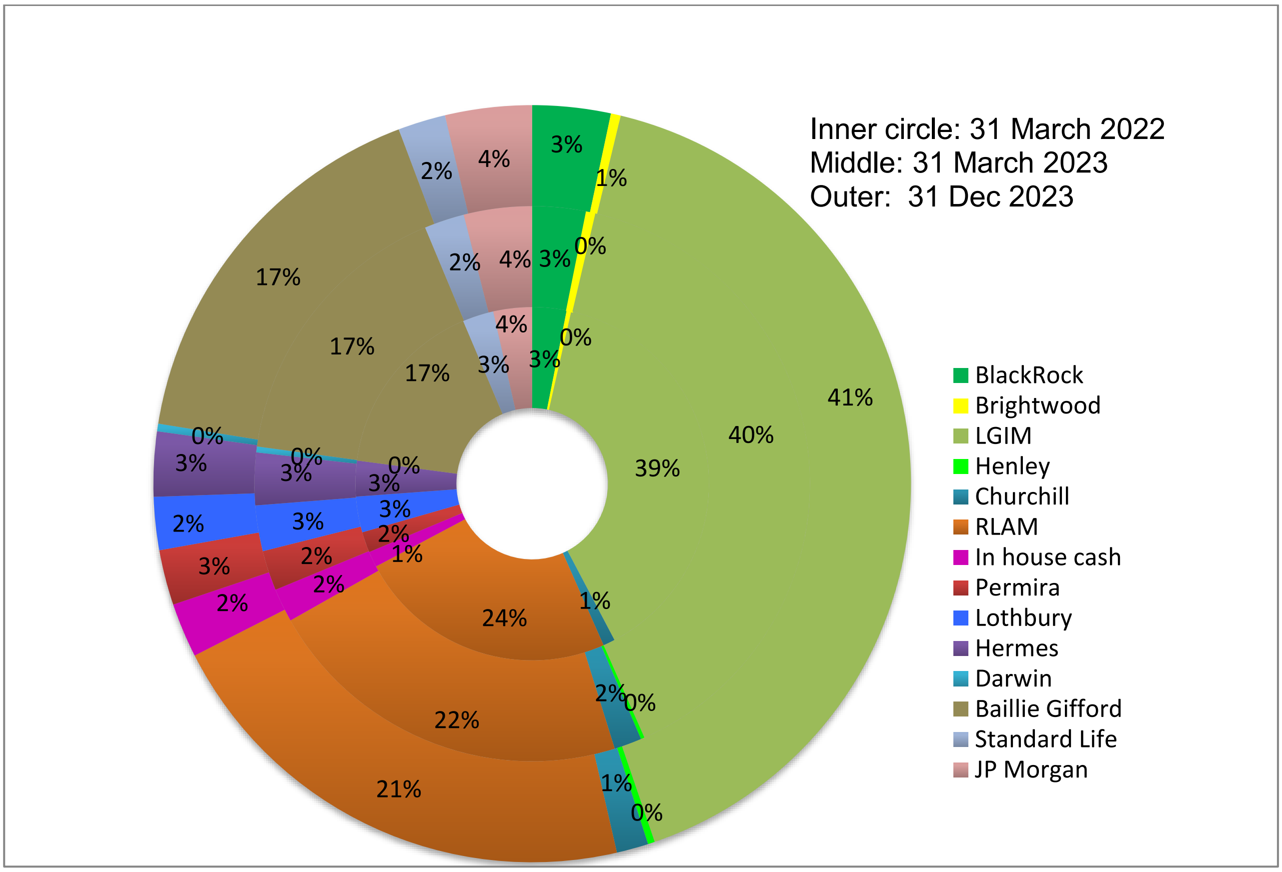
Table 4. Fund Value

FUND MANAGER	Market Values at 30 September 2023 (£m)	Market Values at 31 December 2023 (£m)
RLAM – UK Corporate Bond	310.9	332.1
Baillie Gifford – Global Equity	241.5	263.5
LGIM – Global Equity	607.5	645.5
BlackRock – Global Equity	49.1	52.6
Lothbury – Property	37.9	35.6
Standard Life – Property	33.3	32.0
Hermes – Property	44.5	43.6
Henley – Supported Housing	4.7	4.6
Brightwood – Private Debt	7.5	6.6
Churchill – Private Debt	23.5	21.3
Permira – Private Debt	36.9	37.1
JP Morgan – Infrastructure	58.0	58.2
Darwin – Bereavement Fund	5.1	5.1
Total externally managed	**1,460.4**	**1,537.9**
Cash held internally	27.7	36.6
Total Fund*	**1,488.1**	**1,574.5**

* Numbers may not add up due to rounding

5.11 The chart below shows how the percentage split of the Fund has changed each year.

Chart 1. Percentage of Holding Movement – year to date



The Fund's 16 largest holdings as at 31 December 2023

5.12 **Appendix A** shows the Fund's 16 largest holdings as at 31 December 2023 which represents 22.0% of the total holdings. The top holdings include pooled funds in and outside of the LCIV as well as the Fund's inhouse cash.

Voting lists

5.13 **Appendix B** is the Voting List for LCIV on behalf of the Fund.

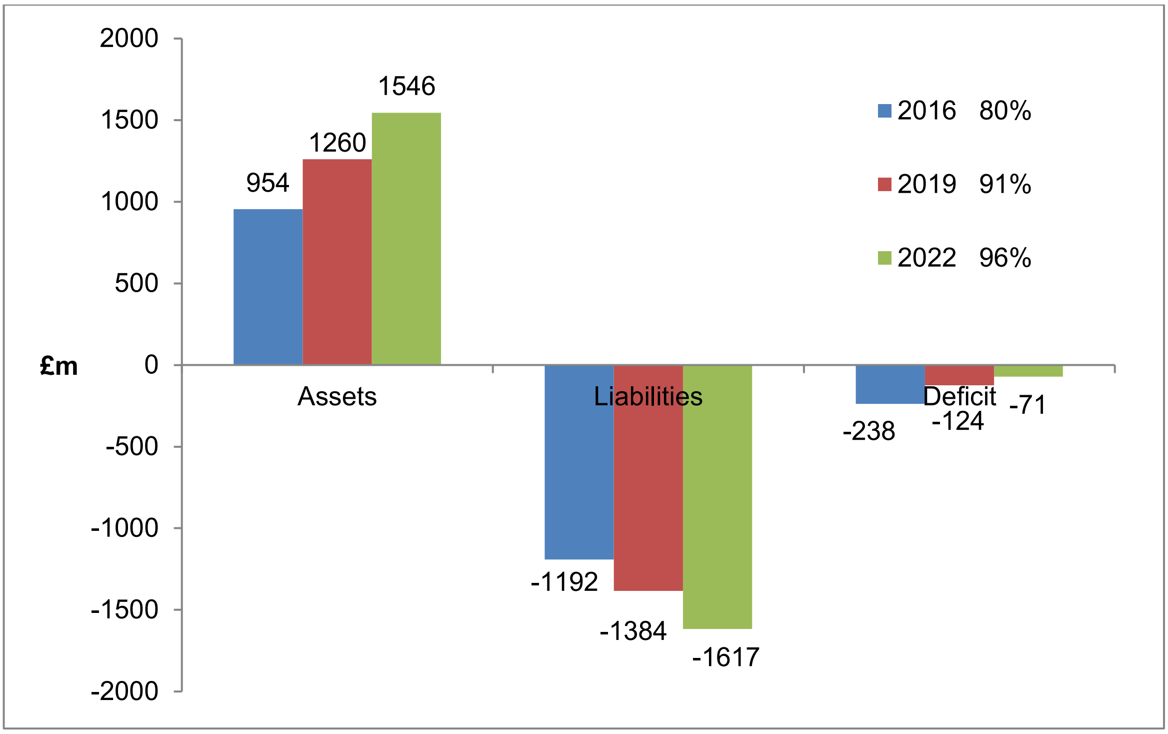
6 Funding Update

6.1 The funding position of the Fund is formally assessed every three years by the Fund's Actuary, Mercer. The 2022 valuation showed the Fund to be 96% funded (compared to 91% as at 31st March 2019).

6.2 The Funding Strategy Statement (FSS) was agreed by the PFP at the March 2023 meeting considering all responses received from employers as part of the consultation process, and with delegation granted to the Strategic Director Resources by the PFP to finalise the FSS as necessary. Subsequent to this, the final contribution outcomes from the 2022 valuation were certified by the Actuary in March 2023, and took effect from 1 April 2023.

6.3 The graph below shows the movement in the Fund's assets and liabilities since the 2016 valuation.

Graph 2: Fund Assets and Liabilities



6.4 The results of the 31 March 2022 actuarial valuation showed that the Fund is 96% funded. This represents a deficit of £72m and is being recovered by secondary rate contributions (where appropriate) payable by employers. At the whole Fund level, the primary rate emerging from the 2022 valuation was 18.5% of pay. Individual employer positions were varied as these are dependent on their own membership profile, experience since 2019, and also their starting point relative to the whole Fund as at 31 March 2019.

6.5 An updated funding position based as at 31 December 2023 is attached at appendix D.

7 Class Action Filings

7.1 Class Action is a procedural means used in litigation to determine the rights and remedies, if any, for large numbers of people whose case includes common themes of law and /or fact. This procedure can be useful for shareholders where a company has been found guilty of giving false or misleading information to investors, who then act on it and suffer financial loss. As a result, substantial sums may be recovered through class actions. Most of the class action reclaims flow from the global equity portfolio and the mandate has transferred to the LCIV. There are currently no class actions.

8 Cash Management

8.1 Cash is held by managers at their discretion in accordance with limits set in their investment guidelines, and internally to meet working capital requirements. Transfers can also be made to fund managers to top up or rebalance the Fund.

8.2 When held internally, the Fund's in-house cash is invested in accordance with the Council's Treasury Management Strategy agreed by Full Council in March 2023, which is delegated to the Strategic Director Resources to manage on a day-to-day basis within set parameters. The Treasury Management Strategy is reviewed monthly at the Treasury Risk and Investment Board (TRIB) meeting, chaired by the Strategic Director Resources.

8.3 As at 31 December 2023, the Pension Fund cash balance was £36.6m. The cash held at the custodian bank account is swept every night into a money market fund operated by Goldman Sachs. The cash held at Lloyds is for the day to day running of the Fund's activities. The Fund also holds a money market fund (MMF) with Federated as an instant access account.

8.4 The internal cash retained in the custodian cash account is to aid transparency, segregation of accounting and performance measurement management.

8.5 The bulk of the cash balance is expected to be deployed to the alternative managers and rebalancing the Fund. The table details where balances were held:

Table 6. Cash Balances

Counterparty	Fitch Long Term Rating	Limit £m	31 December 2023 £m
Lloyds Bank Plc	A+	30.0	0.2
Federated MMF	AAA	30.0	4.5
BNY Mellon Goldman Sachs MMF	AAA		31.9
Total Cash Balance			**36.6**

8.6 The PFP will continue to be updated on inhouse cash investment strategy. Security of the Fund's cash remains the overriding priority, ahead of yield.

9 Procurement and National LGPS Framework Update

9.1 In procuring services for the Fund, the PFP must have regard to the Council's Contract Procedure Rules and the Public Procurement Regulations 2015 as applicable and must tender and award contracts in accordance with these procedures. Where the Council is investing via the LCIV no formal procurement procedures are required.

9.2 At the meeting on 25 November 2021, the PFP approved that the Fund collaborate with other LGPS Funds in the search to identify more strategies that can be funded from the impact bucket. The collaborative search led by London Borough of Merton concluded.

9.3 The National LGPS framework team collect management information from suppliers to monitor both the volumes of work and to ensure the quality of services provided. The review will also establish any rebate due to the Council where the collective level of service provided across the LGPS is over a specified threshold.

10 LGPS and Ealing Scheme Topical Issues Update

Government's Vision for LGPS Investments: Comprehensive Overview

10.1 In October the LGPS community and other stakeholders responded to the pooling consultation issued by DLUHC which addressed three issues, asset pooling, levelling up and private equity. The government has now announced its vision in response to the consultation.

10.2 **Pooling:** The government is moving forward with plans to consolidate pools, aiming for fewer pools with at least £50bn and a potential £200bn in assets by 2040. The requirement to pool listed assets by 31 March 2025 will follow a "comply or explain" approach. Guidance will emphasise delegation in manager selection and strategy implementation, and despite feedback, the government supports pools providing investment advice. Instead of mandating a single pooling model, guidance will focus on "characteristics and outcomes." Passive assets fall under the "comply or explain" requirement, with reporting and oversight specified.

10.3 **Investing in Other Pools:** The government will provide guidelines on circumstances for investing through one's pool in another pool's product, aiming to prevent direct competition between pools.

10.4 **Levelling Up:** The broad definition of Levelling Up investments remains, offering flexibility. The government encourages pool involvement in due diligence and conflict management. The "up to 5%" ambition is not a strict limit, and funds can invest less if opportunities are lacking. The government asserts that these requirements align with fiduciary duty, treating Levelling Up projects like any other investment.

10.5 **Private Equity:** Despite negative feedback, the government persists in encouraging funds to invest 10% in private equity. This won't be enforced, but funds will be set an allocation ambition. Funds have the flexibility to choose investment locations and asset classes. Collaboration with the British Business Bank is encouraged for venture and growth capital opportunities.

10.6 **Other Issues:** Committee training and increased reporting requirements for funds are introduced. Formal training policies and transparent reporting on fund asset allocation will be published. The use of single standardised benchmarks for asset classes has been dropped. Funds must provide an annual update on pooling progress in their reports. Investment strategy statements should include plans for up to 5% investment in Levelling Up projects.

10.7 **Summary:** On the 22 November 2023, the government issued its on response. The 31 March 2025 pooling deadline for Local Government Pension Scheme (LGPS) funds remains following the consultation, but it will be on a "comply or explain" basis. Certain assets can be retained outside of pools if justified for value for money or if a pool doesn't offer a suitable solution.

10.8 The Government maintains ambitions of 5% in levelling-up and 10% in private equity for LGPS funds, but these targets are optional, with funds deciding based on fiduciary duty.

10.9 The adoption of a 'comply or explain' approach by the Government is seen as balanced and pragmatic, allowing funds to justify their decisions. The Government envisions long-term benefits for the LGPS, aiming for economies of scale through consolidation and supporting investment in the UK economy.

10.10 The impact of these directions on members and employers is subject to ongoing debate. Open dialogue with the Government will continue, with a focus on supporting LGPS funds in navigating upcoming changes.

DLUC Taskforce on Climate-related Financial Disclosures (TCFD) consultation Pooling Investment Guidance

10.11 The PFP has previously been informed that, under the powers granted by the Pension Schemes Bill, the Department for Work and Pensions (DWP) conducted a consultation on draft regulations that would require occupational pension schemes to meet climate governance requirements, publish a TCFD report, and include a link to the report in their annual report and accounts.

10.12 Although the regulations will not apply to the LGPS, it was anticipated that the DLUHC will introduce similar proposals mandating TCFD disclosures within the LGPS. The Fund's pooling partner, LCIV actively supports the TCFD and has recently published its second TCFD report in alignment with the recommendations. This report covers the approach to climate change across the thematic areas of Governance, Strategy, Risk Management, and Metrics and Targets. It showcases the progress and developments made in these key areas.

10.13 The LCIV will provide support to partner funds in anticipation of any mandatory reporting requirements, offering training and assistance with reporting. The LCIV has engaged in discussions to understand the carbon reporting requirements for assets, including those currently not held within the pool.

Task Force on Nature-related Financial Disclosures (TNFD)

10.14 The Task Force on Nature-related Financial Disclosures (TNFD) strives to establish a uniform disclosure framework concerning nature-related risks and opportunities for businesses and financial institutions. This international, market-driven initiative is financially supported by government and philanthropic partners, with endorsement from G7 and G20 political leaders. Following a consultation period in 2022/23, the TNFD published its final recommendations in September 2023.

10.15 Aligned with the TCFD framework, the TNFD disclosure pillars encompass governance, strategy, risk, impact management, and metrics/targets. The framework acknowledges that nature and biodiversity considerations are increasingly likely to have financial implications for asset valuations. This underscores the growing recognition of the need for comprehensive disclosure mechanisms to address nature-related risks and opportunities in the business and financial sectors.

10.16 The LGPS is still awaiting comprehensive guidance on the practical implementation of TCFD and TNFD within the sector. This underscores the need for clear directives and frameworks to facilitate the incorporation of climate-related and nature-related financial considerations into the investment strategies and decision-making processes of the LGPS. It is expected that the TCFD will come into force on the 1 April 2024 with first reports due by 31 March 2025.

The Pensions Regulator (TPR) General Code

10.17 On January 10, 2024, the TPR released its anticipated new general code of practice, set to come into force on March 27, 2024, after being presented to Parliament. The code, largely unchanged from its previous draft version, underwent clarifications based on feedback.

10.18 Notably, it confirms the definition of "Governing Body" for public service pension schemes and is structured into five sections: Governing Body, Funding and Investment, Administration, Communications and Disclosure, and Reporting to TPR.

10.19 While some modules are deemed "good practice" rather than mandatory for all pension schemes, LGPS funds are expected to comply with the code's principles. Although there's no formal mandate for public service pension schemes to establish an effective system of governance or undertake an own risk assessment, LGPS funds are encouraged to align with the code's recommendations and prepare for future requirements, such as those from the SAB Good Governance initiative.

10.20 Funds can proactively address these changes by understanding applicable code areas, conducting gap analyses of current policies and procedures, and assessing training needs for committee/board members and officers.

11 London Collective Investment Vehicle (LCIV)

11.1 At the Summer Budget 2015 it was announced that the government will work with LGPS administering authorities to reform how LGPS investments are managed. The Government wanted the 91 LGPS pension funds to pool their assets into around six investment pools in an effort to drive down investment costs and boost infrastructure investment.

11.2 Ealing is one of 32 London pension fund administering authorities and have been active participants in the Collective Investment Vehicle (CIV) programme, the regional pool for London. The CIV has been constructed as a FCA regulated UK Authorised Contractual Scheme (ACS). The ACS is composed of two parts: the Operator and the Fund. Hence, a limited liability company (London LGPS CIV Ltd) was established, with each participating borough holding a share. The London CIV (LCIV) received its ACS authorisation in November 2015. Each London Borough contributed £75,000 towards setting up and receiving FCA authorisation for LCIV. Additionally, participating boroughs subscribed for non-voting redeemable shares, and there is an agreed annual running cost charge of £25,000 per financial year for LCIV.

11.3 Each mandate at the CIV is a separate, ring-fenced, sub-fund within the overall ACS fund.

11.4 As of 31 December 2023, total assets deemed pooled by the LCIV client funds were valued at over £29.4 billion of which, £15.9 billion are in funds managed by London CIV.

11.5 In Update to January 2024:

Business Update

11.6 Aoifinn Devitt has commenced as the new CIO at LCIV, bringing extensive experience from various roles in wealth management and pension funds. Devitt plans to engage with partner funds, focusing on existing and new funds, particularly in Housing, Renewable Infrastructure, Nature Based Solutions, and Private Credit.

Fund Monitoring and Performance

11.7 Currently, there are zero funds on the watchlist, four on enhanced monitoring, and others on normal monitoring.

Fund Launches and Pipeline

11.8 Discussions were held with clients interested in allocating commitments to a new private debt II fund, set to launch in the second half of the year. The Fund is looking to see if an allocation of its private debt will be to the LCIV when they launch their Fund.

11.9 Training sessions on nature-based solutions investment were conducted, and due diligence for potential managers is nearing completion.

11.10 Plans are underway to provide a solution for partner funds with indirect property exposure to improve cost efficiency and performance.

Operational Activities

11.11 Fee modifications have been implemented for various LCIV funds, with a portion of fee savings retained by LCIV.

11.12 Ensuring good governance of the LCIV by the PFP is a necessity, specifically in terms of assets under management, cost savings, responsible investment and overall value for money.

12 Responsible Investments Update

12.1 The PFP accelerated its Responsible Investment journey following a special session to reaffirm its investment beliefs following a significant change in the composition of the PFP.

12.2 A net zero pledge of 2045 was approved at the meeting on the 25 November 2021. In pursuit of its responsible investment drive a number of initiatives outlined below were approved. Another report within this agenda outlines the Fund's activity in the area in more detail.

Climate Change

12.3 Exceptional weather events around the world have been attributed to climate change. And the obvious risks to pensions schemes is the physical or natural environment which will dominate in the longer term. However, a shorter to medium term risk is transition risk, which involves the risks and opportunities that will arise from the global transition to a low carbon economy.

12.4 Officers continue to evaluate strategies to accelerate the Funds responsible investment approach as part of the implementation of the revised SAA and progress towards the 2045 Net Zero objective.

13 Training and Other External Presentations

13.1 Receive a presentation from executives of the HSBC Senior UK Direct Lending Fund II. Hymans Private and confidential Suitability Review is attached in summary

- The HSBC Senior UK Direct Lending Fund II aims to deliver attractive risk-adjusted returns by investing in a diversified portfolio of senior secured loans to middle-market UK businesses, predominantly owned by private equity sponsors.
- Fund structure: Luxembourg RAIF SA, with a target fund size of £1bn.
- Key characteristics include an 8-year legal term with two possible 1-year extensions, quarterly distributions, and a performance objective of 9-11% per annum.
- The fund focuses on senior secured loans, with a maximum 10% allocation to second lien/subordinated loans.
- Flexibility within the Offering Memorandum permits up to £50m in 'Excess Amount' beyond the 7.5% concentration limit.
- The fund expects to invest in 30-40 loans, primarily in the UK, Isle of Man, and the Channel Islands, with potential to support the UK's levelling up agenda.
- Despite market challenges, the fund's target return has been revised upwards to a gross IRR target of 9-11% per annum.
- The investment team consists of 13 professionals with stable metrics in terms of leverage and opening EBITDA.
- While the focus is on the lower mid-market in the UK, the fund aims for a diversified regional exposure, with approximately 70% of the portfolio invested outside of London.

13.2 Overall, the fund's investment strategy and profile are deemed sound, with noted considerations regarding fundraising challenges and regional risk exposure.

1.11 Members are requested to acknowledge and approve the commitment of an undetermined amount to the HSBC Senior UK Direct Lending Fund II, aimed at diversifying the Fund's private debt mix under delegated authority. This responsibility is delegated to the Strategic Director Resources for execution in collaboration with the Fund's advisors, and following consultation with the chair, vice-chair, and opposition spokesperson.

13.3 Standard Life will give an update on performance and outlook across the property market.

14 Legal

14.1 In discharging their functions under the Public Service Pensions Act 2013 and associated Regulations, the PFP must have regard to:
(i) The need for diversification of investments of Fund money.
(ii) The suitability of investments which they propose to make; and
(iii) Proper advice obtained at reasonable intervals.

14.2 The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2016 came into force on 1 November 2016. An authority must, after taking proper advice, formulate an investment strategy which must be in accordance with guidance issued from time to time by the Secretary of State. The authority must invest, in accordance with its investment strategy, any invest money that is not needed immediately to make payments from the Fund.

15 Value for Money

15.1 This report helps in addressing value for money through benchmarking the Council's performance against its customised benchmark.

15.2 By using the National Local Government Pension Scheme framework when procuring custodian and advisory services, it is expected that efficiencies on current contract prices can be found, enhancing the value for money delivered to the Fund and the framework rules.

15.3 The aim of the Fund is to maximise the returns from investments within reasonable risk parameters. Generally, the higher the potential return expected, the higher the associated risk.

15.4 Managing a pension fund is a complex activity that exposes the Council as employer to risks such as increased contribution rate due to poor asset performance or not adequately managing the funding strategy, stakeholder disaffection due to poor communication, higher costs and legal challenges due to poor management of third-party contracts, financial loss due to poor in house cash management.

15.5 The aim of the Fund is to maximise returns within a minimum risk tolerance by setting Fund managers benchmarks, which are monitored both quarterly and in the long term. This monitoring and review of investment strategy ensures the link to the strategic objective of managing resources effectively.

16 Community Safety

None

17 Links to the 3 Priorities for the Borough

17.1 **Creating new jobs**

Though not directly creating new jobs, all Council employees can join the Council run LGPS scheme and designated bodies within the borough can also be admitted into the scheme.

17.2 **Tackling the climate crisis**

The PFP are taking proactive steps to have more sustainable investments and are working towards a net zero target of 2045, effectively taking the Fund to a carbon neutral position by that time.

Members of the PFP commissioned a carbon risk report to establish the carbon intensity of the portfolio. The results indicate that the Fund is doing better than its benchmark on all metrics e.g., that the Fund is less carbon intense than its benchmark, Furthermore, back testing the portfolio (as of November 2021) demonstrated that the carbon intensity of the Fund has been reducing for the past 5 years. This shows that steps taken a few years ago to move the bulk of the Fund's equity portfolio to low carbon and sustainable company indices have been positive.

Members will set and monitor interim carbon reduction targets to aid the glide path to net zero by 2045.

18 **Equalities and Community Cohesion**

None

19 **Staffing/Workforce and Accommodation implications**

20 Representatives of the staff sides of the Joint Consultative Committees attend the PFP meetings and can express their views at any time.

21 **Property and Assets**

None.

22 **Any other implications**

Not applicable.

Appendices

Appendix A –The Fund's 16 largest holdings
Appendix B – Exercise of Voting Rights for LCIV
Appendix C – Lothbury Property Trust - Termination Notice
Appendix D – Funding Update
Appendix E – Hymans Suitability Review of HSBC Senior UK Direct Lending Fund II (Private and Confidential)

Consultation

Name of consultee	Post title	Date sent to consultee	Date response received	Comments appear in report Para:
Councillor Callum Anderson	Chair of the Pension Fund Panel	11/3/2024		
Emily Hill	Strategic Director Resources	11/3/2024		Throughout
Emma Horner	Assistant Director Technical Finance	11/3/2024		
Justin Morley	Head of Legal Services	11/3/2024		
Shahzad Ayub	Senior Lawyer	11/3/2024	12/3/2024	App 3 and E

Decision type: Non-key decision	**Urgency item?** No

Authorised by Cabinet member:	Date report drafted:	Report deadline:	Date report sent:
Report no.:	Report author and contact for queries:		
	Bridget Uku Finance Manager, Pensions & Treasury Nyce Higiro Financial Accountant		