

SURREY COUNTY COUNCIL

PENSION FUND BOARD

DATE: 20 SEPTEMBER 2013

LEAD OFFICER: SHEILA LITTLE, CHIEF FINANCE OFFICER

SUBJECT: MANAGER ISSUES AND INVESTMENT PERFORMANCE



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SUMMARY OF ISSUE:

This report is a summary of all manager issues that need to be brought to the attention of the Pension Fund Board, as well as manager investment performance.

RECOMMENDATIONS:

It is recommended that the Pension Fund Board:

1. approve the report and the decisions as laid out;
2. agree the Surrey Pension Fund make a USD 20m commitment to the Standard Life Secondary Opportunities Fund;
3. agree that the Surrey Pension Fund make a USD 25m commitment to the Global Clean Energy and Infrastructure Fund;
4. agree that the Surrey Pension Fund make a £20m commitment to the Darwin Property Fund.

REASON FOR RECOMMENDATIONS:

In order to achieve best possible performance alongside optimal risk.

DETAILS:

1) Manager Issues during the Quarter

Manager	Issue	Status/Action Required
CBRE	UBS Triton	<p>UBS Triton have updated on the redemption queue. Following the receipt of £197m of new equity raised by the manager, the redemption queue was further reduced by approximately £15m to around £32m by 1 July, a result of investors withdrawing their redemption notice following the notice of the new equity raised. UBS Triton have also indicated that they have exchanged on the sale of another non-core shopping centre asset and have strong interest in another four assets. The proceeds from these disposals will be used to pay down the remaining redemptions and also be used to make some property acquisitions. CBRE regard the Triton Fund as having achieved some stability and expect the fund to perform well relative to most of its core balanced peer group with returns driven by an attractive distribution yield in excess of 6% pa. The Fund will continue to be monitored. A further update by fund managers is expected at the Board meeting.</p>
	Revised Investment Management Agreement (IMA)	<p>Officers have just received a revised IMA following the change to the manager benchmark outperformance requirement. This will be scrutinised, signed and returned. The Board will recall the approval of an additional £25m to the manager. This has not yet been called upon.</p>
LGIM	Rebalancing	<p>Members are invited to discuss the question of rebalancing in line with the meeting notes of 31 May 2013, these being included as an agenda item at this meeting, and the various options available. An up-to-date schedule setting out the asset allocation position at 31 August 2013 is shown in Annex 1.</p> <p>It should be noted that the Board's wish to allocate additional funds to Standard Life should be revisited following the departure of a key member of Standard Life's fund manager team. Standard Life will be attending the meeting to update the Board on latest developments.</p>
Baillie Gifford	Additional Funds	<p>A further £25m was paid to the Baillie Gifford Diversified Growth Fund on 5 July 2013.</p>
Goldman Sachs	Vintage Fund VI	<p>Officers submitted the necessary signed paperwork within the necessary deadlines for the Vintage Fund VI private equity fund. Confirmation of acceptance by Goldman Sachs has been received by officers.</p>
BlackRock	DivPep V Fund	<p>Officers have held back on confirming subscribing to this Fund and will report verbally at the meeting.</p>

Marathon		Update included in minutes of external fund manager meetings held on 31 July 2013 (Annex 2).
Majedie		Update included in minutes of external fund manager meetings held on 31 July 2013 (Annex 2).
UBS		Update included in minutes of external fund manager meetings held on 31 July April 2013 (Annex 2).
Franklin Templeton		Update included in minutes of external fund manager meetings held on 31 July April 2013 (Annex 2).

2) Freedom of Information Requests

The table below summarises the FoI request responses provided by the fund since the last meeting.

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Date	Requestor	Organisation	Request	Response
May -13	Company	Pitchbook	Information on private equity holdings	Provided summary as at 31 Mar 2013
July-13	Resident		Information regarding pensionable payroll and contribution amounts for Surrey and Elmbridge Borough for 11/12 12/13 and 13/14	Provided 11/12 and 12/13 as per requested and deficit contributions expected from both organisations for 13/14
July-13	Company	Proxy Insight Ltd	Proxy voting records for 2012/13 calendar year.	Provided as requested.

3) Future Pension Fund Board Meetings/Pension Fund AGM

The schedule of meetings for 2013 and 2014 is as follows:

- 20 Sep 2013: Board meeting hosted at County Hall
- 15 Nov 2013: Board meeting hosted in City
- 22 Nov 2013: Pension Fund Annual Meeting hosted at County Hall.
- 14 Feb 2014: Board meeting hosted in City
- 23 May 2014: Board meeting hosted in City
- 19 Sep 2014: Board meeting hosted at County Hall
- 21 Nov 2014: Board meeting hosted in City

4) Auto Enrolment

Auto enrolment statistics at 31 July 2013 are set out below

LGPS Auto Enrolment Statistics as at 31 July 2013

Number Auto Enrolled	1,795
Number Opted Out	632
Total Remaining in Scheme	<u>1,163</u>
Total Annual Pay	£19.2m
Total Employer Contributions	£3.3m
Total Employee Contributions	£1.1m
Total	<u>£4.4m</u>

The effect on the liability valuation and overall long term cash flow implications are currently being assessed by the actuary in his work on the triennial valuation and will be reported to the next Pension Fund Board meeting.

5) Stock Lending

Northern Trust (NT) have issued a draft contract with regard to the stock lending process. At the time of writing, this is being scrutinised by the Fund's advisor with a view to further negotiations with NT reference the terms and conditions set out within. It is anticipated that the stock lending programme will commence during October 2013.

Report of the Pension Fund & Treasury Manager

Internally Managed Cash

The internally managed cash balances of the Pension Fund are currently around £7.6m. This is cash managed by SCC as part of the Treasury Management process and is separate from the cash balance held at the Fund's custodian, Northern Trust. The cash is currently split between a NatWest call account paying interest of 0.50% and an RBS money market fund paying 0.40%. It is anticipated that this cash will be used to fund private equity drawdowns as they occur.

Standard Life Capital Secondary Opportunities Fund

Standard Life Capital Partners (SL Capital) is raising SL Capital Secondary Opportunities Fund I to target niche secondary opportunities that can generate target returns of 20% net IRR to investors, by focusing on secondary opportunities. The Fund will primarily focus on acquiring positions in private equity fund of funds or private equity secondary funds, regarded as an emerging niche within the broader private equity secondaries market where assets often sell at discounts to net asset value of 25% or greater. Where such opportunities meet the Fund's target returns, it may acquire secondary positions in European and North American mid-market buyout funds where SL Capital has specific insights and/or an existing relationship angle. All interests targeted by the Fund will be at least 40% funded thereby ensuring good visibility on the underlying portfolio quality. The Fund target size is USD 200m, predominantly European and North American buyout funds, target return is 20% IRR and a management fee of 40 bps on net asset value.

It is recommended that the Surrey Pension Fund make a USD 20m commitment to the Standard Life Secondary Opportunities Fund.

Capital Dynamics

Capital Dynamics is an independent asset manager with 25 years experience and an existing manager of the Surrey County Council Pension Fund. The senior members of the Clean Energy Infrastructure team each have over 20 years global experience as investors/operators in conventional and clean energy. They have expertise in origination, structuring, operational improvement, finance, asset optimisation and risk management. There is an attractive market opportunity with funds being required to meet increasing demand for clean energy over the next 20 years. Energy security, rising fossil fuel prices, carbon taxes and "mothballing" of older coal and nuclear energy infrastructure are all driving demand. Capital scarcity and a lack of sector experience is creating opportunity for attractive risk adjusted returns in select OECD markets for experienced investors.

Capital Dynamics are raising a \$750m Global Clean Energy and Infrastructure Fund. The Fund will invest directly in clean and renewable energy supply infrastructure assets, using only proven technologies. It will be a diversified portfolio targeting markets in mostly the UK and the US, across multiple partners, projects, commercial and utility scale technologies, fuel types, revenue streams, currencies and investment-grade counterparties. The Fund will consist of 10-15 investments, two of which have already been made, with unlevered contracted cash yields of 16% and 18%, in UK wind farms. The target returns are 20%+ gross IRR, with the potential to deliver 5%-10% cash yields from annual operating income, secured by contracted electricity/energy sales to investment grade counterparties. The fee level is 150bps. Risk will be mitigated via disciplined project selection, contractual negotiations and portfolio diversification/construction.

The investment opportunity is rated as a B+ by Mercer.

It is recommended that the Surrey Pension Fund make a USD 25m commitment to the Global Clean Energy and Infrastructure Fund.

Darwin Property Investment Management

The Darwin Group was started in 2003 as a strategic consulting boutique and capital raising advisor. This fund is Darwin's only fund under management. Darwin have identified opportunities in UK holiday parks where scale and management expertise are applied to create investment returns. The team has demonstrated a potential to source existing assets with strong value creation potential and manage the assets in the creation of a nationwide portfolio. The asset management strategies are a blend of value creation and lower risk income generation.

The areas where Darwin can add value to a newly acquired asset are clear and the investment process focuses on identification of a likely asset which will fit within the portfolio, where the asset is likely to produce the required return before any value-added activity by Darwin, and where Darwin is likely to be able to add significant value after acquisition. Darwin's competition in this space is fragmented with much of the existing market run by family businesses, and not managed to any great efficiency. The Fund aims to produce a total return to investors (net of charges) of at least 8% per annum. 75% of this return is expected to come from the regular income stream generated by the operating profits of the parks, with the remainder generated through the capital growth achieved as a result of park upgrades and redevelopments. The Fund target size is £300m, target return is 8% to 12% IRR with a net initial yield of 6.2%, and a management fee of 100 bps on gross asset value.

The investment opportunity is rated as an A by Mercer.

It is recommended that the Surrey Pension Fund make a £20m commitment to the Darwin Property Fund.

Actuarial Update

The process of data transfer to the Fund's actuary for the triennial actuarial valuation as at 31 March 2013 is now complete. Officers are in regular contact with the actuary with regard to the processing and quality checking of the data. The Pension Fund and Treasury Manager has been in regular contact with the Surrey Treasurer's Association to keep them apprised of progress. An initial result meeting will be held on 4 October with the actuary attending County Hall. The Pension Fund and Treasury Manager will report full results at the Pension Board meeting of 15 November.

Governance Strategies and Policies

All outstanding papers have now been drafted and presented to the Board, apart from the Pensions Administration Strategy and the Pensions Administration Service Level Agreement. These will be presented to the Board for the 15 November 2013 meeting.

Fund Manager Meetings on 31 July 2013

Notes of the fund manager meetings are shown as Annex 2.

Report of the Pension Fund & Treasury Manager

Financial and Performance Report

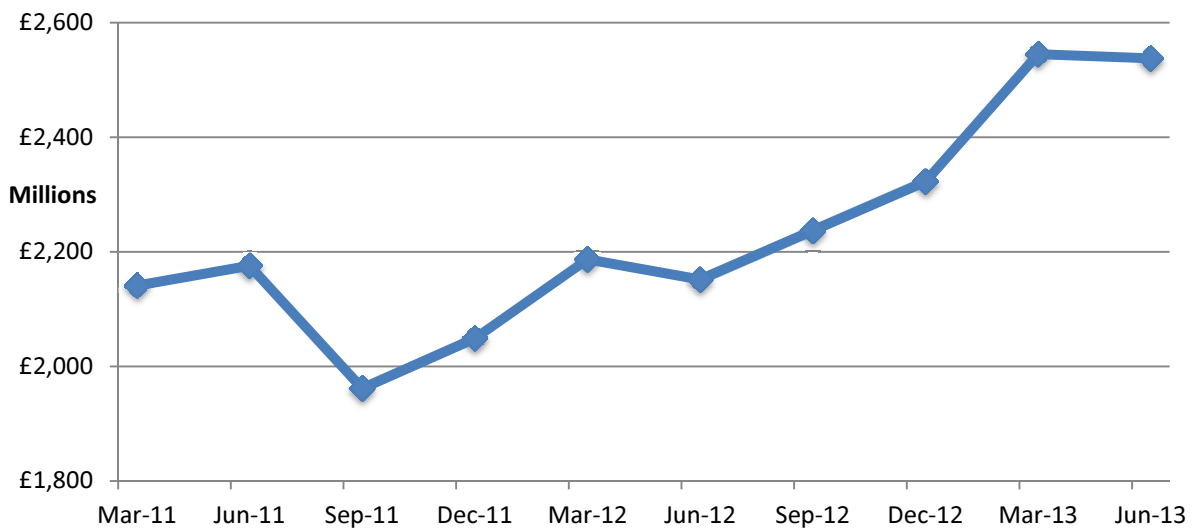
1. Market Value

The value of the Fund was £2,537.5m at 30 June 2013 compared with £2,545.0m at 31 March 2013. Investment performance was -0.3% for the quarter against the customised (hedged) benchmark return of -1.2%

The decrease is attributed as follows:

	£m
MARKET VALUE AT 31/03/2013	2,545.0
Contributions less benefits and net transfer values	9.8
Investment income received	14.0
Investment expenses paid	-1.8
Market Movements	-29.5
Market Value at 30/06/2013	2,537.5
Estimated Market Value at 31/08/2013	2,580.1

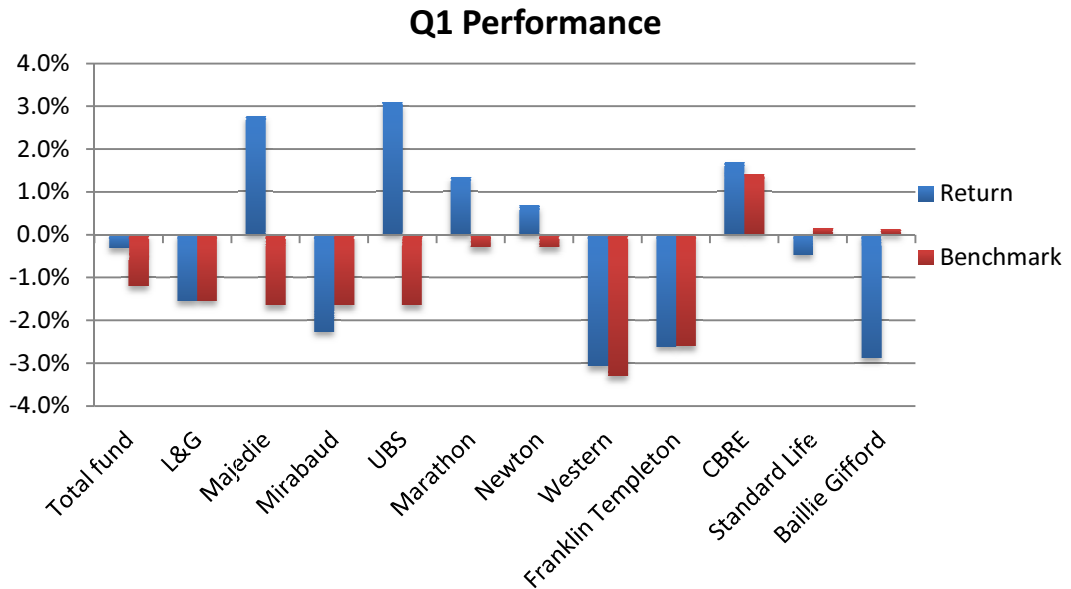
Total Fund Value



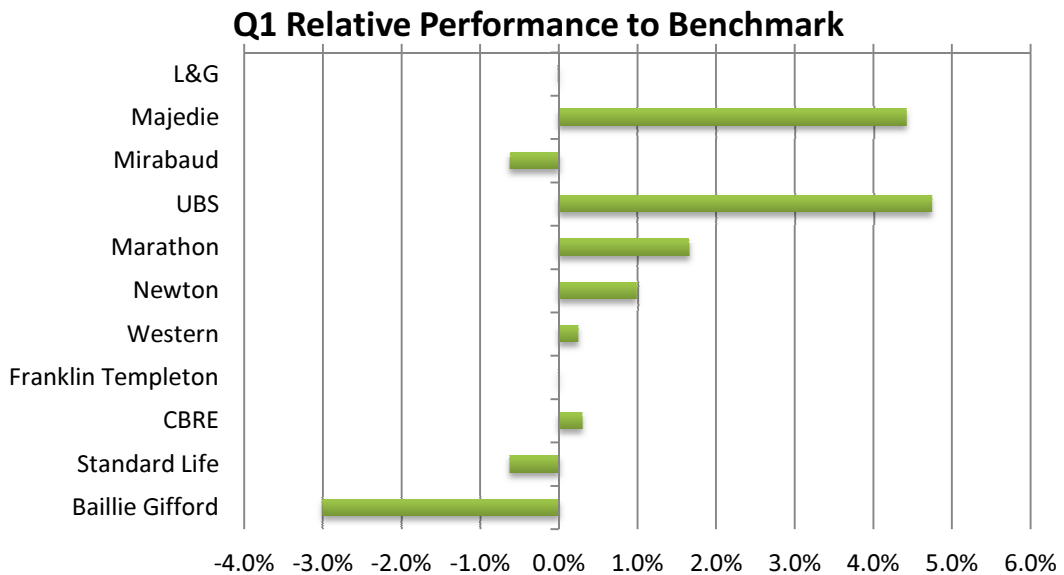
2. Fund Performance

Summary of quarterly results

Overall, the total fund returned -0.3% in Q1 2013/14, a shallower reduction compared to the customised (hedged) benchmark return of -1.2% during Q4 of 2012/13.



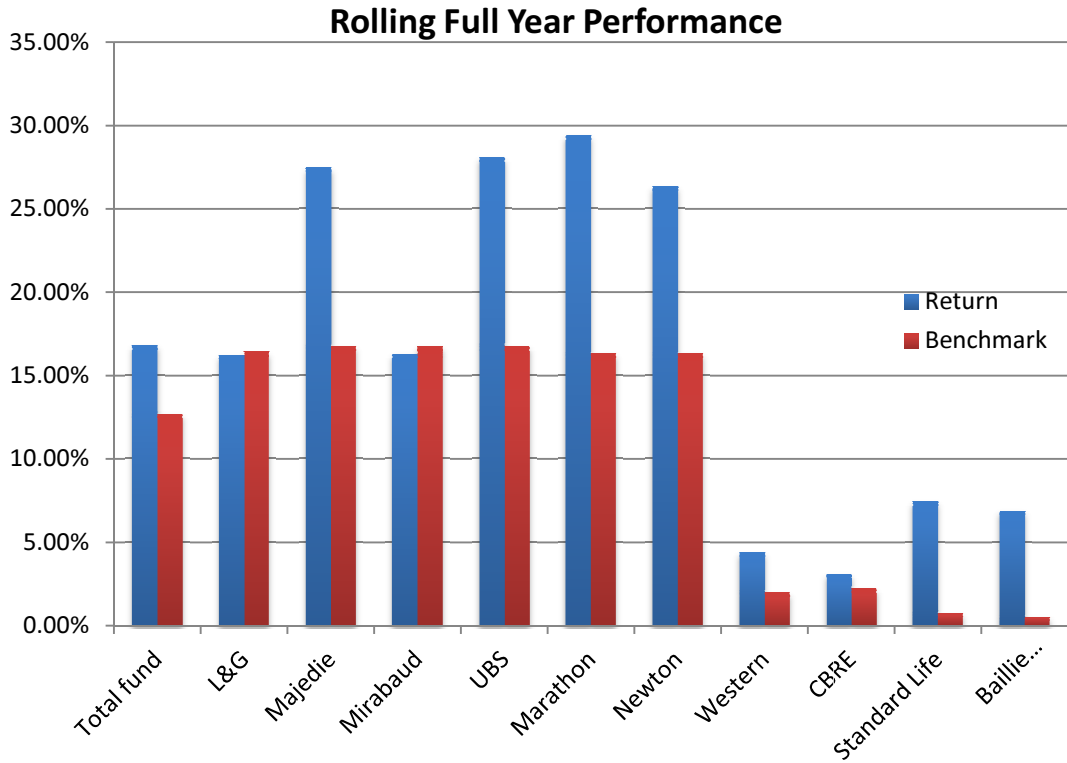
Most markets suffered declines in value during Q1 of 2013. All benchmark performances, with the exception of property and the nominal cash benchmark for DGFs, were in negative return for Q1. This follows very significant positive asset price movements during Q4 of 2012/13.



Relative to the benchmark, Majedie and UBS secured strong quarterly results with positive absolute returns in negative market conditions. Both DGFs (Standard Life and Baillie Gifford) declined in value during Q1.

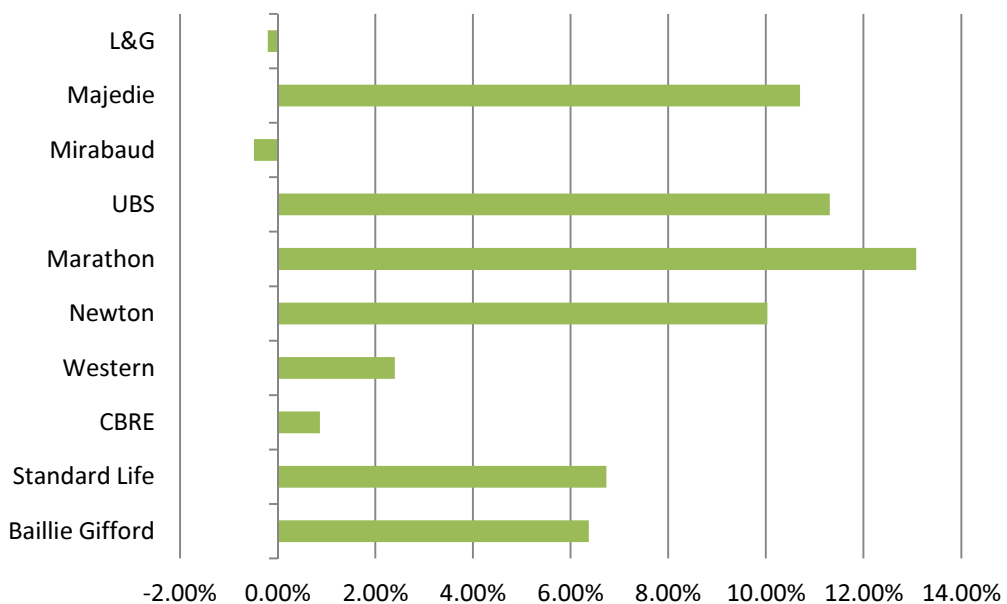
Summary of Full Year Results

Over the past 12 months to 30 June 2013, the total Fund returned 16.8% outperforming its benchmark of 12.7% by +4.1%.



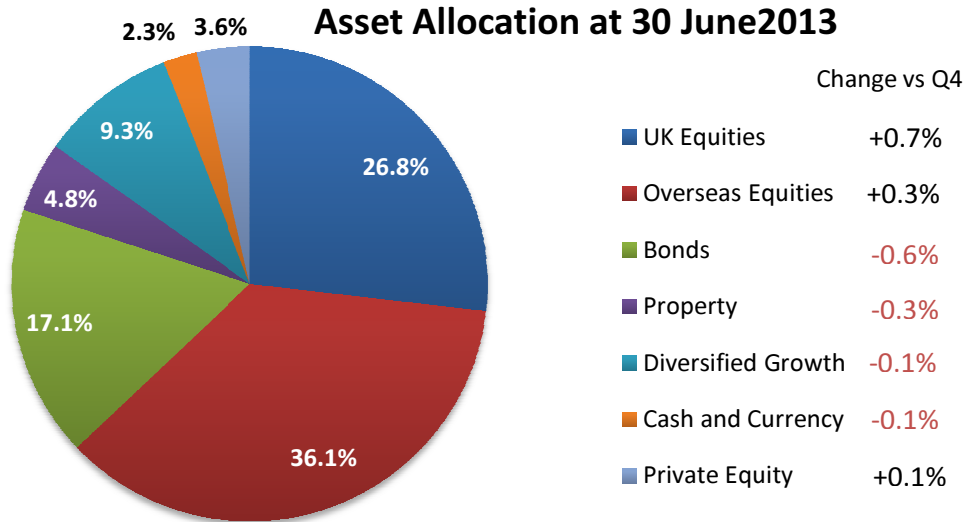
Equities provided the greatest overall return for the Fund over the last year with Marathon, UBS, Majedie and Newton all recording absolute investment returns greater than 25% and reaching double digit out-performance to the benchmark.

Full Year Relative Performance to Benchmark



3. Asset Allocation

The graph and table below summarise the asset allocation of the managed elements of the fund, excluding private equity holdings and internally held cash balances.



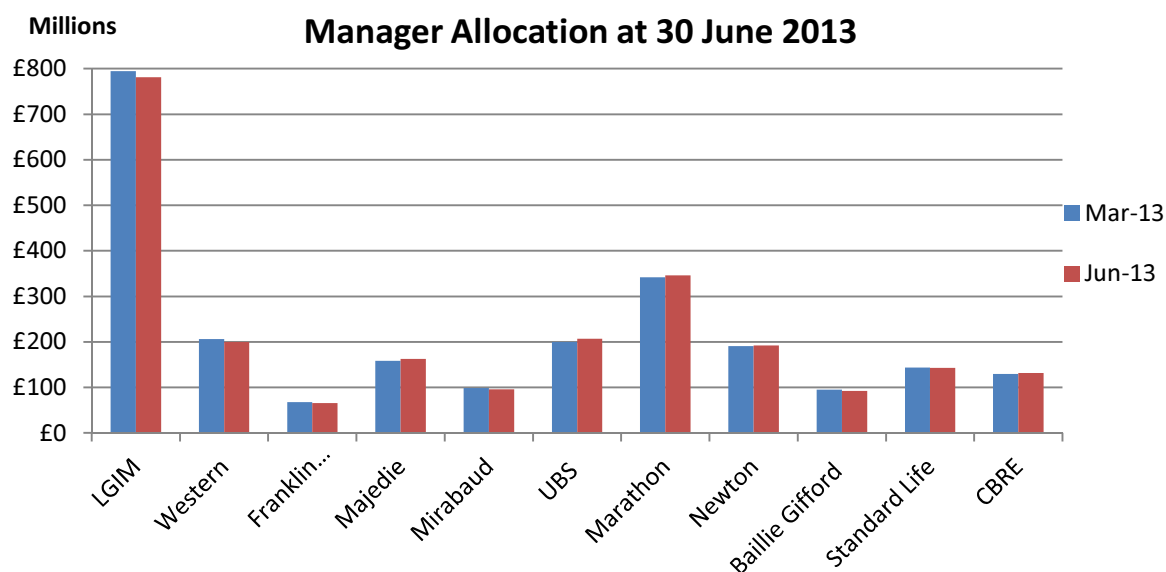
The table below compares the actual asset allocation as at 30 June 2013 against that target asset weightings.

	TOTAL FUND		Actual %	Target %	Last Quarter	
	£m	%			£m	%
Fixed Interest						
UK Government	108.3	4.2	5.0	103.3	4.1	
UK Non-Government	165.9	6.5	7.6	178.0	6.9	
Overseas	4.6	0.2	0.0	2.2	0.1	
Total Return	65.9	2.6	2.7	67.7	2.7	
Index Linked	90.1	3.6	3.8	99.4	3.9	
Equities						
UK	680.7	26.8	27.5	665.7	26.1	
Overseas	915.8	36.1	32.3	909.9	35.8	
Property Unit Trusts	121.4	4.8	6.6	129.8	5.1	
Diversified growth	235.6	9.3	9.5	239.0	9.4	
Cash	65.7	2.6	0.0	65.7	2.6	
Currency hedge	-7.6	-0.3	0.0	-5.9	-0.2	
Private Equity	91.1	3.6	5.0	90.3	3.5	
TOTAL	2,537.5	100.0	100.0	2,545.0	100.0	

This table includes private equity and cash held by investment managers separately, in contrast to the asset allocation shown in annex 1 which includes cash held by managers as part of their mandate.

4. Manager Allocation

The graph below shows the current manager allocation.



The table below includes the actual and target manager allocation weightings for those investments managed through the custodian Northern Trust as at 30 June 2013. This excludes the internal cash and private equity portfolio.

Investment Manager	Asset Class	Market Value £m	Actual Allocation %	Target Allocation %
LGIM	Multi-Asset	781.4	32.5	33.0
Western	Bonds	199.6	8.3	8.25
Franklin Templeton	Bonds	65.9	2.7	2.75
Majedie	UK Equity	163.0	6.7	7.0
Mirabaud	UK Equity	95.9	4.0	4.0
UBS	UK Equity	206.7	8.5	8.0
Marathon	Global Equity	346.2	14.3	12.0
Newton	Global Equity	192.3	7.9	8.0
Baillie Gifford	Diversified Growth	92.6	3.8	4.0
Standard Life	Diversified Growth	142.9	5.9	6.0
CBRE	Property	131.9	5.4	7.0
	Residual Cash	0.9	0.0	0.0
TOTAL		2,419.3	100.0	100.0

5. Fees

The following table shows a breakdown of fees due for Q1 2013/14.

Manager	MV 30/06/13 £m	Fee Q1 £	Annualised Average Fee %
LGIM*	781.4	185,450	0.09%
Western	199.6	99,740	0.20%
Franklin Templeton	65.9	82,788	0.50%
Majedie	163.0	135,407	0.33%
Mirabaud	95.9	140,962	0.59%
UBS	206.7	51,006	0.10%
Marathon	346.2	331,576	0.38%
Newton	192.3	108,608	0.23%
Baillie Gifford*	92.6	118,370	0.51%
Standard Life*	142.9	244,889	0.69%
CBRE	131.9	61,542	0.19%
Total		1,560,338	0.26

*Estimated

CONSULTATION:

6 The Chairman of the Pension Fund Board has been consulted on this report.

RISK MANAGEMENT AND IMPLICATIONS:

7 Risk related issues have been discussed and are contained within the report.

FINANCIAL AND VALUE FOR MONEY IMPLICATIONS

8 Financial and value for money implications are discussed within the report.

CHIEF FINANCE OFFICER COMMENTARY

9 The Chief Finance Officer is satisfied that all material, financial and business issues and possibility of risks have been considered and addressed.

LEGAL IMPLICATIONS – MONITORING OFFICER

10 There are no legal implications or legislative requirements associated with this report.

EQUALITIES AND DIVERSITY

11 The approval of the various options will not require an equality analysis, as the initiative is not a major policy, project or function being created or changed.

OTHER IMPLICATIONS

12 There are no potential implications for council priorities and policy areas.

WHAT HAPPENS NEXT

13 The following next steps are planned:

- Implementation of the various recommendation approvals.

Contact Officer:

Phil Triggs, Strategic Finance Manager (Pension Fund and Treasury)

Consulted:

Pension Fund Board Chairman

Annexes:

1. Asset Allocation Policy and Actual as at 30 June 2013 and 9 September 2013
2. Fund manager meeting notes on 31 July 2013

Sources/background papers:

None

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