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Cashflow Review

Surrey Pension Fund

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Summary

Cashflow position

Overall position looks to be relatively neutral over the next few years
(before taking any income from assets)

Not expected to be cash-flow negative until 2029

Potential excess cash requirements expected to be largely covered by return of income/capital from CBRE over next 3 years. Straight-forward to switch on.

Some income could also be taken from MAC to provide a buffer

Estimated income for 2023 from Property and MAC could be in excess of c.£40m

Operational Issues

Border to Coast's Equity and Multi-Asset Credit (MAC) funds invest in accumulation units.
Taking income from the funds essentially means making a disinvestment, but this can be done without incurring costs subject to a limit which is calculated by Border to Coast each January.

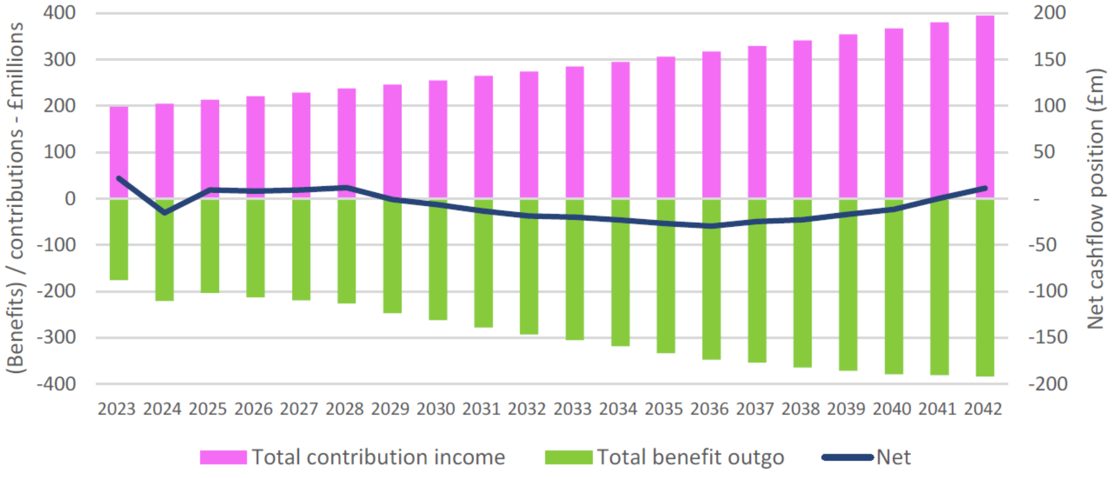
Longer-Term

In theory, there is a healthy level of income potential from the assets (e.g. we estimate asset based income could be around £180m p.a. in future).

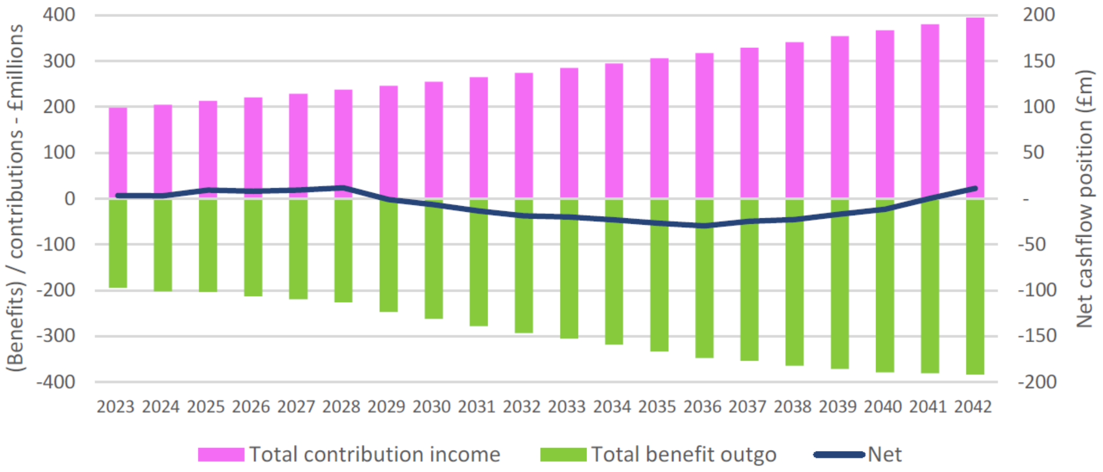
This allows significant flexibility as to how the Fund invests over the long-term, relative to the estimated cashflow needs to pay benefits

Projected Cashflow Scenarios

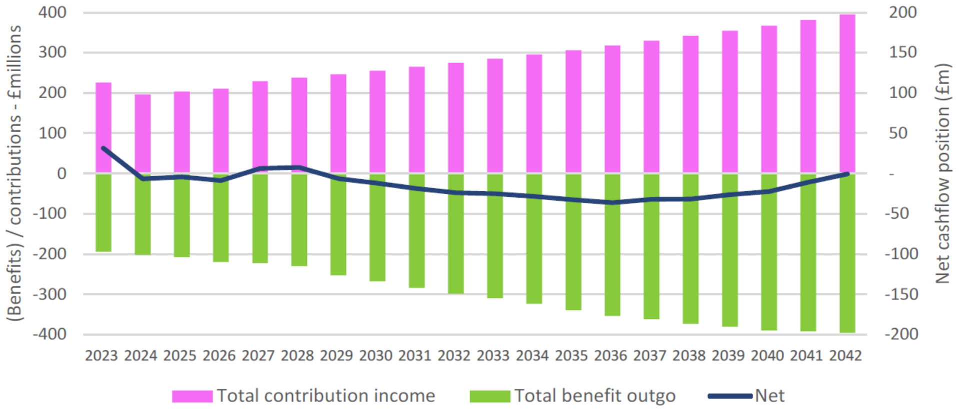
Cashflow baseline



Cashflow allowing for short term benefit smoothing



Cashflow allowing short term benefit smoothing, updated CPI assumptions and prepayments



- Hymans have produced 3 different projections of the Fund's estimated net cash flow position (contributions minus benefit outgo). See separate paper from Hymans for more details.
- The results for the scenarios are broadly similar; the Fund is not expected to be cashflow negative until 2029.
- Over the period 2029 to 2040, the average net negative cashflow is estimated to be around £22m, peaking at c.£36m in 2036/7.
- This analysis excludes the impact of what level of income could be expected from the assets, which we consider further in this report.

Source: Hymans Robertson. For more information on their cashflow projection modelling, please see Hyman's Cashflow Projection report dated 7 November 2022.

Asset Class Income Assessment

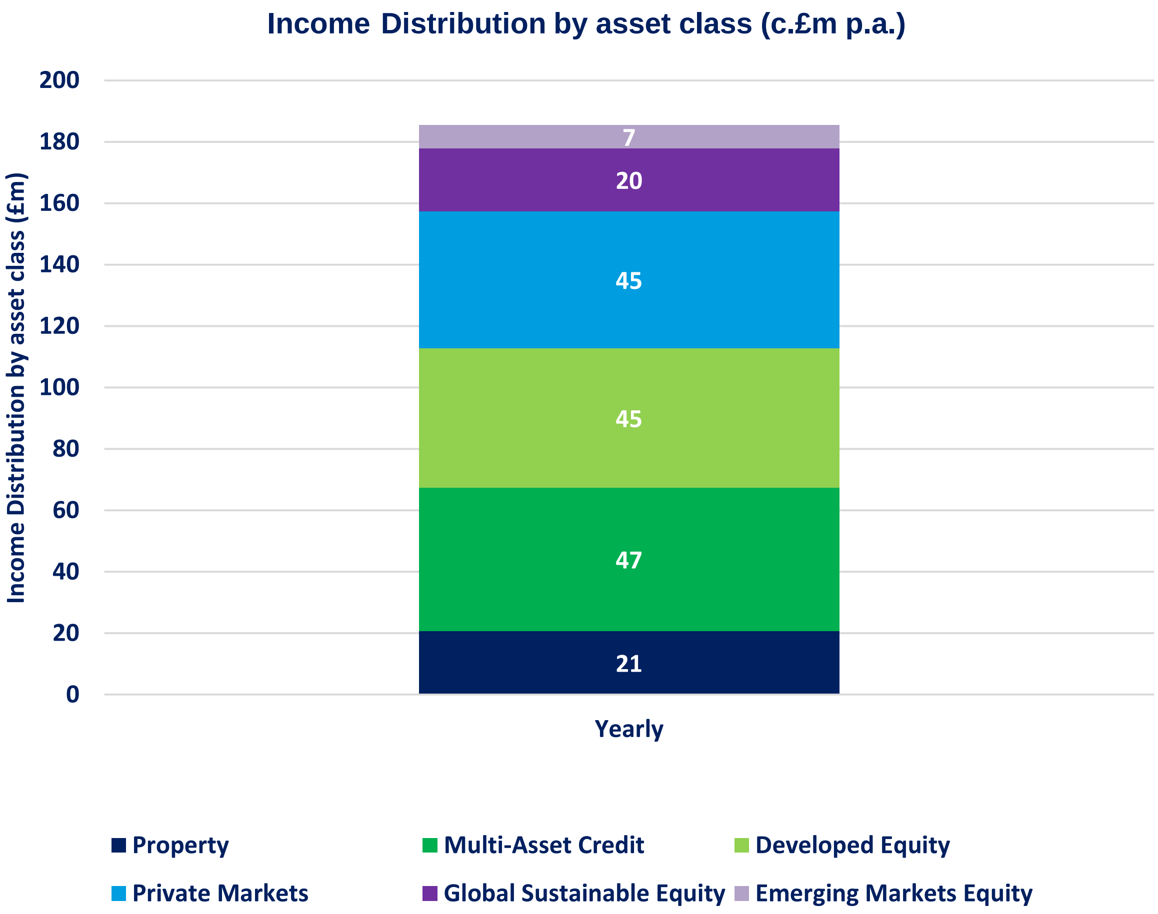
Key issues:

- The amount of meaningful income that can be automatically taken from the assets currently (without disinvesting) appears to be limited primarily to the CBRE property portfolio. Border to Coast's pooled funds for liquid assets currently only offer "accumulation" units – income cannot be automatically paid out. As such, to meet any cashflow needs (above income from CBRE), assets need to be disinvested (potentially incurring costs).

Asset Class	Target Allocation	Potential Yield p.a.	Comments
Global Equity	51.0%	2 - 4%	Longer-term we would only look to take equity dividends as income, if income from Property, Multi-Asset Credit and Private Markets are insufficient. This is unlikely to be an issue for many years. Border to Coast's equity and LGIM's Future World fund range do not currently offer an income payment facility. Assets with Newton and the regional LGIM equity funds could pay out income (c.2% to 3%) but these are unlikely to be long-term holdings for the Fund.
Emerging Markets Equity	3.8%	2 - 3%	
Multi-Asset Credit	12.1%	10 - 12%	Given current market yields, this asset class offers a very attractive source of income. Income would need to be taken from Border to Coast in the form of the cash withdrawal plan. In 2022, a maximum of £1.6m per month (c.£20m p.a.) could have been withdrawn without incurring a dilution levy. This figure will be recalculated in January 2023 based on the yield of the fund at the time minus a haircut. We expect the amount to increase but this is to be confirmed.
Property	7.6%	4 - 5%	CBRE estimate income/return of capital for the following periods as being: 2022/2023 = £25m, 2023/2024 = £19m and 2024/2025 = £17m. We understand arrangements will need to be put in place to implement this. Income is currently being re-invested.
Infrastructure	6%	9 - 15%	These allocations are expected to be good sources of contractual income over the long-term, but it will take several years and multiple vintage cycles to achieve target allocations. The source of funds to meet capital commitment for these assets is in theory invested in the Border to Coast Listed Alternatives fund, which eases near term sourcing issues. Distributions to be expected from previous Private Equity holdings. It would be useful to undertake more detailed analysis of the expected future distributions from the asset classes at a future review (not required at this time, in our view). Yield estimates also make an allowance for return of capital.
Private Debt	6%	8 - 12%	
Private Equity	5%	9 - 15%	
Miscellaneous Alternatives / Climate Opps	3%	Too early	
Gilts	5.5%	3 - 4%	Income levels have increased this year due to rise in yields.

Based on estimates from Mercer and underlying investment managers based on current market conditions. Subject to change.

Future Portfolio Income Potential



- This is estimated theoretical analysis providing an indication of the level of income that could be achieved from the Fund's portfolio, once the allocations to Private Markets are up to target.
- Based on the value of the assets as at 31 March 2022.
- Given the contribution and benefit outflow projections from Hymans, the Fund is not expected to be cashflow negative (excluding asset income) until 2029.
- This allows significant flexibility as to how the Fund invests over the long-term.
- Ideally, all of Border to Coast's pooled funds would be set-up operationally to be able to automatically pay out income without incurring transaction costs.
- We understand that Border to Coast will be reviewing this at some point. In the meantime, we would suggest that Officers make a formal request to Border to Coast's to investigate this further.

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