

# Surrey Pension Fund Committee

Manager Review Meeting Minutes

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**29<sup>th</sup> July 2024**

## Attendees

Councillor Nick Harrison, Chairman of the Pension Fund Committee

Neil Mason, Assistant Director – LGPS Senior Officer

Lloyd Whitworth - Head of Investment and Stewardship

Anthony Fletcher, Independent Adviser

## Background

The purpose of this meeting was to receive an update from CBRE on the performance, activity and outlook for the UK and Global property funds managed on behalf of the Surrey Pension Fund. And to receive a progress report from BCPP on the development of their investment solutions for global and UK property.

# CBRE

## *Mandate Summary*

CBRE manage a Property Fund-of-Funds with holdings valued at £285 million in 25 underlying funds and a further net £4 million in cash. On 30<sup>th</sup> June 2024, the portfolio's asset allocation was 74.4% in a range of UK funds and 25.6% in the CBRE Global Alpha Fund. The performance objective for the total mandate is to outperform the MSCI/AREF UK QPFI All Balanced Property Fund Index + 0.5% p.a. over a rolling 3 year period in GBP terms. Surrey appointed CBRE in April 2004.

## *Performance*

The total return of the CBRE portfolio was -2.1% compared to +0.1% for the benchmark over 12 months. Over 3 years the total return was +0.8% p.a. compared to the benchmark return of +0.6% p.a., while ahead of the benchmark by +0.2% this outcome is -0.3% p.a. behind the performance objective. The total return is lower than the benchmark and objective over 5 years at +1.2% p.a. compared to the objective of +2.0% p.a. The total return since inception is +1.6% p.a. -1.5% p.a. behind the Surrey performance objective and -1.0% behind the benchmark.

Over the 12 months to June 2024 CBRE's attribution analysis estimates that the 5 best positive contributions to performance came from; Industrial Property Investment Fund, Unite Student Accommodation, currency, Octopus Healthcare Fund and M&G Secured Property Income Fund. The 5 funds with the largest negative contributions were CBRE Global Alpha, Ardstone UK Regional Office Fund, Standard Life, Long Lease, Airport Industrial Property Unit Trust and Schroders Capital UK Real Estate fund. CBRE cited the overall increase in yields, increased cost of debt and the pressure of redemptions for the fall in capital values and negative performance of the whole fund. The distribution yield of the portfolio has also fallen from 3.4% to 3.1%

In terms of absolute return 8 funds achieved a positive return, with a long tail of negative absolute returns from -1% to -56%. Within this only 7 funds delivered above benchmark returns, 1 in line with the benchmark and all the others below benchmark. Once again, one of the largest negative returns was achieved by Nuveen's UK shopping centre fund which delivered -31.8% compared to -57% in 2023 and -38.6% in 2022. The Millstone around this fund's neck is its largest development project, the St James Quarter in Edinburgh, which has been beset by numerous issues over the years.

## *Current Positioning*

In January 2023 in anticipation of the launch of BCPP's Global and UK property fund solutions Surrey made changes to the UK segregated mandate instructing CBRE to make no new investments into closed ended property funds but provided guidance that investment into open ended funds and funds with at least an annual redemption window was allowed. Furthermore, they instructed that any income generated by the UK segregated portfolio should not be reinvested but instead returned to Surrey. Over the year under review the UK portfolio made new purchases of £14.2 million into open ended funds; £2.2 million of drawdowns to Fiera Logistic development fund and repaid £8.3 million of capital received from 4 different closed end funds. The CBRE Global Alpha investment is via a pooled fund vehicle so Surrey's instructions cannot be applied, hence the manager has continued to invest without these constraints.

The UK market remains in an adjustment phase caused by the overhang of corporate DB pension fund sellers, still seeking liquidity after the Gilt crisis in September and October 2022. CBRE claim this has been more of a problem for Schroders' and Blackrock's UK property businesses. Nonetheless until the secondary supply has cleared market performance will remain under pressure, although it may create opportunities for unleveraged equity investors to buy potentially undervalued assets.

In the UK portfolio CBRE remain committed to industrial/logistics especially in the Southeast where land is scarce and in both UK and Global portfolios, residential both affordable and private housing, student accommodation and new health care / nursing homes. Residential is an area where they believe there is structural under-supply of good quality assets. At the sector level CBRE remain underweight and continue to reduce exposure to office and retail, except where they can find opportunistic high quality, prime assets, with high ESG ratings and resilience to changing trends in user behaviour.

CBRE's Global Alpha fund has had none of the problems manifest in the UK. The fund has met all redemptions (US\$345 million) on time and in full and has attracted US\$425 million of new cash, has a queue of prospective investors with commitments of US\$412 million. CBRE highlighted two deliberate policies, the first, to be defensive which means they tend to capture less of the "upside" but also hopefully less of the "downside" of the markets pricing cycle, the second is to monitor its investors by "type" to ensure that it doesn't become dominated by one type of investor, specifically to try and avoid the UK DB Pension Fund liquidation *problem*.

14 The dominant asset allocation is 46% industrial, 30% residential and 10% healthcare practices. It only has 4% in Office worldwide, with none in the US, 1 each Prime properties in London and Berlin plus a few higher quality properties in Paris. It only has 2% exposure to China all in logistics, the balance about 7% is in cash to manage cashflows, awaiting completion or seeking opportunities to invest.

### ***Outlook***

CBRE's UK macro-economic outlook in July 2024 foresees reasonable economic growth and continued moderating inflation from the middle of the year onwards. They expect a fall in interest rates and bond yields, which will help revalue the property sector. They see the current higher yields and pressure from liquidations driven by motivated sellers as an attractive entry point for UK property. They remain selective and quality driven in terms of the selection and retention of assets for the Surrey portfolio while at the same time seeking to achieve the best exits from the portfolio's problem assets.

### ***Adviser View***

As I mentioned last year, CBRE were too optimistic about the UK and global markets being at a turning point. This year they are much more cautious on the UK in particular and they cited the problems other managers are still having clearing their redemptions queues. Naturally they saw this as an opportunity for them, they are still expecting most of the returns to be income led but their total return forecast for the UK over the next few years has been increased to +7% to 8% p.a. The global team were much more bullish and expect to hit their US\$ absolute return objective of 9% to 11% p.a.

CBRE, gave a very clear and impressive presentation, they were clearly on top of the subject, especially the global team, both teams expectations are well thought through and based on their views appeared reasonable. CBRE remain important to the Surrey Pension Fund as the CBRE Global Alpha Property Fund will be a significant proportion of the BCPP Global Property fund offering.

I remain confident that CBRE have the resources and the skill to manage Surrey's Property allocation.

## BCPP

Alistair Smith - Head of Real Estate  
Paul Campbell – Global Portfolio Manager  
Sharmila Sikdar – Client Relationship Manager

Surrey's pooling partner BCPP is in the process of final design of their UK property offering having established the Global offering in the third quarter of 2023. The Global offering will use a core and satellite approach with CBRE's Global Alpha Fund the largest investment, other specialist or regional funds will be added over time. The UK approach will involve migrating away from funds to a property portfolio that will be predominately direct property investments with no more than 15% in specialist pooled vehicles.

### *Global Core Fund*

The Global Real Estate Core Fund will target a return of 6% p.a. over 10 years, by investing in a range of funds targeting the Core and Core Plus property segments, the focus will be on high quality buildings with low vacancy rates, with returns dominated by rental income and low development risk. The design is sufficiently flexible to allow for both the transition of legacy assets in and if required full redemption out. The Core fund will, once portfolio construction is complete, consist of 45% - 100% in core funds, with a limit of 55% in core plus funds. The geographic ranges are 30% - 70% North America; 20% - 60% Europe; 10% - 60% Asia Pacific; and 0% - 20% the rest of the world.

Advanced due diligence is progressing on the 3 legacy vehicles, the largest of which is CBRE's generalist core plus Global Alpha Fund (43%), Clarion Lion Industrial Trust a core plus US thematic fund (8%) and Prologis European, a core thematic fund (9%). Once these are complete BCPP's team will focus on adding 4 further core diversified vehicles, 2 in the US, and 1 each in Europe and Asia Pacific. The aim of the team is to achieve the best portfolio construction rather than to chase funds with discounts to NAV and then have to rebalance especially as care needs to be taken to avoid tax implications and round trip fees. The team are aiming to have a completed phase 1 portfolio by the first quarter of 2026 and will re-open for new subscriptions in April 2026.

### *Adviser View*

Slow progress is being made to build the global property fund, but at least on day 1, it will consist largely of Surrey's existing investment in CBRE's Global Alpha Fund and over time enable Surrey to increase its global property exposure from cash.

### *UK Real Estate offering*

BCPP outlined their progress in the establishment of the Main UK real estate fund. Establishment of the Gateway fund has been delayed until after the Main fund is up and running. The Main fund is expected to consist of only 66 physical property assets valued at about £1.1 billion after one of the partner funds that was considering passing its direct property portfolio to BCPP decided not to proceed at this stage. Phase 1 pre-launch due diligence and valuation of the 66 physical seeding assets is progressing and expected to be complete by the 30<sup>th</sup> September. This will enable the start of phase 2 – seeding window 1<sup>st</sup> October 2024 – 31<sup>st</sup> March 2025 consisting of the phase 1 66 direct holdings and a further £100 - £150 million of cash from Partner Funds. Phase 3 – Main fund launch 1<sup>st</sup> April 2025 onwards.

### *Surrey's interest*

Surrey has no direct property holdings to seed the Main fund, but it does have approximately £100 million of mis-allocated capital to invest in order to increase its property allocation to neutral exposure within the Surrey's SAA. This £100 million will form part of the phase 2 seeding. In addition to this Surrey has 24 UK funds in its CBRE portfolio, only 3 of which are expected to be eligible for transfer to the indirect portion of the Main fund. These 3 funds worth approximately £40 million cannot be transferred until the start of phase 3. The remaining 21 funds worth approximately £180 million will be wound down or sold with the proceeds invested into the Main fund over time.

The three specialist funds that are expected to be eligible for transfer to the Main fund are; CBRE Affordable Housing,

Octopus Healthcare and Unite Student Accommodation. Unfortunately, BCPP will not give a commitment that these 3 funds will be part of the portfolio until they have completed their due diligence, which will only begin after the physical asset DD is complete. Furthermore, BCPP reminded us that there is a 15% cap on the size of the indirect allocation in the Main fund, and that depending upon the size of other partner funds holdings in these 3 funds, there may not be capacity for all of Surrey's investment to be transferred in. They further muddied the water by suggesting that BCPP may wish to have a more diversified portfolio of in-direct holdings and that could further reduce capacity to take Surrey's indirect investments into the BCPP Main fund or lead to them being sold down in future.

14 **Adviser View**

Despite the execution risk I still believe the real advantage that Surrey could gain by an investment in the UK Main fund is exposure to direct physical property investments. In my experience, bearing in mind that past experience will not always play out in the future, direct property investment delivers better risk and return outcomes at a much lower cost, with potentially much lower volatility and with only slightly less liquidity.

Unfortunately, BCPP are not helping decision making for Surrey with uncertainty and delay relating to the inclusion of the specialist in-direct property investments. This is making it difficult for Surrey to take advantage of the possibility of cheaper market entry opportunities and the ability to top up its invested allocation rather than its commitments to Property in-line with the Fund's strategic asset allocation.



**Anthony Fletcher – Independent Adviser to the Surrey Pension Fund**

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