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# AGENDA

# PENSIONS INVESTMENT COMMITTEE

## Date: WEDNESDAY, 12 JUNE 2013 at 7.00 pm

**Committee Room 3**
**Civic Suite**
**London SE6 4RU**


**Enquiries to:** **Daisy Cairns**
**Telephone:** **020 8314 8975 (direct line)**
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**COUNCILLORS**

Councillor Dan Whittle (Chair)
Councillor Paul Maslin (Vice-Chair)
Councillor Chris Best
Councillor Julia Fletcher
Councillor John Muldoon
Councillor Mark Ingleby
Councillor Philip Peake
Councillor Eva Stamirowski

Observers
Mrs Humble
Mr Whittet (UNISON)

Officers
Janet Senior (Executive Director for Resources and Regeneration)
Selwyn Thompson – Group Manager
Shola Ojo – Principal Accountant
Carol Eldridge – Group Manager (Pensions and Payroll)
Conrad Hall – Head of Business Management and Service Support

**Members are summoned to attend this meeting**

**Barry Quirk**
**Chief Executive**
**Lewisham Town Hall**
**Catford**
**London SE6 4RU**
**Date: 4 June 2013**

INVESTOR IN PEOPLE

**The public are welcome to attend our committee meetings, however occasionally committees may have to consider some business in private. Copies of reports can be made available in additional formats on request.**

# ORDER OF BUSINESS – PART 1 AGENDA

| PENSIONS INVESTMENT COMMITTEE | | | |
|---|---|---|---|
| **REPORT TITLE** | Appointment of Chair and Vice Chair | | |
| **KEY DECISION** | | **Item No:** | 1 |
| **WARD** | N/A | | |
| **CONTRIBUTORS** | Chief Executive | | |
| **CLASS** | Part 1 | **Date:** | 12 June 2013 |

## RECOMMENDATION

To elect a Chair and Vice Chair of the Pensions Investment Committee for the municipal year 2013/14.

# Agenda Item 2

| PENSIONS INVESTMENT COMMITTEE | | | |
|---|---|---|---|
| **Report Title** | **MINUTES** | | |
| **Key Decision** | | | **Item No. 2** |
| **Ward** | | | |
| **Contributors** | **CHIEF EXECUTIVE** | | |
| **Class** | **Part 1** | **Date: 12 JUNE 2013** | |

**Recommendation**

That the Minutes of the meeting of the Committee, which was held on 21 February 2013 be confirmed and signed.

**MINUTES OF THE PENSIONS INVESTMENT COMMITTEE**
**Thursday, 21 February 2013 at 7.00 pm**

PRESENT: Councillors Dan Whittle (Chair), Alex Feakes, Mark Ingleby, John Muldoon and Julia Fletcher

ALSO PRESENT: Scott Donaldson, Hymans Robertson (Independent Investment Adviser to the Committee); Conrad Hall, Selwyn Thompson, Shola Ojo, (LB Lewisham)

Apologies for absence were received from Councillor Susan Wise and Councillor Paul Maslin.

**1. Minutes**

**RESOLVED** that the Minutes of the Pensions Investment Committee held on November 15 2012 be confirmed and signed.

**2. Declarations of Interest**

Councillor Muldoon declared a personal interest in Item 6 as a friend of Sir Paul Judge, the Chair of Schroder Income Growth Fund plc.

**3. Pension Fund Post Transition Summary**

3.1 Selwyn Thompson informed the Committee that the transition from active to passive management had been completed in November 2012.

3.2 Members then received a presentation from Simon Hutchinson and Kate Lander who tabled a written report. (copy filed with minutes).

3.3 Members thanked the Northern Trust representatives for their presentation.

RESOLVED that the report be noted.

**4. Investment Performance for the Quarter ended 31 December 2012**

4.1 Mr Donaldson presented this item and circulated a written report.

RESOLVED that the report be noted.

**5. Legal Implications for Investment in Social Housing and Infrastructure**

The Chair confirmed consideration of this item would form part of the previously agreed training session.

RESOLVED that this item be deferred pending a training event.

**6. Schroders**

6.1 The Committee received a presentation from three Schroder representatives, Mr Anthony Doherty, Property Fund Manager, Graeme Rutter, Head of Property Multi-

Manager and Dan Hunter, Client Director. They tabled a report and a briefing paper on affordable housing.

6.2 The Committee explored options available to them to diversify investment towards affordable housing, creative industries and related social infrastructure.

6.3 Councillor Muldoon reminded the Committee that its first duty was to maximise returns for the Pension Fund and that it could not use the assets entrusted to its supervision as an economic development fund.

6.4 The Chair said the Committee would continue to be interested in investment possibilities in the sectors identified and he said it was important to keep a dialogue open. He reminded the Committee of the previously agreed intention to utilise 1% of the fund to acquiring affordable housing debt. Mr Hall said officers would seek Mr Donaldson's advice on looking at Funds that might meet that intention.

6.5 The Committee accepted the Chair's suggestion that they receive an update at their next meeting.

RESOLVED that the report be noted.

## 7. Exclusion of Press and Public

**RESOLVED** that under Section 100 (A) (4) of the Local Government Act 1972, the press and public be excluded from the meeting for the following items of business on the grounds that they involve the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12 (A) of the Act, as amended by the Local Authorities (Executive Arrangements) (Access to Information) (Amendments) (England) Regulations 2006 and the public interest in maintaining the exemption outweighed the public interest in disclosing the information:

8. Closed Minutes

The following is a summary of the items considered in the closed part of the meeting.

## 8. Closed Minutes

**RESOLVED** that the Minutes of the meeting held on November 15 2012, which was not open to the press and public, be confirmed and signed.

The meeting ended at 9.01pm.

Chair

| PENSIONS INVESTMENT COMMITTEE | | | |
|---|---|---|---|
| **Report Title** | **DECLARATIONS OF INTERESTS** | | |
| **Key Decision** | NO | **Item No.** | **3** |
| **Ward** | | | |
| **Contributors** | **CHIEF EXECUTIVE** | | |
| **Class** | **Part 1** | **Date: 12 June 2013** | |

**Declaration of interests**
Members are asked to declare any personal interest they have in any item on the agenda.

**Personal interests**
There are two types of personal interest :-

(a) an interest which you must enter in the Register of Members' Interests*
(b) an interest where the wellbeing or financial position of you, (or a "relevant person") is likely to be affected by a matter more than it would affect the majority of in habitants of the ward or electoral division affected by the decision.

*Full details of registerable interests appear on the Council's website.

("Relevant" person includes you, a member of your family, a close associate, and their employer, a firm in which they are a partner, a company where they are a director, any body in which they have securities with a nominal value of £25,000 and
(i) any body of which they are a member, or in a position of general control or management to which they were appointed or nominated by the Council, and
(ii) any body exercising functions of a public nature, or directed to charitable purposes or one of whose principal purpose includes the influence of public opinion or policy, including any trade union or political party) where they hold a position of general management or control,

If you have a personal interest you must declare the nature and extent of it before the matter is discussed or as soon as it becomes apparent, except in limited circumstances. Even if the interest is in the Register of Interests, you must declare it in meetings where matters relating to it are under discussion, unless an exemption applies.

**Exemptions to the need to declare personal interest to the meeting**
You do not need to declare a personal interest where it arises solely from membership of, or position of control or management on:

(a) any other body to which your were appointed or nominated by the Council
(b) any other body exercising functions of a public nature.

In these exceptional cases, unless your interest is also prejudicial, you only need to declare your interest if and when you speak on the matter .

**Sensitive information**
If the entry of a personal interest in the Register of Interests would lead to the disclosure of information whose availability for inspection creates or is likely to create a serious risk of violence to you or a person living with you, the interest need not be entered in the Register of Interests, provided the Monitoring Officer accepts that the information is sensitive. Where this is the case, if such an interest arises at a meeting, it must be declared but you need not disclose the sensitive information.

**Prejudicial interests**
Your personal interest will also be prejudicial if all of the following conditions are met:

(a) it does not fall into an exempt category (see below)
(b) the matter affects either your financial interests or relates to regulatory matters - the determining of any consent, approval, licence, permission or registration
(c) a member of the public who knows the relevant facts would reasonably think your personal interest so significant that it is likely to prejudice your judgement of the public interest.

**Categories exempt from being prejudicial interest**

(a)Housing – holding a tenancy or lease with the Council unless the matter relates to your particular tenancy or lease; (subject to arrears exception)
(b) School meals, school transport and travelling expenses; if you are a parent or guardian of a child in full time education, or a school governor unless the matter relates particularly to the school your child attends or of which you are a governor;
(c) Statutory sick pay; if you are in receipt
(d) Allowances, payment or indemnity for members
(e)Ceremonial honours for members
(f) Setting Council Tax or precept (subject to arrears exception)

**Effect of having a prejudicial interest**
If your personal interest is also prejudicial, you must not speak on the matter. Subject to the exception below, you must leave the room when it is being discussed and not seek to influence the decision improperly in any way.

**Exception**
The exception to this general rule applies to allow a member to act as a community advocate notwithstanding the existence of a prejudicial interest. It only applies where members of the public also have a right to attend to make representation, give evidence or answer questions about the matter. Where this is the case, the member with a prejudicial interest may also attend the meeting for that purpose. However the member must still declare the prejudicial interest, and must leave the room once they have finished making representations, or when the meeting decides they have

finished, if that is earlier. The member cannot vote on the matter, nor remain in the public gallery to observe the vote.

**Prejudicial interests and overview and scrutiny**

In addition, members also have a prejudicial interest in any matter before an Overview and Scrutiny body where the business relates to a decision by the Executive or by a committee or sub committee of the Council if at the time the decision was made the member was on the Executive/Council committee or sub-committee and was present when the decision was taken. In short, members are not allowed to scrutinise decisions to which they were party.

| PENSIONS INVESTMENT COMMITTEE | | | |
|---|---|---|---|
| **REPORT TITLE** | Terms of Reference | | |
| **KEY DECISION** | No | **Item No:** | 4 |
| **WARD** | N/A | | |
| **CONTRIBUTORS** | Chief Executive | | |
| **CLASS** | Part 1 | **Date:** | 12 June 2013 |

## RECOMMENDATION

It is recommended that the terms of reference of the Pensions Investment Committee as set out below be noted.

## TERMS OF REFERENCE

'To exercise all functions of the Council in relation to local government pensions under Section 7, 12 or 24 Superannuation Act 1972 and all other relevant pensions legislation. By way of illustration this includes:

- review with fund managers of the investment performance of the superannuation fund on a quarterly basis;

- to examine the portfolio of investments, and its market value, at the end of each quarter for suitability and diversification;

- to inform the fund managers of the Council's policy regarding investment of its superannuation funds, and to take advice on the possible effect on performance resulting from implementing the policy;

- to review from time to time the appointment of the fund manager;

- to determine the overall investment strategy and policies of the fund on professional advice;

- responsibility for compliance with the ten Myners principles incorporated in the "CIPFA Pensions Panel Principles for Investment Decision Making" and all other relevant guidance in relation to the Local Government Pension Scheme in force and issued by CIPFA from time to time.'

# Agenda Item 6

| PENSIONS INVESTMENT COMMITTEE | | | |
|---|---|---|---|
| **REPORT TITLE** | Update on affordable housing options | | |
| **KEY DECISION** | No | **Item No:** | 5 |
| **WARD** | N/A | | |
| **CONTRIBUTORS** | Executive Director for Resources & Regeneration | | |
| **CLASS** | Part 1 | **Date:** | 12 June 2013 |

## 1. PURPOSE

1.1 This paper provides Members with an update on the options for an affordable / social housing investment options for the Lewisham Pension Fund. It focuses on the further developments taking place at Schroders which currently manages the property mandate for the Lewisham Pension Fund. Representatives from Schroders attended this Committee in February 2013 and presented options for social housing investment opportunities.

## 2. RECOMMENDATIONS

It is recommended that:

2.1 Members note the contents of this report.

2.2 The previously agreed decision to use up to 1% of the Pension Fund to acquire an appropriate affordable housing investment solution should be maintained. However, given the lack of a meaningful investment opportunity at this stage, officers look again in a year's time at what options exist then, subject to any decisions taken at this meeting.

## 3. BACKGROUND

3.1 There is a critical shortage of social housing in UK and increasing political pressure in increase housing supply. Over the course of the last 18 months, Members of Pensions Investment Committee have considered various options for investing in an affordable housing scheme.

3.2 As with any investment idea considered by the Committee, an allocation to social housing would need to be made principally on the basis that the return expectations are attractive in the context of the risk of the investment and the overall objectives of the Fund. It is valid for the Committee to also consider Environmental, Social and Governance ("ESG") issues in making investment decisions, but the investment rationale must remain paramount.

3.3 It was notable that the member ‘training’ event which took place for back in November 2011 did not showcase any viable options for which the Pension Fund could invest in at that stage. Since this time, officers have looked at a numbers of other schemes and developments taking place in London and the South East and nationally, such as the Manchester City consortium to build affordable homes in the city and the community interest company proposal presented by the group Catalyst for Homes.

3.4 Given that they manage the property mandate for the Lewisham pension fund, Schroders attended this committee in February 2013 and presented a number of options for investing in affordable housing. An update on developments since they attended the committee has been set out in the following paragraphs.

3.5 Update on Schroders Property

3.5.1 Schroders have continued to investigate investment into the social / affordable housing sector over the part few months following the last meeting of this committee. In their view, there is still not a proposition which at present fits with the scheme’s property investment objectives. Members should note that some progress has been made and is summarised as follows:

- Schroders have met with representatives of L&Q, one of the largest registered providers and incidentally based in Lewisham. They are certainly active in the affordable housing sector, but are only really interested in partnering with institutions who would effectively provide debt finance at rates comparable with those they have already achieved in the bond markets – circa 4% - 4.5%. This is below the portfolio’s return requirements and so is not something Schroders are likely to pursue.

- Schroders have met with representatives of Hillcrest, the largest registered provider in Scotland. As a smaller corporation they have less access to capital markets and are therefore more willing to adopt a land-led joint venture model of the kind described by Schroders as one of their favoured models when we presented to the PIC at the last meeting. However, these investments would be targeted in Scotland. There are no firm proposals confirmed at this stage, therefore Schroders will await a proposal from Hillcrest.

- The most recent development has been the HCA’s extension of Build to Rent funding to £1bn. This funding essentially offers finance at relatively inexpensive terms (circa 2.5%) to residential developers. Developers have been invited to apply for this funding to develop some of their land holdings which they have hitherto held as land as starting development has not been economic. The real estate here is typically private rented residential, rather than social housing. However, as well as cheap funding from the HCA, the developer (and ultimately the HCA) would also require an institution to acquire the developments once they have been built. As a result, Schroders met with representatives of the HCA last month as well as a number of developers to explore what kind of investment model might be adopted and how Schroder clients might take a role by potentially acquiring the developments at completion. Again, there are a number of moving parts which are yet to be agreed between all parties, and there is a risk that the model will ultimately not be suitable for the Lewisham Pension scheme.

3.5.2 In December 2012, Schroders produced a briefing note on affordable housing which sets out and assess the options available for pensions funds looking to allocation a proportion of their property portfolios to the sector. For information, this has been attached at Appendix 1. The current position remains as it was back in December 2012, in that there does not appear to be a viable option for the pension fund to invest in at this moment in time.

3.6 Updates from other organisations

3.6.1 Officers met with Catalyst for Homes (C4H) towards the end of April this year. It describes its aim is to create an attractive pension fund investment, with secure low risk returns and delivery continuity regardless of prevailing market conditions, whilst achieving unmatched ethical and social objectives.

3.6.2 Hearthstone Investment plc is specialist residential property fund manager, providing access to residential property for both private investors and institutional pension schemes. This group has successfully managed to secure the investment of £20m from the London Borough of Islington into what is a pooled residential housing scheme. There is a presentation from Hearthstone elsewhere on this agenda.

## 4. FINANCIAL IMPLICATIONS

4.1 There are no financial implications directly arising from this report. However, Members should note that any investment into an affordable / social housing scheme would need to make economic sense for the pension scheme and be able to achieve the performance objective and investment restrictions.

## 5. LEGAL IMPLICATIONS

5.1 The Local Government Pension Scheme (Management and Investment of Funds) (Amendment) Regulations 2013 increased the percentage of the pension fund that can be invested in partnerships from 15% to 30% from 1 April 2013, after consultation. The consultation leading to this change had proposed a new asset class of “infrastructure”, but this was considered by respondents to the consultation too difficult to define so instead this new increase in limit will apply to infrastructure funds which are structured as limited partnerships.

5.2 The Committee has to take proper advice and a risk assessment before investing in such partnerships.

## 6. CRIME AND DISORDER IMPLICATIONS

6.1 There are no crime and disorder implications directly arising from this report.

## 7. EQUALITIES IMPLICATIONS

7.1 The are no equalities implications directly arising from this report.

## 8. ENVIRONMENTAL IMPLICATIONS

8.1 There are no environmental implications directly arising from this report.

**APPENDIX 1**

Schroders – Affordable Housing Briefing Note

**FURTHER INFORMATION**

If there are any queries on this report or you require further information, please contact either:

Selwyn Thompson, Group Finance Manager Budget Strategy on 020 8314 6932

# Schroders

## UK Property Multi-Manager - Affordable housing briefing

Anthony Doherty, Property Fund Manager, Multi-Manager

### Introduction

This note discusses the research case for investing in affordable housing and assesses the options available for pension funds looking to allocate a proportion of their property portfolios to the sector. It considers the likely portfolio implications for risk and return and highlights issues we think should be taken into account by investors considering an allocation to the sector.

### Market overview

The case for investing into the affordable housing sector in the UK is supported by demand and supply fundamentals. Official projections estimate that the number of households in the UK will grow on average by 272,000 per year between 2008 and 2033. In England this equates to 5.8 million extra households - a 27% increase. However, most commentators agree that the supply-side is not keeping pace with demand. Even before the financial crisis of 2008, the UK wasn't building enough new homes and the situation has deteriorated over the past five years. The number of new homes completed in the UK fell from 219,070 in 2006-07 to 140,790 in 2010-11, a drop of 36%.

**Chart 1. Capital value of asset classes compared**

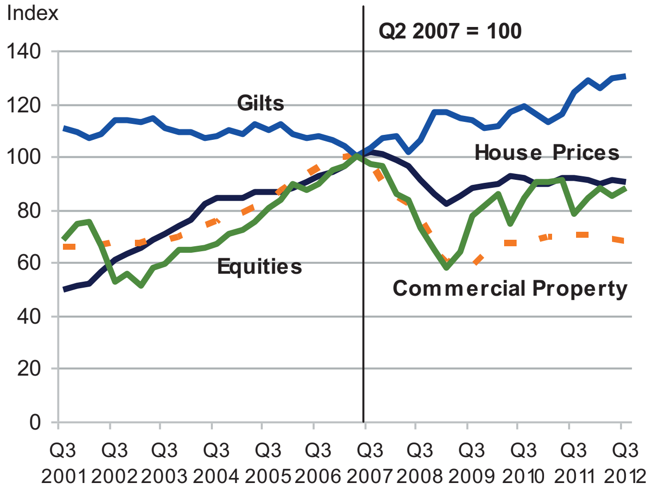
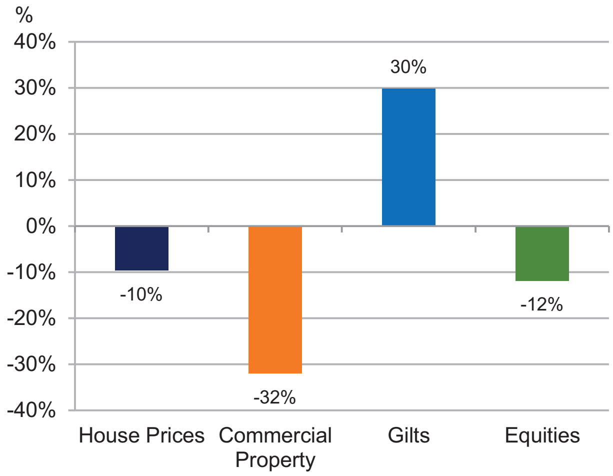


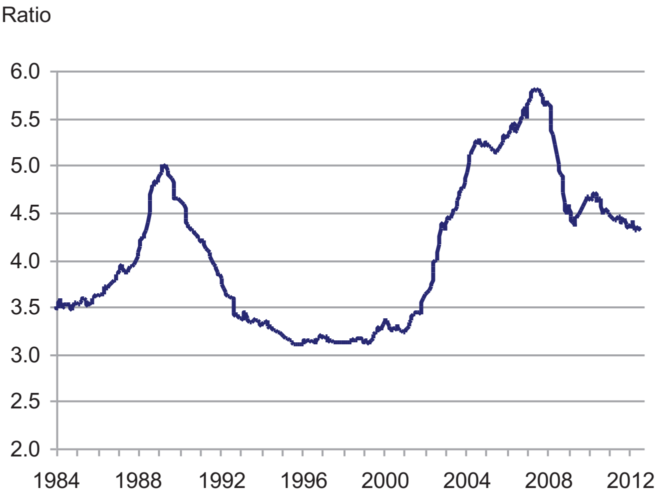

**Chart 2. Change in asset class values since Q2 2007**




Source: Investment Property Databank, Nationwide House Price Index, Thomson Datastream at 30 September 2012

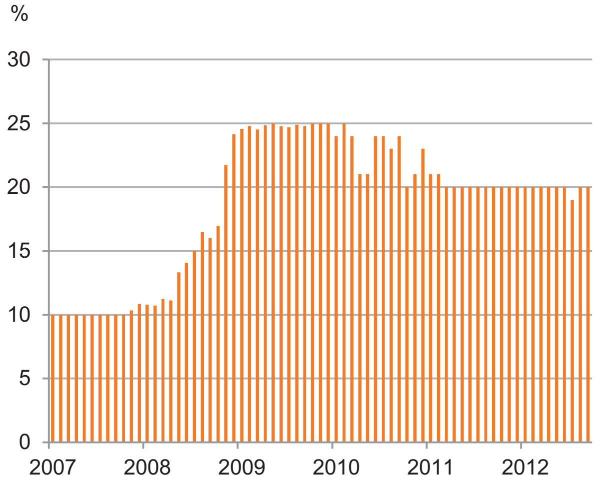
To some extent these imbalances in supply and demand explain why the fall in house prices since mid 2007 has been less pronounced than commercial property (10% versus 32% - see charts 1 and 2 above) where supply and demand dynamics have been quite different. But this relative resilience in valuation has its consequences for occupiers. Affordability is still a major hurdle for potential home owners, particularly for first time buyers. The ratio of house prices to incomes remains high (chart 3). These ratios have been impacted further by the fact that since the credit crunch banks have rationed mortgage lending by doubling the size of the required deposit from 5-10% to 15-20% of purchase price (chart 4). Research by the Council for Mortgage Lenders shows that the proportion of first time buyers aged under 30 who are able to buy without assistance from their parents / grandparents has fallen from 65% in 2005 to 22% in 2011 as a result.

**Chart 3. House Price: Average Earnings Ratio**




Source: Thomson Datastream at 31 July 2012

**Chart 4. Average deposit paid by First Time Buyers (% house value)**




Source: Capital Economics at 30September 2012

Given these themes the private rented sector is increasingly the only option available for many households, as they are unable to access social housing due to eligibility constraints and unable to afford owner-occupation. The number of households who rent private accommodation has grown rapidly as a consequence, from 2.5 million in 2006 (12.2% of the total), to 3.6 million households (16.5%) in 2011 (source: Department for Communities and Local Government[1]). Around half of this growth is households with children. The number of families in private rented accommodation has increased from around 500,000 to around 1 million in the last five years (source: Shelter[1]). If recent trends continue, then 20% of all households will live in private rented accommodation by 2020.

The opportunity for investors, particularly in the affordable end of the market rent space, could be significant. However, the value of rented property is ultimately determined by its vacant possession value in the owner occupier market and given the relatively modest correction in house prices since the credit crunch, we expect capital growth in this sector to be flat over the next few years. The key question then for investors is how to access a market where rents are low by definition and capital growth is expected to be flat while still achieving the investment performance objectives of their portfolios.

The next section of this report tackles this question by discussing the key considerations undertaken by Schroders before investments are made on behalf of a pension scheme's property portfolio and how investment into the residential sector and affordable housing in particular currently compares.

## Key investment considerations

Before undertaking any investment on a pension scheme's behalf the investment is appraised and its suitability for inclusion in the property portfolio assessed.

This initial appraisal generally focuses on the following areas:

1. Total return expectations
2. Portfolio risk considerations
3. An assessment of the Management Team

[1] From Building New Homes for Rent – Building and Social Housing Foundation (BHSF) at October 2012

### 1. Total return expectations

One of the most important assessments made is whether the investment is expected to meet the performance objectives of the property portfolio. Schroders' performance objective is generally to achieve total returns which exceed the benchmark by 0.75% per annum over a rolling three year period net of our fees. The long term returns of the benchmark have been 7% per annum (source: Investment Property Databank). As a consequence, investments are likely to be suitable for the portfolio if they can achieve total returns of around 7-8% per annum over the medium term.

### 2. Portfolio risk considerations

The expected total return of an investment is not the only criteria by which we judge opportunities. Investments must also meet the investment risk restrictions contained within our mandates. These are typically focused on promoting a diversified spread of investments within the portfolio, limiting exposure to speculative development and leverage while maintaining a level of liquidity to enable returns to be realised.

### 3. Assessment of the Management Team

A final key area of due diligence focuses on the third party management team whose responsibility it is to source and manage the underlying property assets. Among other things property managers should be able to demonstrate proven track records of performance, financial stability, repeatable investment processes and robust risk management and governance procedures.

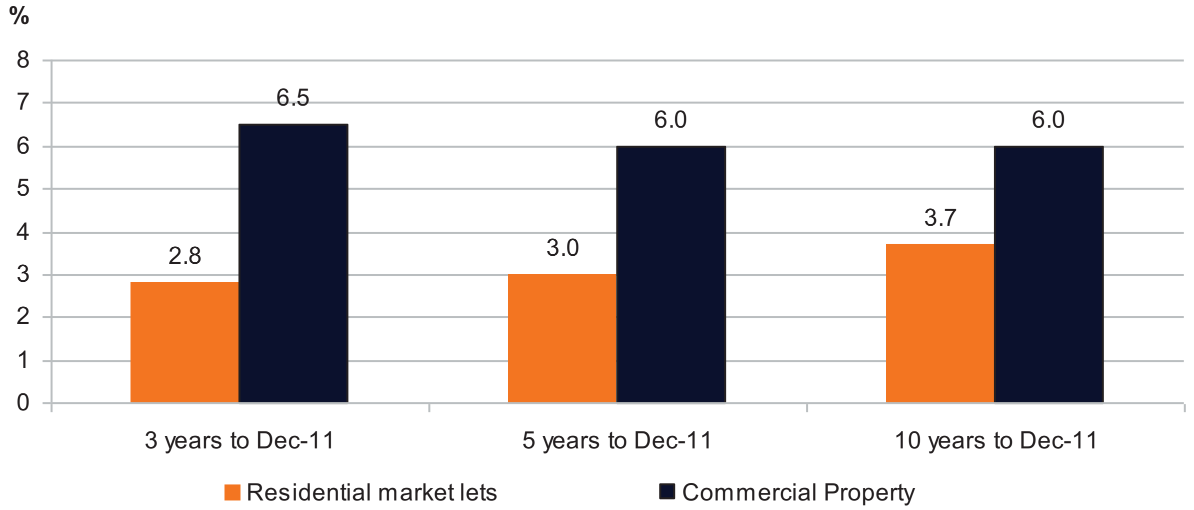
### How residential property measures up

There are no residential funds (excluding student accommodation) in our clients' property portfolios nor are there any in the AREF/IPD Pooled Funds Index, which includes the portfolio's benchmark and which in total comprises £30 billion property assets across 60 property funds. In our view the key reason why institutional property investors are currently reluctant to invest in the sector boils down to income returns.

Management costs for residential property are high relative to commercial property where leases are usually structured on an FRI (fully repairing and insuring) basis. These costs reduce the net income return receivable by investors and are one of the main reasons that the income yields for residential property are not typically as attractive as those of the commercial property sectors (see chart below).

For pension funds investing in property who are seeking returns of around 7-8% per annum the bulk of performance must therefore come from capital growth – higher house prices. In today's economic environment significant house price growth appears challenging.

### Chart 5. Net income returns from residential versus commercial property




Source: Association of Real Estate Funds and Investment Property Databank at June 2012

In our view, to meet the total return objectives of the portfolio an investment in this sector would need to deliver an income return of at least 5% net of costs. It would then need to be able to deliver rental growth which matches inflation (assuming this to be 3%) to achieve a nominal total return target of 7-8%. As chart 5 shows, the net income return on residential property has been less than 3% over the past three years to December 2011. This implies that rents would need to grow at a challenging 5% per annum, roughly twice the rate of inflation, in order to achieve a return comparable with commercial property.

**What are the investment options and how do they compare?**

Despite the challenges in 'getting the numbers to add up' for institutional investors several potential investment models have emerged over the past eighteen months. These models fit into four broad areas: 'strip income', debt funding, shared ownership and land-led joint ventures. Each model is described below and its investment characteristics compared with the general investment objectives of our clients' property portfolios.

**1. Strip income funds**

A strip income property fund 'strips' the income and capital payments from its underlying assets. These investments are targeted at annuity investors looking for long term cash flows linked to inflation.

Under this model the freehold interest in residential property is purchased by the fund and leased to a registered provider or local authority for 40-50 years who use the proceeds to build social housing. Under the terms of the lease, the registered provider is responsible for letting the properties and for all ongoing repair, maintenance and void costs, and pays rent to the fund which is typically reviewed annually in line with the retail price index. The fund's initial investment is amortised over the lease term such that at the end of the lease ownership of the assets reverts to the registered provider.

These funds typically target annuity style returns. The examples we have reviewed are benchmarked against index linked bonds +1.5% per annum. On current pricing this implies a total return target of just over 4% assuming inflation of 2.5% per annum, significantly below the long term required rate of return for a pension fund's property portfolio.

This kind of investment has merit for annuity style investors looking for fixed-income style returns. However in our view there are a number of shortcomings for property investors. These are set out below:

- **Liquidity and investment duration**: The hold period for investors is 40-50 years
- **Total return expectations**: Total returns of 4% are more akin to the long run returns of gilts than commercial property
- **Social housing focus and housing benefit risk**: Social housing is primarily funded with housing benefits which at present is paid directly to the registered providers. Any changes to the level of housing benefit or the way that it is paid (e.g. directly to the tenants) could affect the revenue collected by the registered provider and hence its ability to meet its own rent payment obligations to the strip income fund.
- **No actual property investment**: At the end of the investment hold period investors do not necessarily own the land or property as the registered provider would have an option to acquire the assets at nil value. Ultimately, like a fixed income instrument, the return of this investment is not linked to the quality, or underlying rental growth of the property assets but the covenant strength of the registered provider and interest rates.

## 2. Debt funding

Over the past few years debt funds, which lend to the providers of social housing, have been launched to target investors looking for inflation linked cash flows. These funds offer private financing to registered providers to fund the development of social housing. The debt is secured on the property assets with a long-term maturity profile of 30-40 years. While the bank has a charge on the property assets during the term of the loan the properties are owned by the registered provider. These funds typically target long term nominal returns to investors of c4.5% per annum assuming inflation of 2.5%.

As a debt instrument, these funds are clearly fixed income investments. They also share a number of the shortcomings highlighted for 'strip income' investments. Namely, illiquidity and long term hold periods (30-40 years), relatively low long term investment returns (c4.5%), a focus on social housing tenure and no actual underlying property investment.

## 3. Shared ownership

Shared ownership is a form of house purchase whereby the purchaser buys a proportion of the home, usually from a local authority or housing association, and rents the rest. Over the past few years some companies have tried to raise equity to provide occupiers with funding on a portion of the property in return for 'rent'. This is very similar to the role a bank may play when providing a mortgage. However, the key difference is that the shared-ownership fund would actually own the property jointly with the occupier.

The typical terms of the shared-ownership proposals we have analysed are summarised below:

- Leveraged total return targets of 10% per annum
- The Fund charges occupiers 6-7% 'rent' on its share of the property, which is often linked to RPI.
- The occupier is responsible for 100% of the maintenance costs of the property as well as the full legal, agency and stamp duty costs incurred on the transaction.
- The occupier has a right to acquire the asset in full or in part after a period of time, usually five years. This is how the investors release their equity and crystallise their returns and is called 'staircasing'.
- The fund typically uses leverage (c30% loan to value) to enhance returns.

We think that the modelling assumptions of the proposals we have seen in this space have several shortcomings:

- **Affordability**: We question whether occupiers would be able to afford a 6-7% 'rent' charged by the fund especially if it ratchets up annually by RPI
- **Exit for investors**: There is also considerable uncertainty over whether occupiers would be able to buy back the fund's share of the property and when this might occur. As a consequence, the exit timing for investors in the fund is highly uncertain.
- **Transaction costs**: We also have difficulty justifying the allocation of 100% of the transaction costs to the occupier who owns a minority stake in the property.
- **Quality of the investment managers**: The managers promoting funds in this space have difficulty providing relevant and successful track records.
- **Modelling assumptions**: The modelling assumptions used for such funds typically assume a level of house price inflation and leverage to ensure the returns look attractive to investors. In general, we have found the modelling assumptions for house price growth and cost of finance to be questionable.

### 4. Land-led joint ventures

A land-led joint venture is where investors partner with a land owner, either public or private, to create an investment vehicle which funds the development of residential property on that land. The land is invested into the joint venture by the land owner while the investor commits equity. As such both parties have a stake in the joint venture and benefit from the returns it generates. The model can be used to fund different types of tenure, including market rent and affordable rent.

Equity investors enjoy a priority return on the investment such that an ungeared total return of c8% is paid to them before returns are paid on the land. However, once these returns are achieved the land-owner shares proportionately in the financial returns of the investment.

The advantages of this approach are that the land owner is able to kick-start its development project on its own time scale rather than selling the land to a developer who will start the development when it sees fit, which in the present investment environment may mean that development is delayed. For the equity investor, a total return is achievable which is comparable with the long term performance of commercial property and is commensurate with the risks of the investment.

The shortcomings of this model are:

- **That it is largely unproven**: while this idea is not new it has not been used prolifically to date. This is partly because it has not needed to be as the grant system has allowed registered providers to fund developments economically.
- **Land value**: The model depends largely on the value assigned to the land. Some land owners are unwilling to invest their land assets below the value they have assigned to it in their books in return for a share of the profits of the partnership.
- **Regulation**: There has been some uncertainty as to whether the injection of public land into a joint venture would need to go through the OJEU tendering process (Official Journal of the European Union). However, we understand that land-led investments would be excluded from this process.

The table overleaf summarises the key investment characteristics of the four investment models described above. In our view each have their merits and will likely all play a role in the funding of social, affordable and market rent housing over the coming years.

### Table 1. Key investment characteristics of affordable housing investment models

| | 1. Strip Income | 2. Debt funding | 3. Shared ownership | 4. Land-led joint ventures |
|---|---|---|---|---|
| **Total Return target** | c4% pa | c4.5% pa | 10% pa | 8% pa |
| **Income yield** | c4% pa | c4.5% pa | c6% | 5% |
| **Investment period** | 40-50 years | 30-40 years | 10 years (in theory) | 5-10 years |
| **Exit mechanism** | Essentially an amortising investment with the Registered Provider having an option to acquire the freehold at zero value at the end of the term. | Fully amortising loan. Repaid at the expiry of the loan term. | Uncertain and dependent on occupiers' ability to 'staircase' – buy back some or all of the fund's share of the property | Sale after minimum hold period of 5-10 years |
| **Property assets** | The freehold is owned but subject to call option from Registered Provider at the end of the lease | No property ownership. | Owned jointly with the owner occupier | Owned in Joint Venture by investor and land owner |
| **Is the investment accessible?** | Yes, over a 12-18 month period. | Yes, over a 12-18 month period. | No suitable funds at present. | Not as a fund. Investments potentially available on a deal by deal basis. |
| **Strengths** | • Bond style cash flow returns linked to inflation | • Bond style cash flow returns linked to inflation | • Potentially attractive total returns. | • Potential returns comparable with long term commercial property.<br>• Clear exit for investors<br>• Both partners share in potential upside |
| **Weaknesses** | • Liquidity and investment duration<br>• Relatively low long term investment returns (c4% per annum)<br>• Social housing focus and housing benefit risk<br>• No actual property investment | • Liquidity<br>• Long term hold periods of 30-40 years<br>• Relatively low long term investment returns (c4.5% per annum)<br>• A focus on social housing tenure<br>• No actual underlying property investment | • Affordability for occupiers<br>• Exit for investors<br>• Quality of the investment managers<br>• Modelling assumptions | • Unproven model<br>• Potential sensitivity for public bodies regarding the value at which land would be invested |

Source: Schroders at December 2012

### Important considerations

It is natural for Local Authorities to prefer funds targeting affordable housing to be directed to their own localities. However, before a Local Authority Pension Fund makes an allocation to this sector we would recommend that the following issues are considered carefully:

– **Fiduciary responsibilities of the Investment Manager:** The pension scheme's Investment Manger would need to believe that such an investment met the terms of its Investment Management Agreement before it could be recommended. In short, the investment would need to make economic sense for the pension scheme and be able to achieve the performance objective and investment restrictions set for the property portfolio.

– **Employer Related Investments (ERI)**: An investment by the Local Authority Pension Scheme into the Local Authority's social or affordable housing sector is likely to be classed as an ERI and therefore be subject to allocation limits.

– **Diversification:** The investments held in our clients' property portfolios are diversified in their exposure to properties and regional locations. A single investment into potentially one residential scheme and one location would not meet the typical diversification requirements of our mandates, particularly when the benchmark against which it is assessed has no or little exposure to residential, not least residential in one particular region or location.

– **Benchmarking:** In order to assess the relative performance of any residential allocation a suitable comparison would need to be made. At present the industry's current benchmark – a commercial property sample – would not be suitable as its investment characteristics vary significantly. A new measure to assess how a residential investment, and hence its investment manager, has performed would need to be agreed.

**Conclusions**

- The case for investing into the UK affordable housing sector is supported by demand and supply fundamentals. However, valuations in this sector are ultimately determined by vacant possession values in the wider owner-occupier market, which has experienced only a relatively modest correction in prices since 2007. As a result, investment returns in this sector are likely to be driven by rental income, which by definition is relatively low.
- For pension funds looking to allocate funds to this sector the key question then is whether investment returns from an allocation to affordable housing would be able to match the target returns set for their property portfolio (c7-8% per annum).
- We have assessed four main models for investment into the sector. Each offer relatively low returns or are as yet un-proven models.
- In addition, local authority pension funds would also need to consider the implications of investing in their own locality: Employee Related Investment regulations, diversification and performance measurement should each be considered carefully.
- One potential solution to the challenge of meeting 7-8% total returns would be to make an allocation to the sector outside of existing property portfolio mandates and measure the performance against a lower total return objective. A lower target return objective would mean that several 'strip income' and debt investments would become more eligible investments for pension scheme property portfolios.
- Similarly, the issues of ERI and diversification might be alleviated if an allocation was made to a pool of investments. For example, we could foresee regional local authorities pooling their allocations to invest in affordable housing across their regions. Ultimately, this idea would be feasible if investments can be structured to provide pension fund investors with required rates of return. This may involve land-led investment partnerships or some level of income guarantee by the public body.
- We would be happy to discuss either of these solutions further if they are of interest.

*To discuss the themes in this article further, please contact Anthony Doherty, Property Fund Manager at anthony.doherty@schroder.com, telephone +44 (0) 207 658 6010 or Graeme Rutter, Co-Head Property Multi-Manager at graeme.rutter@schroders.com, telephone +44 (0) 207 658 6768.*

## Important Information:



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# London Borough of Lewisham Pension Fund

## 2013 Actuarial Valuation – An introduction

- Geoffrey Nathan
- 12 June 2013

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# Agenda

1. Background to 2013 valuation
2. Valuation assumptions
3. Inter-valuation experience
4. Stabilising contribution rates

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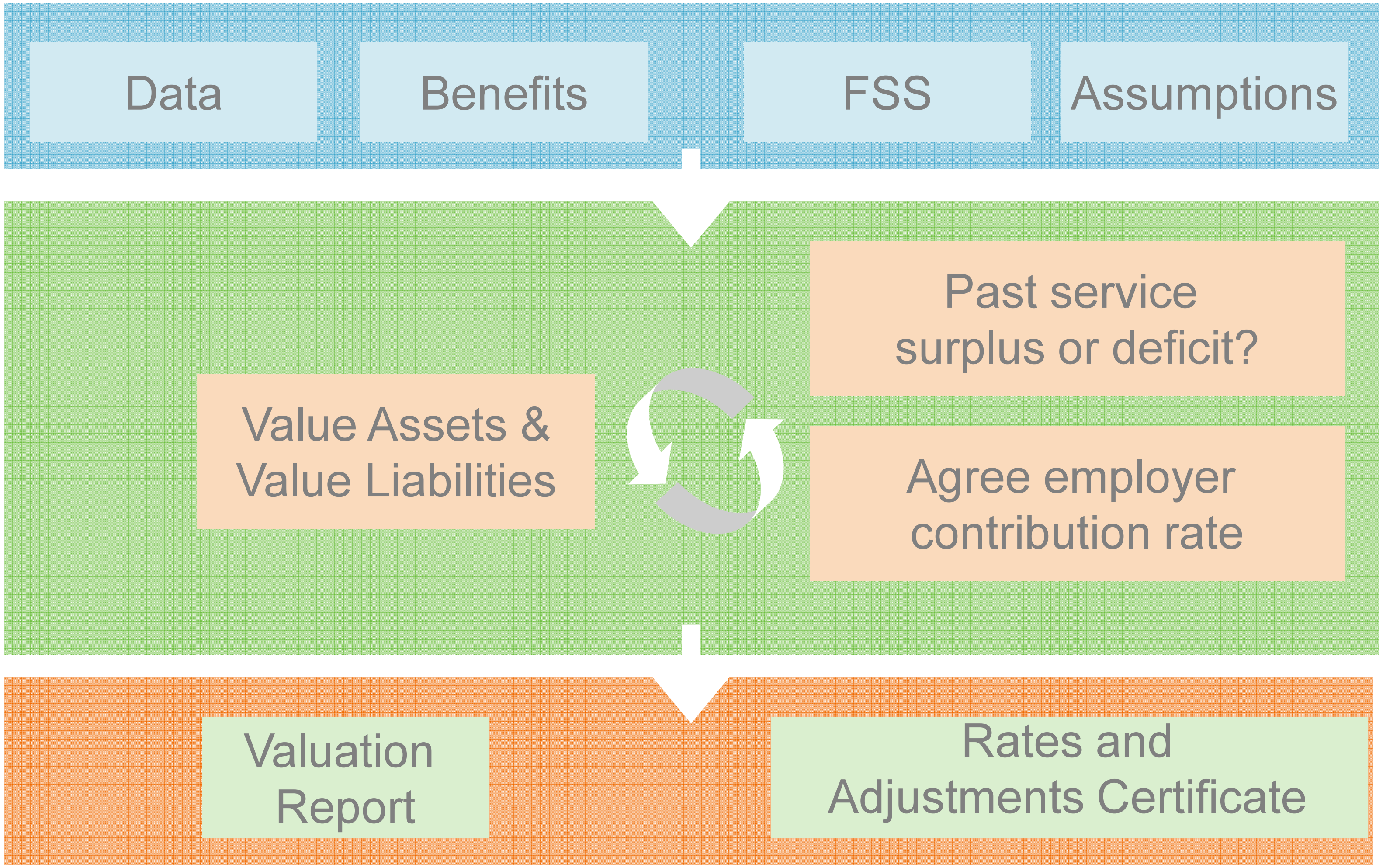
# 1. Background to 2013 valuation

# Why do we do a valuation?

- Compliance with legislation
- Recommend contribution rates
  - Common rate
  - Individual employer rates
- Determine money needed to meet accrued liabilities
- Calculate solvency ("funding level")
- Monitor experience vs. assumptions
- Manage risks to Fund

Review the Funding Strategy Statement (FSS)

# Summary of the valuation process



# Valuation timetable

31 March 2013

31 December 2013

31 March 2014

**2012/Q1 2013**
- Preparation for valuation

**Q2 2013**
- Data for actuary

**Q3 2013**
- Actuary does his sums

**Q4 2013**
- Valuation results
- Update FSS

**Q1 2014**
- Finalise employer contributions

**New Rates Payable**

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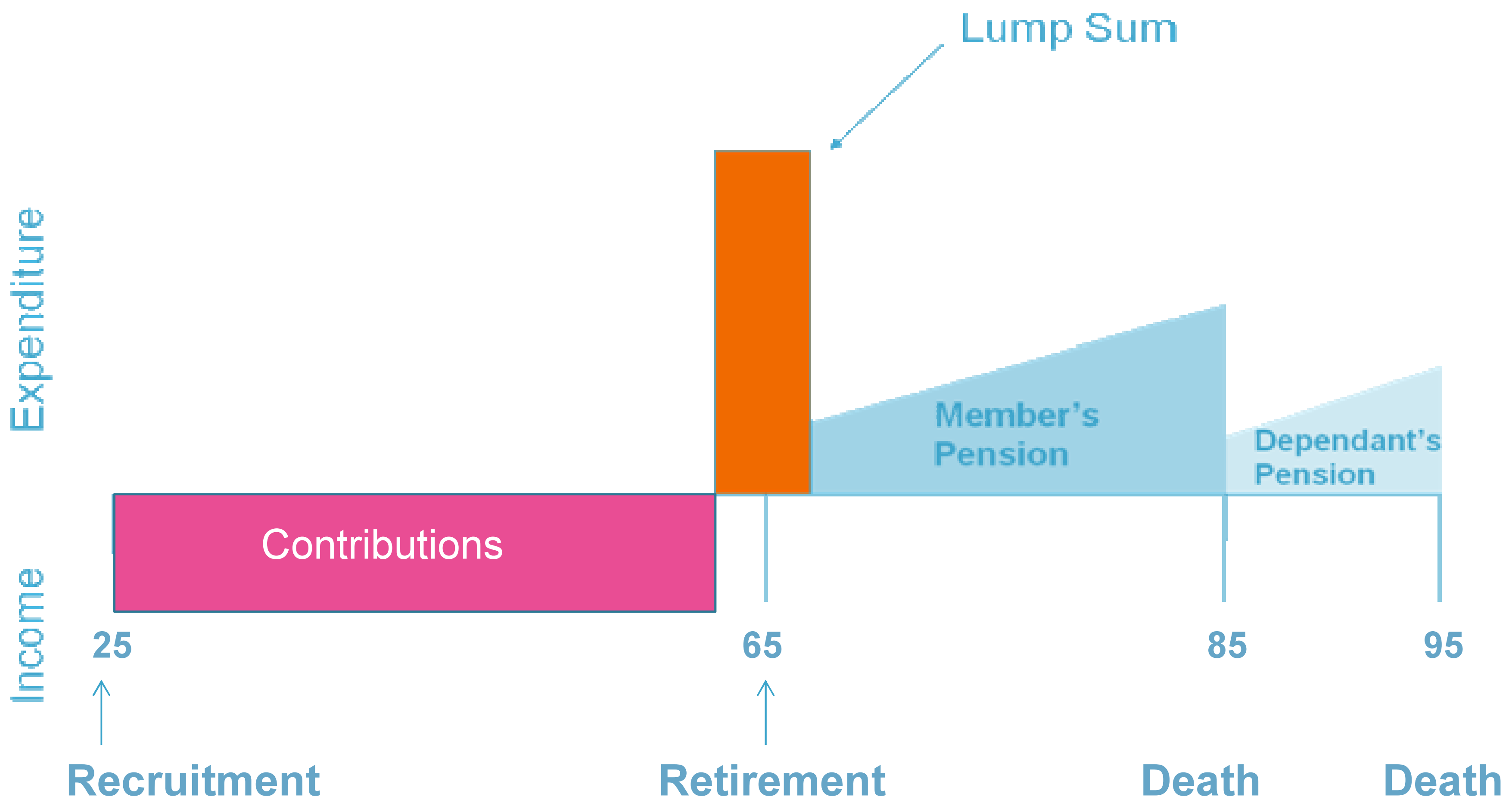
# 2. Valuation assumptions

# The pensions promise



# Fund valuation - assumptions

Amounts paid and probability of payment

**Financial Assumptions**

- Inflation
- Pay increases
- Pension increases
- Investment return

Consider:

- Economic outlook
- Actual Fund assets
- Historical pay growth

**Demographic Assumptions**

- Life expectancy
- Retirement age and cause
- Withdrawals
- Marriage statistics

Consider:

- Population trends
- Members’ lifestyle factors
- Past Fund experience

# Likely impact of key drivers since 2010

| Key driver | Deficit | Contribution rate | |
|---|---|---|---|
| Market conditions | ↑ | ↑ | ☹ |
| Investment returns | ↓ | ↔ | ☺ |
| Life expectancy | ↑ | ↑ | ☹ |
| LGPS 2014 | ↔ | ↓ | ☺ |
| **Overall Impact** | ↑ | ↑ | ☹ |

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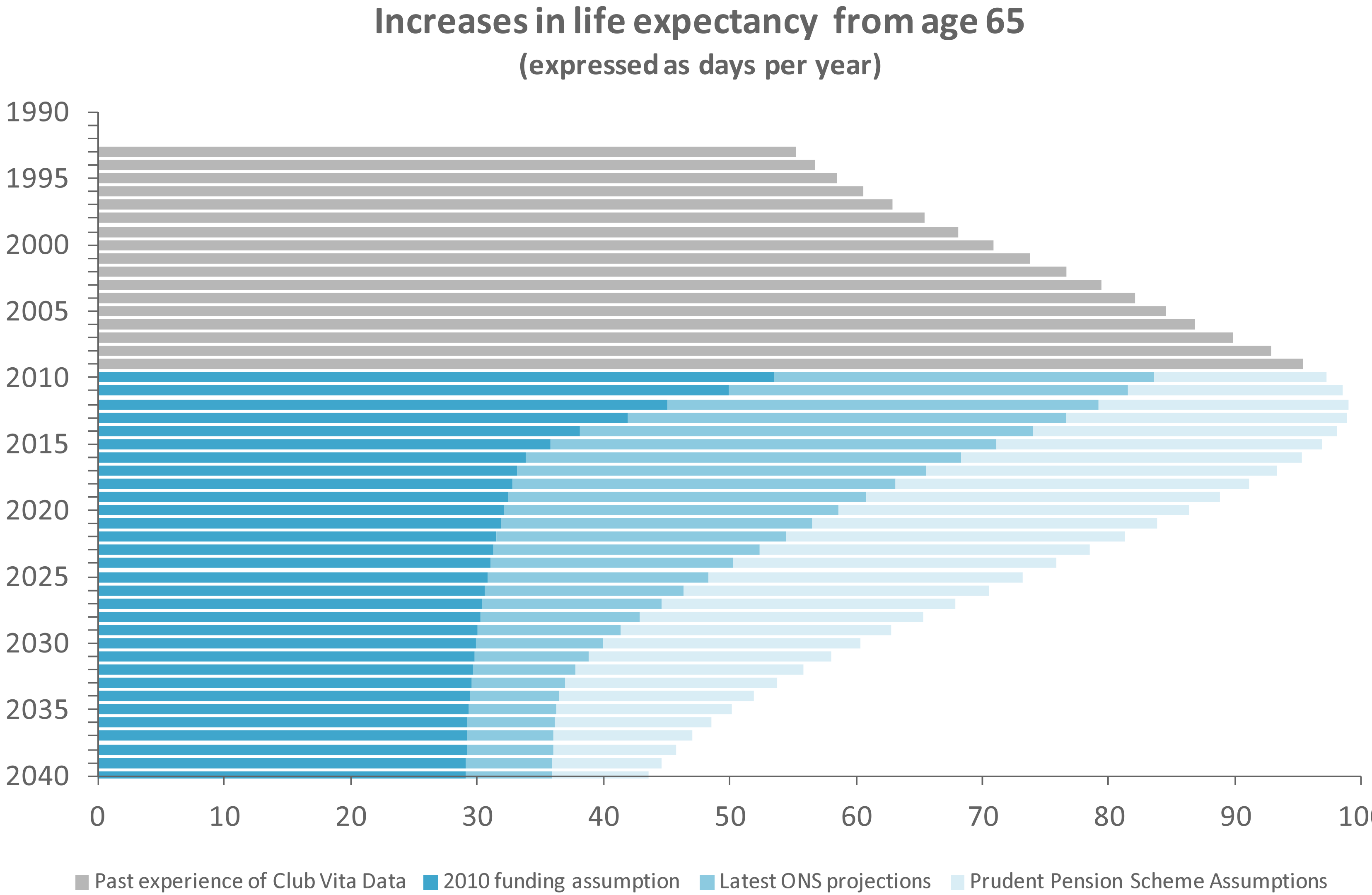
# Male life expectancy keeps marching on...




Source: Own calculations based upon Club Vita data and CMI projections library. Prudent pension scheme assumptions reflects the assumptions of **private sector** pension scheme trustees who are concerned that improvements have yet to peak and so are allowing for a few more years of strong improvements before year-on-year improvements slow down.

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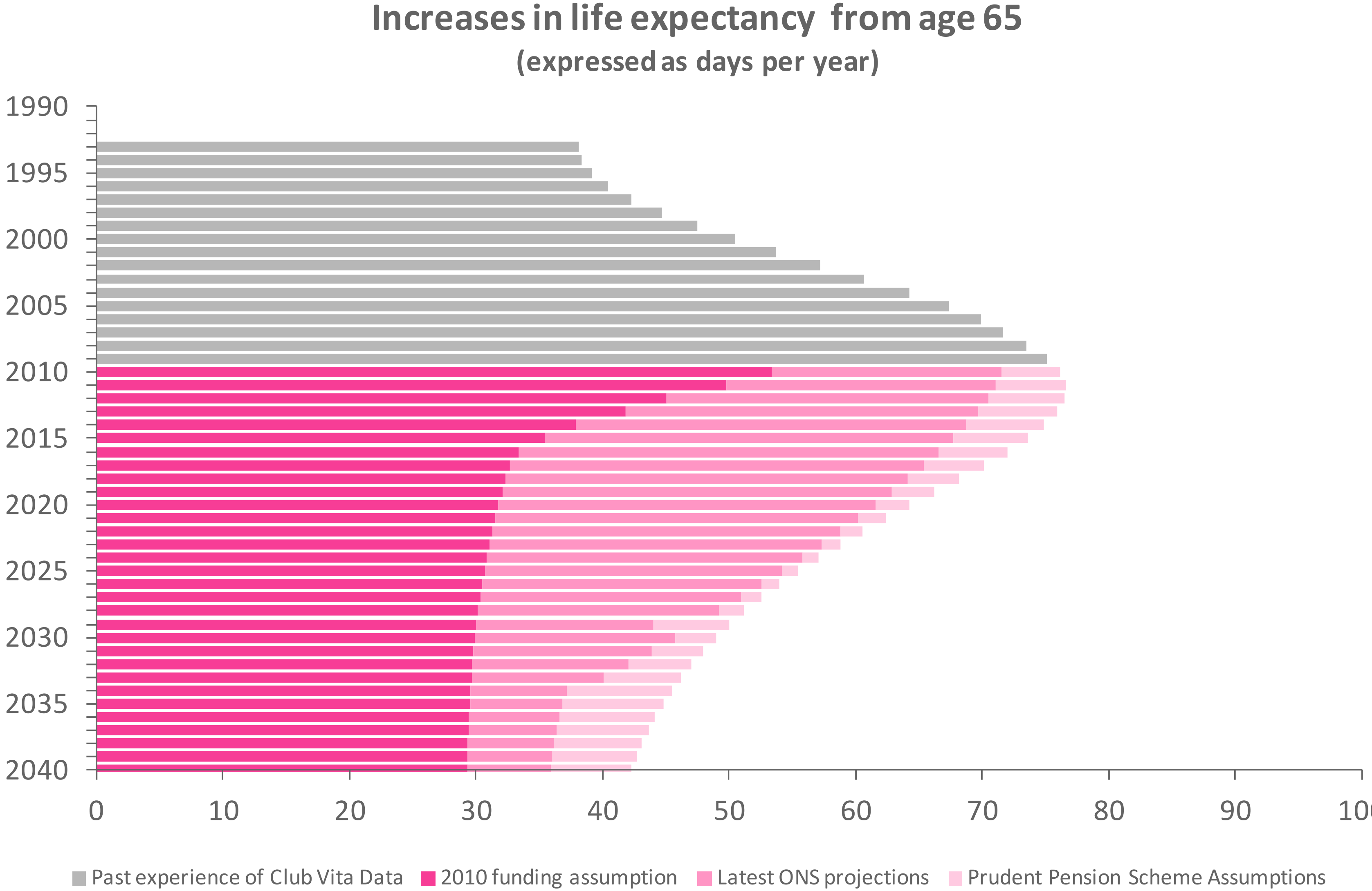
# ...and also for women (but a little slower)




Source: Own calculations based upon Club Vita data and CMI projections library. Prudent pension scheme assumptions reflects the assumptions of **private sector** pension scheme trustees who are concerned that improvements have yet to peak and so are allowing for a few more years of strong improvements before year-on-year improvements slow down.

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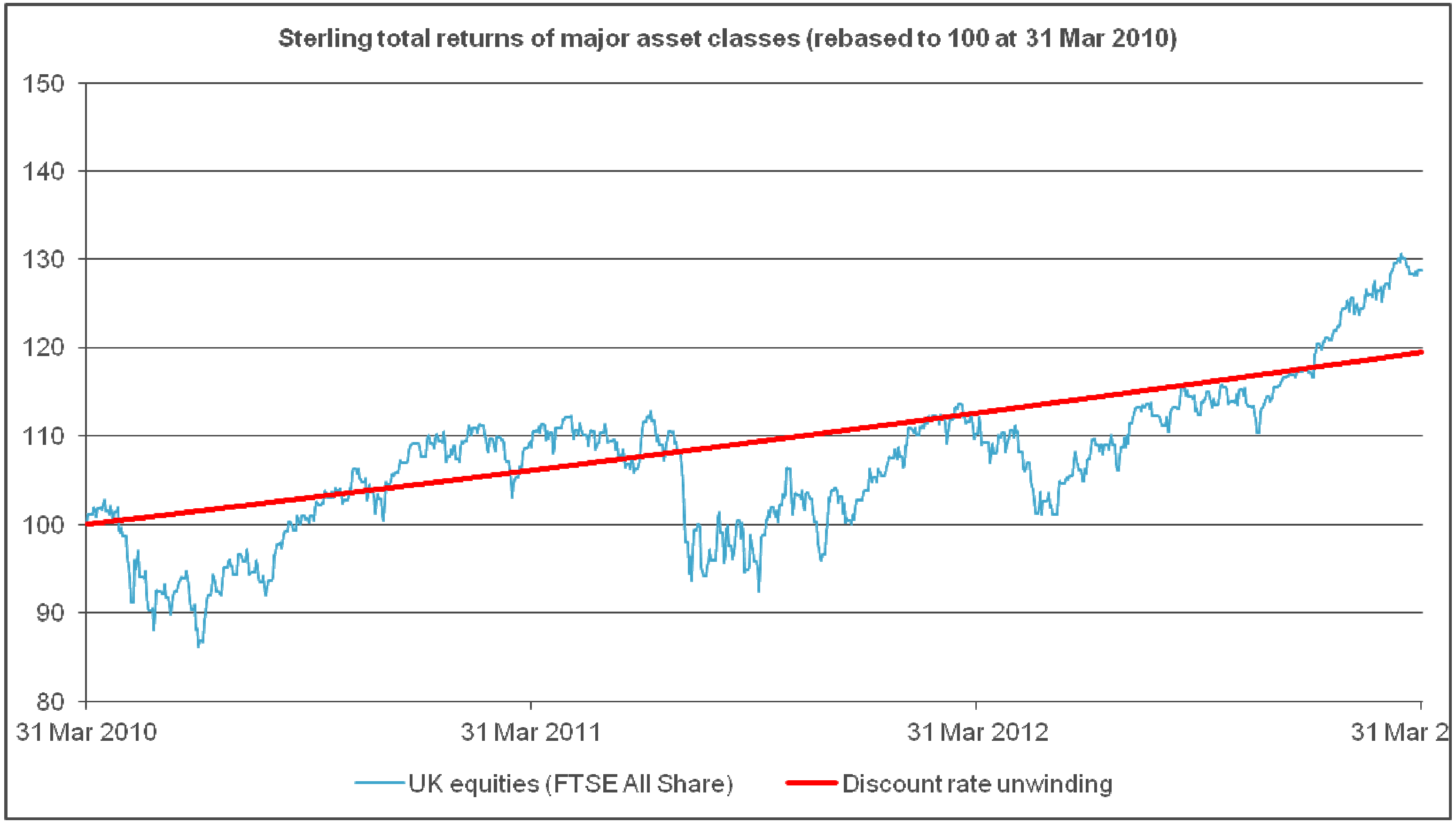
# 3. Inter-valuation experience

# Post 2010 valuation events

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## Recovery on the horizon?

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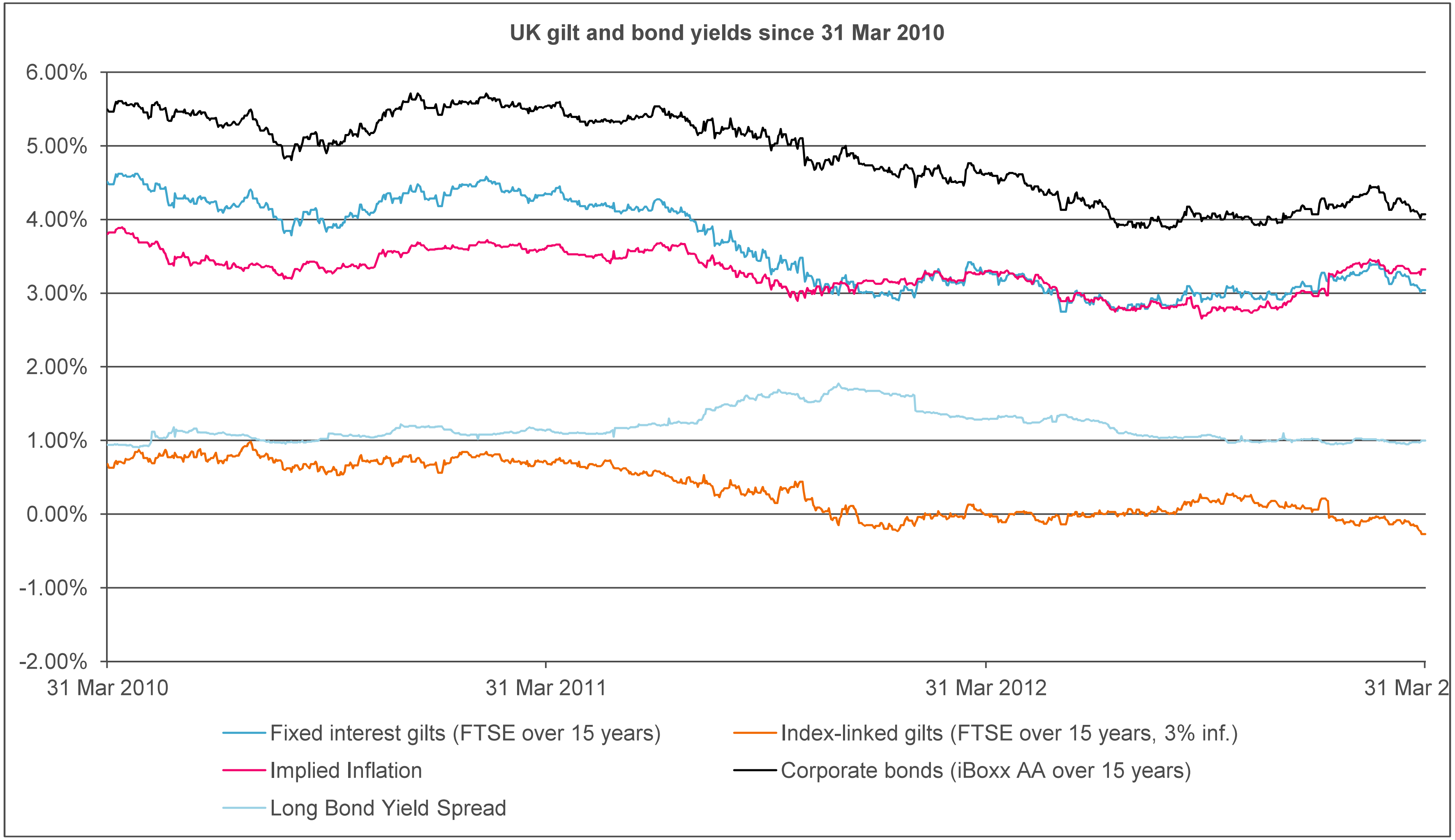
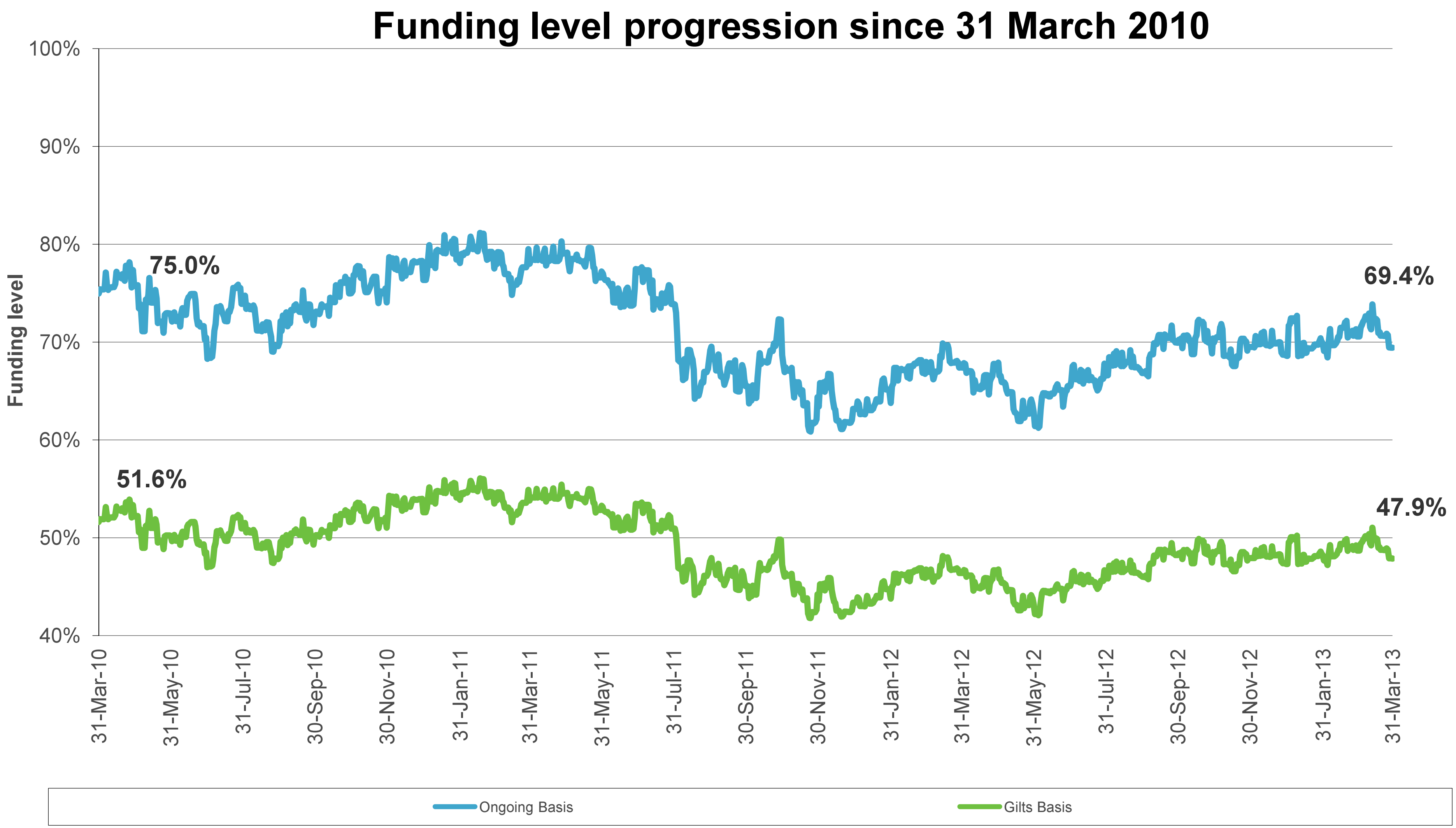
# Movement in bond yields / implied inflation

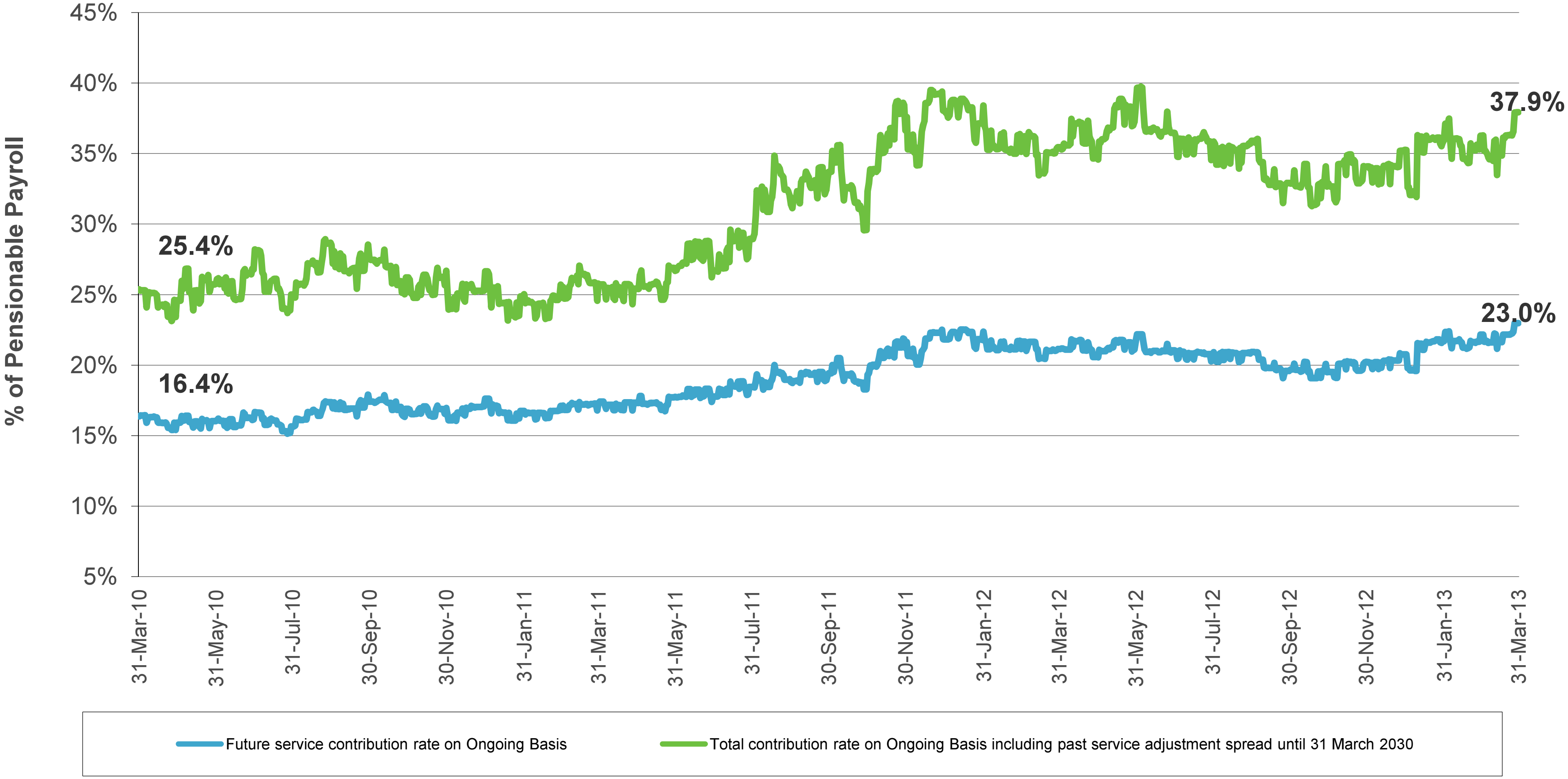


# ... falling funding level....




Source: Own calculations based on median LGPS Fund

# ... rising common contribution rate




Source: Own calculations based on median LGPS Fund

# Outlook for 2013

## Compared against 2010 valuation:

- Funding levels *likely* to be lower
- Deficits *likely* to be bigger
- (Theoretical) contribution rates *likely* to be higher

# 4. Stabilising contribution rates

# Contribution Stability Mechanism

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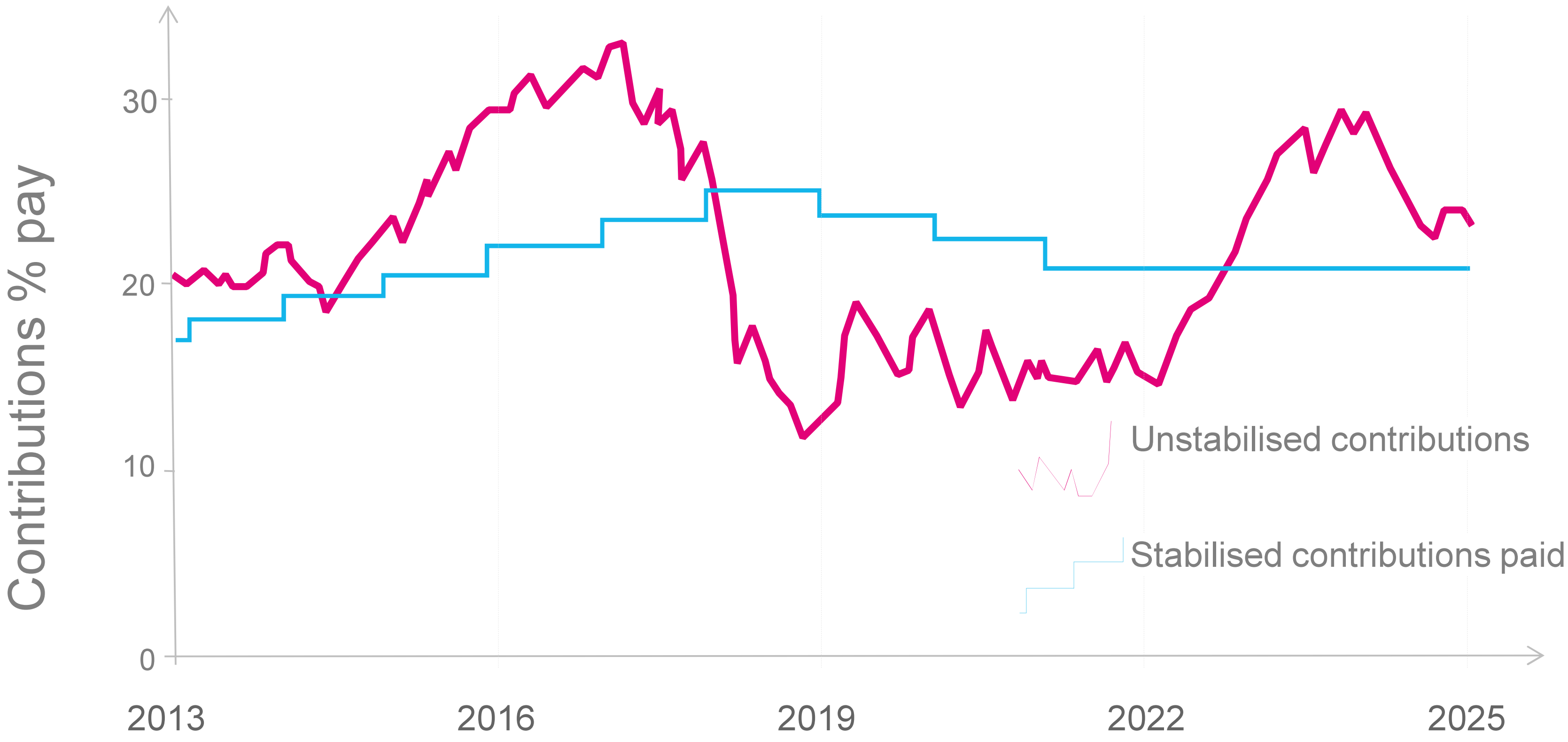


## Stabilise contributions for long term secure employers

# Stabilising contributions

- Model inputs:
  - Contribution level that may be affordable
  - Investment strategy
  - Different future interest rates, investment returns, inflation
  - Best estimate returns, normalisation of interest rates
- Model outputs:
  - Projected funding level (distribution)
  - Likelihood of success
- Iterate:
  - get right balance between affordability and risk

Risk based approach to setting contributions

# Stabilisation recap

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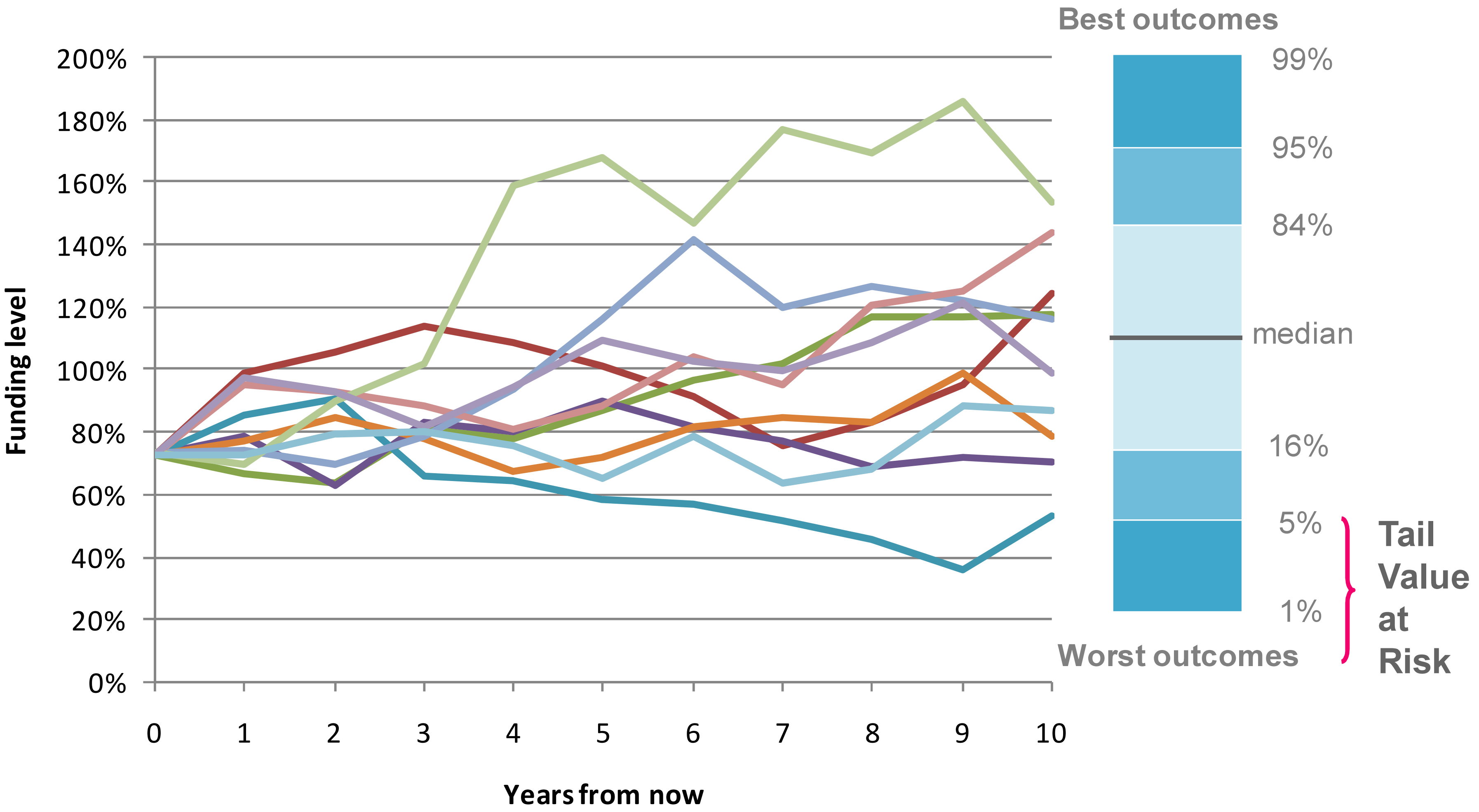
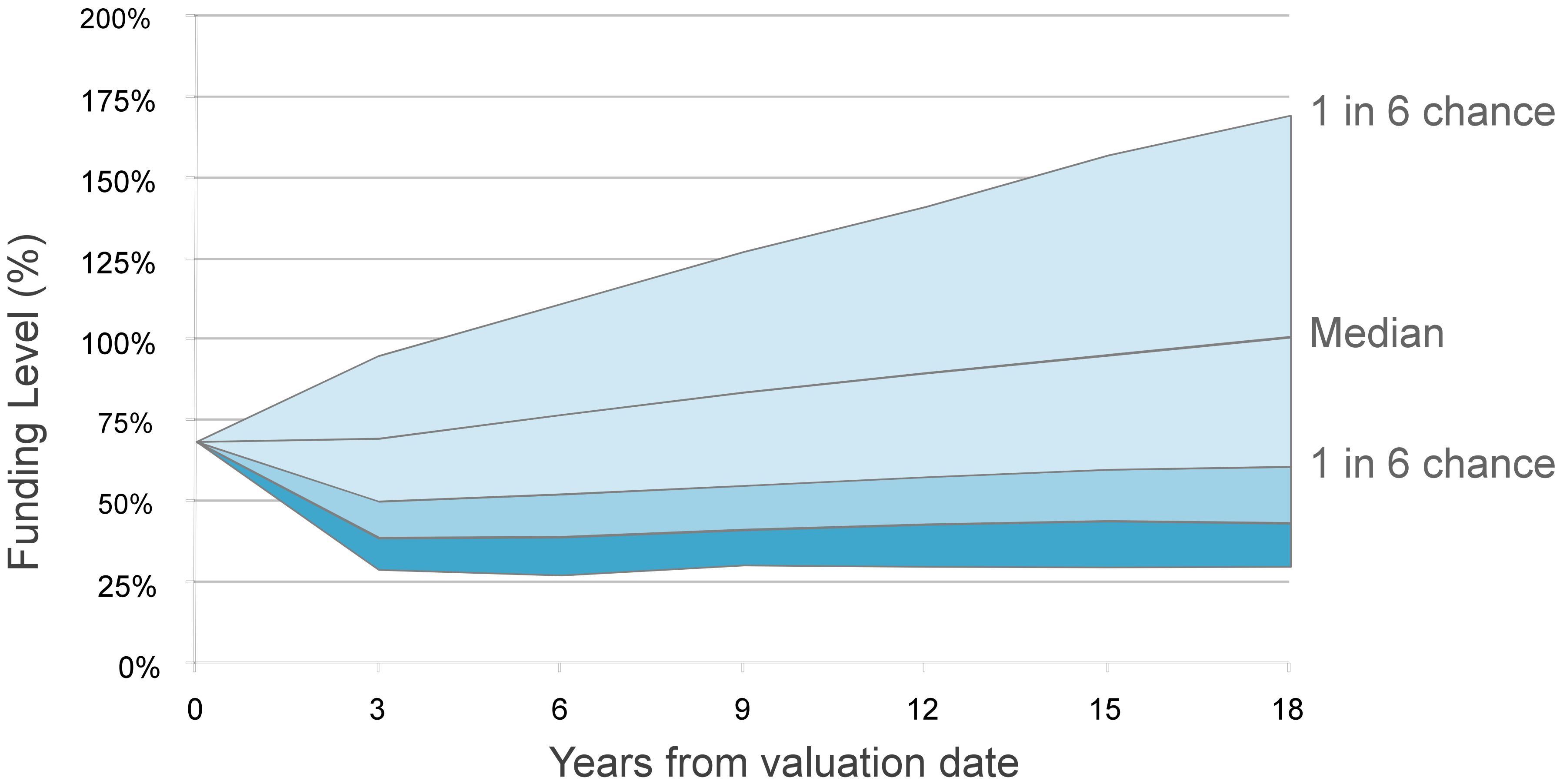



## Assess the likelihood of different outcomes

# 5,000 scenarios gives a distribution of outcomes

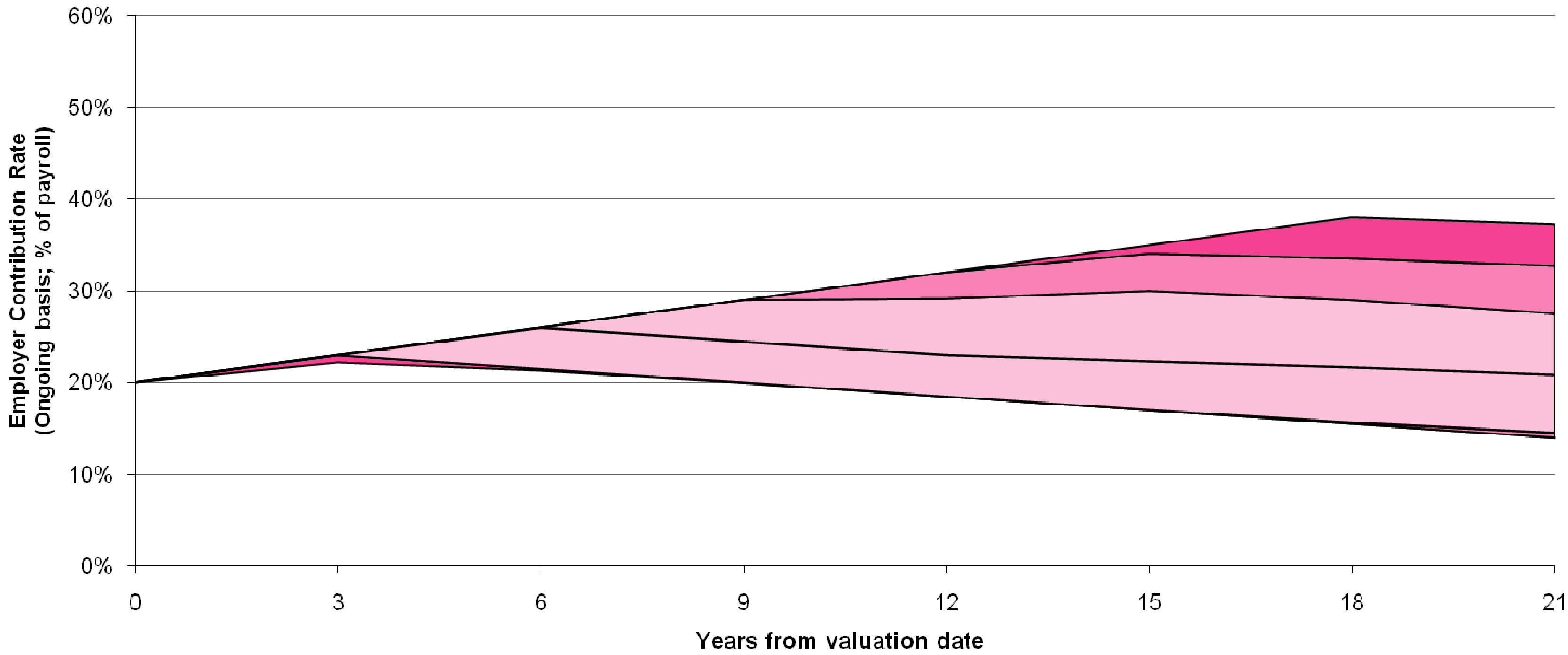



More than 50% chance meet funding objective

Source: Hymans Robertson LLP, comPASS, sample fund

# 5,000 scenarios gives a distribution of outcomes



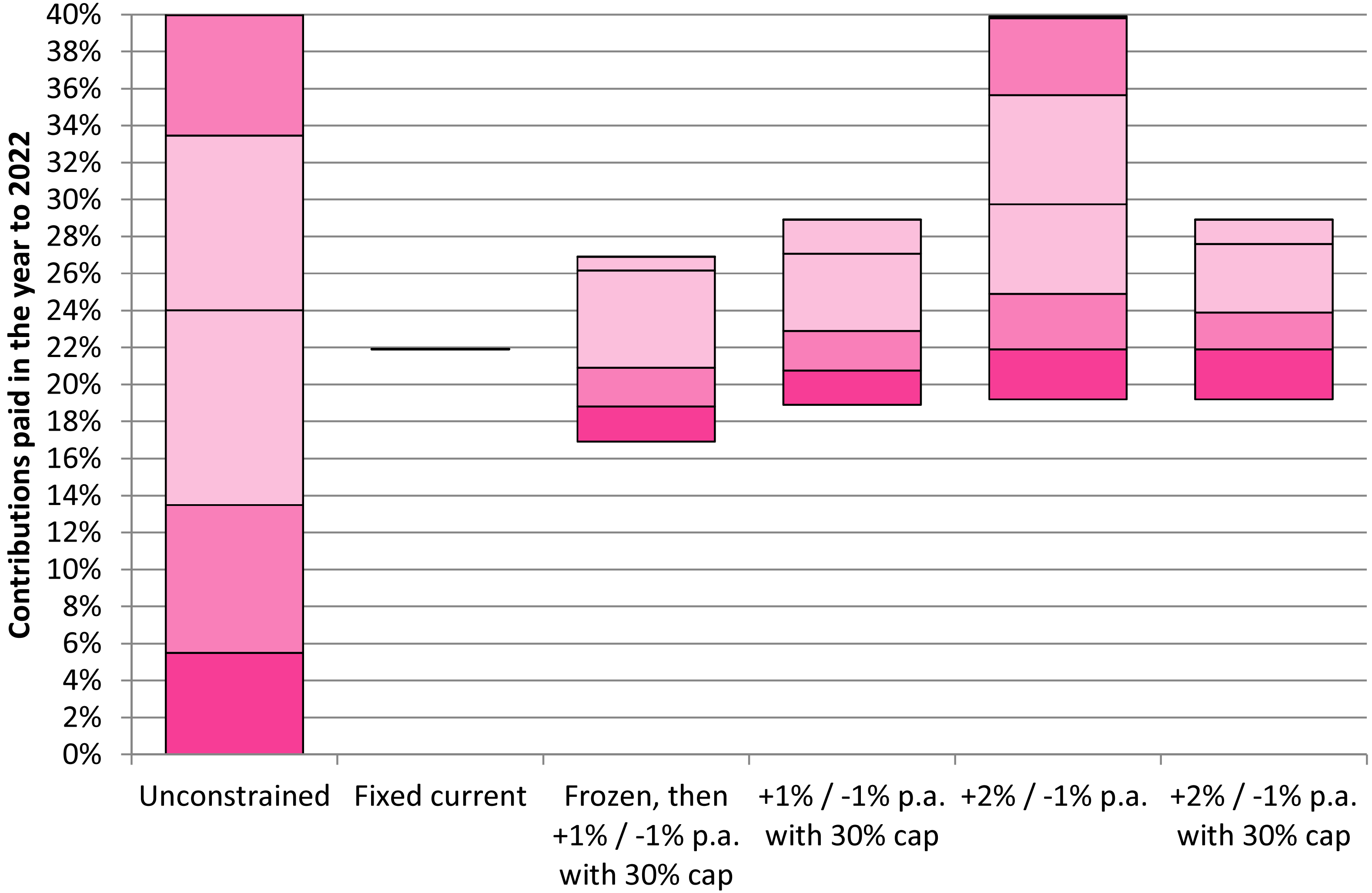



## Range of likely contributions over long term

Source: Hymans Robertson LLP, comPASS, sample fund

# Various contribution scenarios






Source: Hymans Robertson LLP, comPASS, sample fund

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# Thank you

Any questions?

| PENSIONS INVESTMENT COMMITTEE | | | |
|---|---|---|---|
| **REPORT TITLE** | Investment Performance for the quarter end 31 March 2013 | | |
| **KEY DECISION** | No | **Item No:** | 9 |
| **WARD** | N/A | | |
| **CONTRIBUTORS** | Executive Director for Resources & Regeneration | | |
| **CLASS** | Part 1 | **Date:** | 12 June 2013 |

## 1. SUMMARY

1.1 This report sets out the performance of the Pension Fund investment portfolio and that of the individual managers for the quarter ended 31 March 2013.

1.2 The report comprises the following sections:

2. Recommendation
3. Background
4. Portfolio Summary
5. Conclusions
6. Financial Implications
7. Legal Implications
8. Crime and disorder implications
9. Equalities Implications
10. Environmental Implications

## 2. RECOMMENDATION

2.1 The Committee is recommended to note the contents of the report.

## 3. BACKGROUND

3.1 This report sets out the performance for the quarter ended 31 March 2013 and since inception, as provided by the Fund's investment advisors Hymans Robertson. The full report and performance commentary will be provided at the meeting by the investment advisors.

## 4. PORTFOLIO SUMMARY

4.1 The Pensions Fund had an overall market value of £869.8m for the quarter ended 31 March 2013. The Fund's value has increased by £72.8m over the quarter, with the Fund's equity mandates the main contributors to the Fund's return. The Fund has performed in line with its benchmark returning 9.2%.

4.2 The Fund employs six specialist managers with mandates corresponding to the principal asset classes. The Fund's valuation summary has been set out below in Table 1.

**Table 1 – Portfolio Valuation Summary**

| **Manager** | **Mandate** | **Asset Value Qtr 4 (Dec' 2012) £m** | **Asset Value Qtr 1 (Mar' 2013) £m** | **Actual Proportion %** | **Target Proportion %** |
|---|---|---|---|---|---|
| Blackrock | Passive Multi-asset | 304.9 | 339.4 | 39.0 | 39.0 |
| Harbourvest | Venture Capital | 34.5 | 37.5 | 4.3 | 3.0 |
| Investec | Commodities | 35.6 | 37.9 | 4.4 | 5.0 |
| M&G | UK Financing Fund | 13.3 | 13.4 | 1.5 | 1.0 |
| Schroders | Property | 69.4 | 71.0 | 8.2 | 10.0 |
| UBS | Passive Multi-asset | 307.1 | 340.3 | 39.1 | 39.0 |
| Cash | | 32.2 | 30.3 | 3.5 | 3.0 |
| **Total Fund** | | **797.0** | **869.8** | **100.0** | **100.0** |

4.3 The performance of the individual managers relative to the appropriate benchmarks is as set out in Table 2. This indicates the volatility of returns and the continuing mixed performance of all mandates.

**Table 2: Managers Performance Relative to Target**

| **Manager** | **Quarter Ended 31 March 2013** | **Year Ended 31 March 2013** | **Since Inception** |
|---|---|---|---|
| Blackrock – Passive Multi-asset | 0.9% | N/A | -0.2% |
| Harbourvest – Venture Capital | -3.0% | 1.9% | 0.5% |
| Investec – Commodities | 0.5% | -1.7% | 0.4% |
| M&G – UK Financing Fund | 1.0% | 5.3% | 2.5% |
| Schroders – Property | 1.4% | -0.4% | -0.8% |
| UBS – Passive Multi-asset | -0.1% | N/A | -0.1% |

4.4 The performance of individual managers will be analysed and appraised by the Council's Investment Advisor, Hymans Robertson, at the meeting.

## 5. CONCLUSION

5.1 Relative performance from the Fund's active managers was mixed, with outperformance from Schroders (Property), Investec (Commodities) and the M&G UK Financing Fund offset somewhat by underperformance from HarbourVest (Private Equity).

## 6. FINANCIAL IMPLICATIONS

6.1 The comments of the Executive Director for Resources & Regeneration have been incorporated into the report.

## 7. LEGAL IMPLICATIONS

7.1 As the administering authority for the Fund, the Council must review the performance of the Fund's investments at regular intervals and review the investments made by Fund Managers quarterly.

7.2 The Pension Regulations require that the Council has regard to the proper advice of its expert independent advisers in relation to decisions affecting the Pension Fund. They must also have regard to the separate advice of the Chief Financial Officer who has statutory responsibility to ensure the proper administration of the Council's financial affairs, including the administration of the Pension Fund.

## 8. CRIME AND DISORDER IMPLICATIONS

8.1 There are no crime and disorder implications directly arising from this report.

## 9. EQUALITIES IMPLICATIONS

9.1 There are no equalities implications directly arising from this report.

## 10. ENVIRONMENTAL IMPLICATIONS

10.1 There are no environmental implications directly arising from this report.

**APPENDICES**

The full report and performance commentary will be provided at the meeting by the Council's investment advisors, Hymans Robertson.

**FURTHER INFORMATION**

If there are any queries on this report or you require further information, please contact:

Selwyn Thompson, Group Finance Manager Budget Strategy on 020 8314 6932.

HYMANS ROBERTSON
The Spirit of Independence

# London Borough of Lewisham Pension Fund

## Review of Investment Managers' Performance for First Quarter of 2013



Prepared By:

Scott Donaldson - Partner
Albert Chen - Associate Consultant
Chris Beattie - Investment Analyst

For and on behalf of Hymans Robertson LLP
May 2013

Real people. Real skills. Real results.

# Contents

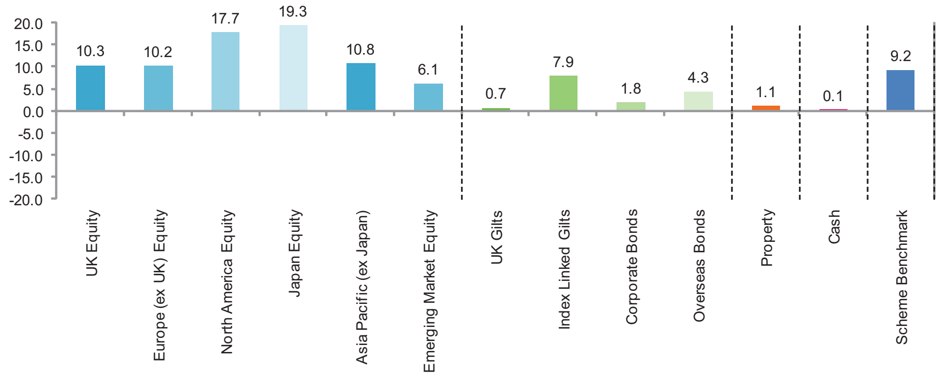




Please note the value of investments, and income from them, may fall as well as rise. This includes equities, government or corporate bonds, and property, whether held directly or in a pooled or collective investment vehicle. Further, investment in developing or emerging markets may be more volatile and less marketable than in mature markets. Exchange rates may also affect the value of an investment. As a result, an investor may not get back the amount originally invested. Past performance is not necessarily a guide to future performance.

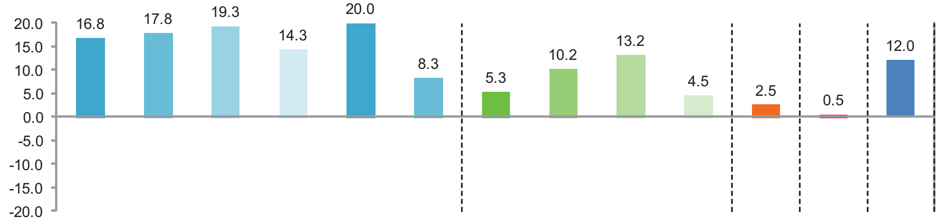
# Historic Returns for World Markets to 31 March 2013

3 Months (%)

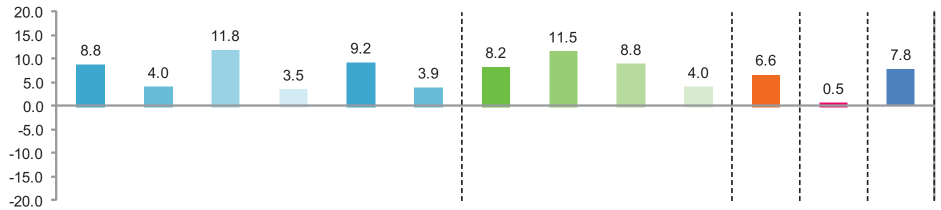





12 Months (%)




3 Years (% p.a.)




## Historic Returns - Comment

Equity markets performed strongly over the first quarter of 2013. Towards the end of March, the main equity indices in the US were approaching all-time highs. The positive tone in equity markets belied concerns about the global economic outlook. In the UK and Eurozone, economic activity contracted during the final quarter of 2012, the most recent period for which figures are available. Although the US economy showed signs of relative strength, policy makers remained cautious and were in no mood to reverse earlier stimulatory measures.

As economic activity in the UK and Eurozone faltered, the effectiveness of quantitative easing and other stimulatory measures was widely questioned by an investing public. In the UK, there was even discussion of negative interest rates as a means of persuading banks to lend more. Sterling fell 4.2% in trade-weighted terms.

The Chancellor of the Exchequer presented his March budget against a background of downward revisions to economic growth forecasts and a cut in the country's credit rating. With rising debt, austerity remains the order of the day. The budget incorporated further cuts in public spending.

Key events during the quarter were:

**Global Economy**

- The UK's credit rating was cut by Moodys, on concerns over continuing economic weakness;
- The UK reported a fall in economic activity in Q4 2012, raising concerns of a return to recession;
- Short-term interest rates in UK, US, Eurozone and Japan were held at record lows;
- Unemployment in Eurozone reached 12%, with wide variations (Germany 5.4%, Spain 26.3%);
- Japan announced a new package of measures (£72bn) to stimulate its 'moribund' economy. The Japanese Yen continued to fall sharply;
- The Eurozone reported a third consecutive quarter of economic contraction.

**Equities**

- Rio Tinto wrote off $14bn in its aluminium and coal businesses;
- The strongest sectors relative to the 'All World' Index were Health Care (+7.5%) and Consumer Services (+3.8%); the weakest were Basic Materials (-11.7%) and Oil & Gas (-2.7%).

**Bonds**

- The US announced the continuation of the bond purchase programme ($85bn per month);
- Index linked gilts (+7.9%) outperformed fixed interest gilts (+0.7%); this followed the decision of the UK Statistical Authority to retain the current RPI calculation methodology.

# Portfolio Summary

## Valuation Summary

| Asset Class | Values (£m) Q4 2012 | Q1 2013 | Actual Proportion % | Target Proportion % | Difference % |
|---|---|---|---|---|---|
| Global Equity | 470.0 | 522.1 | 60.0 | 60.0 | 0.0 |
| Bonds | 142.0 | 157.5 | 18.1 | 18.0 | 0.2 |
| Property | 69.4 | 71.0 | 8.2 | 10.0 | -1.8 |
| Private Equity | 34.5 | 37.5 | 4.3 | 3.0 | 1.3 |
| Cash | 32.2 | 30.3 | 3.5 | 3.0 | 0.5 |
| UK Financing Fund | 13.3 | 13.4 | 1.5 | 1.0 | 0.5 |
| Commodities | 35.6 | 37.9 | 4.4 | 5.0 | -0.6 |
| **Total Client** | **797.0** | **869.8** | **100.0** | **100.0** | |

## Comments

The value of the Fund's assets increased by £72.8m over the quarter to £869.8m as at 31 March 2013, with the Fund's equity mandates the main contributors to the Fund's return. The Fund performed in line with its benchmark, returning 9.2%.

Relative performance from the Fund's active managers was mixed, with outperformance from Schroders (Property), Investec (Commodities) and the M&G UK Financing Fund offset somewhat by underperformance from HarbourVest (Private Equity).

The passive mandate with UBS performed broadly in line with it's composite benchmark for the quarter. Although the BlackRock multi-asset mandate outperformed its benchmark over the quarter, this reversed underperformance from the previous quarter. Additional detail on the BlackRock mandate is provided on page 8.

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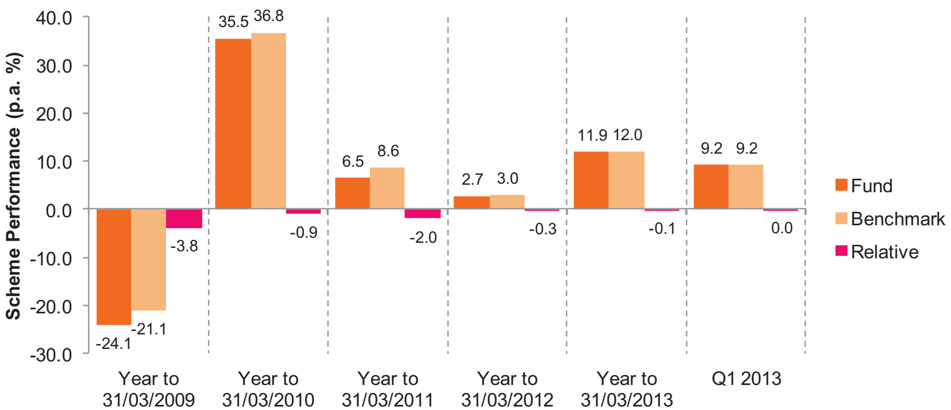
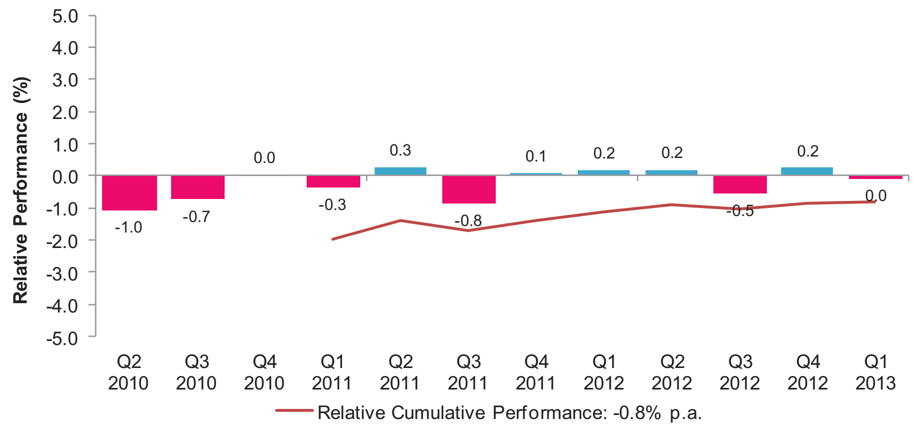
## Performance Summary [i]



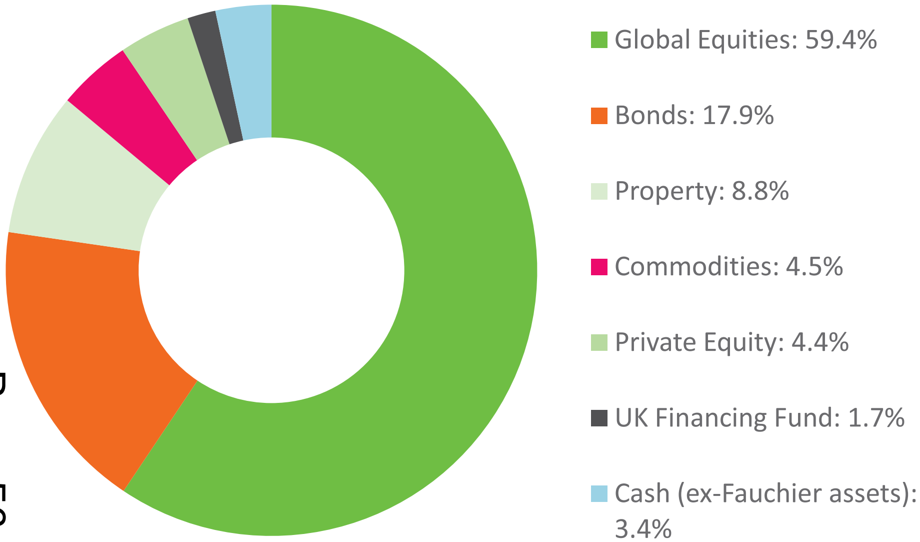

## Relative Quarterly and Relative Cumulative Performance



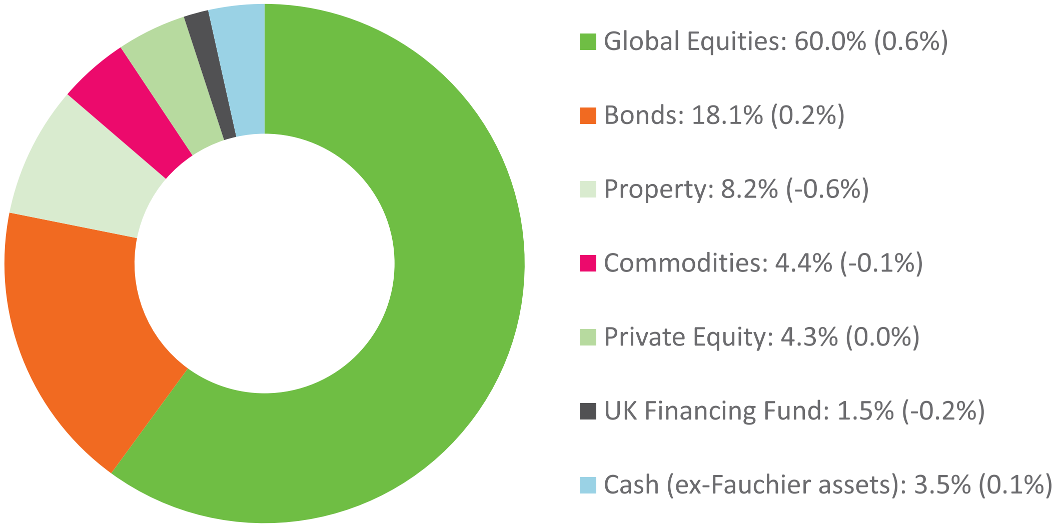

Source: [i] DataStream, Fund Manager, Hymans Robertson

# Fund Asset Allocation

## Asset allocation as at 31 December 2012




## Asset allocation as at 31 March 2013






## Comments [i]

Over the quarter, there were no significant changes to the Fund's asset allocation, at an asset class level, with minor changes in the allocations attributable to relative market movements.

Source: [i] Fund Manager, Hymans Robertson

# Manager Summary

## Manager Valuations

| Manager | Value (£m) Q4 2012 | Value (£m) Q1 2013 | Actual Proportion % | Target Proportion % | Difference % |
|---|---|---|---|---|---|
| BlackRock - Passive Multi-asset | 304.9 | 339.4 | 39.0 | 39.0 | 0.0 |
| UBS - Passive Multi-asset | 307.1 | 340.3 | 39.1 | 39.0 | 0.1 |
| Schroders - Property | 69.4 | 71.0 | 8.2 | 10.0 | -1.8 |
| Investec - Commodities | 35.6 | 37.9 | 4.4 | 5.0 | -0.6 |
| Harbourvest - Venture Capital | 34.5 | 37.5 | 4.3 | 3.0 | 1.3 |
| M&G - UK Companies Financing Fund | 13.3 | 13.4 | 1.5 | 1.0 | 0.5 |
| Cash | 32.2 | 30.3 | 3.5 | 3.0 | 0.5 |
| **Total** | **797.0** | **869.8** | **100.0** | **100.0** | 0.0 |

## Manager Summary

| Manager | Date Appointed | Benchmark Description | Performance Target (% p.a.) | Rating * |
|---|---|---|---|---|
| BlackRock - Passive Multi-asset | 20 Nov 2012 | Composite | - | ● |
| UBS - Passive Multi-asset | 15 Nov 2012 | Composite | - | ● |
| Schroders - Property | 12 Oct 2004 | IPD Pooled Property Fund Index | - | ● |
| Investec - Commodities | 25 Feb 2010 | Dow Jones-UBS Commodities Total Return Index | - | ● |
| Harbourvest - Venture Capital | 29 Jun 2006 | MSCI All Country World Developed Index | 5% p.a. above benchmark | ● |
| M&G - UK Companies Financing Fund | 01 May 2010 | LIBOR | 4-6% p.a. above benchmark | ● |

* For information on our manager ratings, see individual manager pages

Key:- - Replace - On-Watch - Retain

# Performance Summary - Managers

## Performance Summary [i]

| Period | Measure | BlackRock - Passive Multi-asset | UBS - Passive Multi-asset | Schroders - Property | Investec - Commodities | Harbourvest - Venture Capital | M&G - UK Companies Financing Fund | Cash | Total Fund |
|---|---|---|---|---|---|---|---|---|---|
| 3 Months (%) | Absolute | 11.9 | 10.8 | 2.2 | 6.4 | -0.7 | 1.1 | N/A | 9.2 |
| | Benchmark | 10.9 | 10.9 | 0.8 | 5.8 | 2.4 | 0.1 | N/A | 9.2 |
| | Relative | 0.9 | -0.1 | 1.4 | 0.5 | -3.0 | 1.0 | N/A | 0.0 |
| 12 Months (%) | Absolute | N/A | N/A | 1.2 | 0.2 | 7.0 | 6.0 | N/A | 11.9 |
| | Benchmark | N/A | N/A | 1.6 | 1.9 | 5.0 | 0.7 | N/A | 12.0 |
| | Relative | N/A | N/A | -0.4 | -1.7 | 1.9 | 5.3 | N/A | -0.1 |
| 3 Years (% p.a.) | Absolute | N/A | N/A | 3.6 | 1.5 | 4.2 | N/A | N/A | 7.0 |
| | Benchmark | N/A | N/A | 5.3 | 2.5 | 4.8 | N/A | N/A | 7.8 |
| | Relative | N/A | N/A | -1.6 | -1.0 | -0.5 | N/A | N/A | -0.8 |
| Since Inception (% p.a.) | Absolute | 14.8 | 14.9 | 2.1 | 1.6 | 4.8 | 3.2 | N/A | 7.6 |
| | Benchmark | 15.0 | 15.0 | 2.9 | 1.3 | 4.3 | 0.7 | N/A | 8.1 |
| | Relative | -0.2 | -0.1 | -0.8 | 0.4 | 0.5 | 2.5 | N/A | -0.4 |

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Source: [i] DataStream, Fund Manager, Hymans Robertson, Investment Property Databank Limited

# BlackRock - Passive Multi-Asset

## HR View Comment & Rating


BlackRock, with over £950bn of passively managed equities, remains one of the largest and best regarded global passive managers. BlackRock continues to develop its index-fund range with planned product developments including income distributing funds. In April 2013, BlackRock published its 2012 Engagement Review, “Shaping Global Governance”, which set out the manager’s approach to corporate governance and responsible engagement.  During 2012, the manager engaged with over 1,400 companies and voted at over 14,000 meetings.

BlackRock have announced that James Charrington is stepping back from his role as Head of EMEA following 20 years of service. His replacement has been announced as David Blumer who was previously Chief Investment Officer (CIO) at Swiss Re and joined BlackRock on 8 April 2013 as a Senior Managing Director. BlackRock also announced the appointment of Jeff Shen as Head of Emerging Markets. Mr Shen will continue his role as co-head for Scientific Active Equity. Mr Shen’s new role will be to help identify new emerging market opportunities and develop the manager’s strategy for growth in this area.

## Performance Summary - Comment

The BlackRock composite benchmark comprises the FTSE All Share (20.5%), MSCI AC World (56.5%), FTSE All Stocks Index-Linked Gilts (7.7%), FTSE All Stocks Gilts Index (7.6%), and iBoxx £ Non-Gilts All Stocks (7.7%).

Over the quarter, the BlackRock multi-asset mandate delivered a positive return of 11.9%, outperforming its composite benchmark return of 10.9%.  Although the mandate outperformed its benchmark over the quarter, this reverses the underperformance from the previous quarter.  The disparity between mandate and benchmark performance has been due to BlackRock having been previously invested in the All Stocks Gilts and All Stocks Index-Linked Gilts funds, versus the benchmark Over 15 Year Gilts and Over 5 Year Index-Linked Gilts funds.  BlackRock are now invested in line with their benchmark, following fund switches in February, and we are comfortable that the overall performance of the mandate, since inception, has been broadly in line with the benchmark.

## Performance Summary to 31 December 2012

| | 3 Months (%) | 12 Months (%) | 3 Years (% p.a.) | Since Inception* (%) |
|---|---|---|---|---|
| Fund | 11.9 | N/A | N/A | 14.8 |
| Benchmark | 10.9 | N/A | N/A | 15.0 |
| Relative | 0.9 | N/A | N/A | -0.2 |

* Inception date 20 Nov 2012.

# UBS - Passive Multi-Asset

## HR View Comment & Rating


Gavin Lewis, formerly of Russell Investments, has joined UBS in the new role of Business Development Director for the UK Institutional Business. In his previous role, Lewis was responsible for establishing relationships with key institutional clients, including Local Government Pension Schemes, Corporate Pension Schemes and Investment Managers.

Bruno Bertocci, manager of the Global Sustainable Equities strategy, has been appointed to lead a newly organised team to manage BlackRocks sustainable equities strategies and funds.

There was no significant news to report for the UBS passive business during the quarter.



## Performance Summary to 31 December 2012

| | 3 Months (%) | 12 Months (%) | 3 Years (% p.a.) | Since Inception* (%) |
|---|---|---|---|---|
| Fund | 10.8 | N/A | N/A | 14.9 |
| Benchmark | 10.9 | N/A | N/A | 15.0 |
| Relative | -0.1 | N/A | N/A | -0.1 |

* Inception date 15 Nov 2012.

## Performance Summary - Comment

The UBS composite benchmark comprises the FTSE All Share (20.5%), FTSE All World (inc UK) (56.5%), FTSE > 15 Year Fixed Gilts (7.6%), FTSE > 5 Year Index LInked Gilts (7.7%) and iBoxx Sterling Non-Gilts All Stocks (7.7%) indices.

During the quarter, the UBS multi-asset mandate delivered a positive return of 10.8%, marginally behind its composite benchmark return of 10.9%. All of the underlying allocations within the mandate performed broadly in line with their respective benchmarks, as we would expect.

On 22nd March, a transition from the actively managed UBS Life Duration Neutral UK Corporate Bond Fund to the passively managed UBS Sterling Corporate Bond Indexed Fund was completed. All funds within the mandate are now managed on a passive, index-tracking basis.

# Schroders - Property

## HR View Comment & Rating

**Rating**

Replace ← On Watch → Retain

There was no significant news to report in relation to the Schroders property business.

## Performance Summary to 30 September 2012 [i]

| | 3 Months (%) | 12 Months (%) | 3 Years (% p.a.) | Since Inception* (%) |
|---|---|---|---|---|
| Fund | 2.2 | 1.2 | 3.6 | 2.1 |
| Benchmark | 0.8 | 1.6 | 5.3 | 2.9 |
| Relative | 1.4 | -0.4 | -1.6 | -0.8 |

* Inception date 12 Oct 2004.

## 3 Year Relative Return

| Actual % p.a. | Target % p.a. |
|---|---|
| -1.6 | 0.0 |

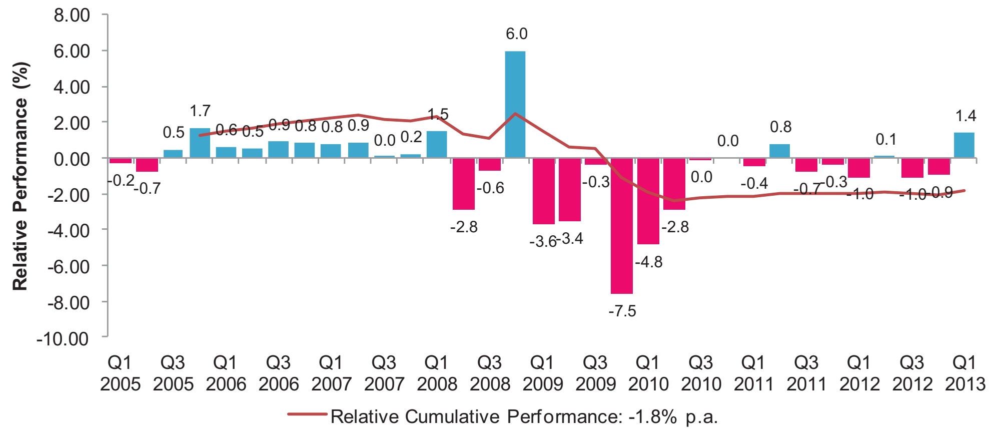
## Performance Summary - Comment

The portfolio outperformed its benchmark over the quarter, returning 2.2% against the benchmark return of 0.8%.

Outperformance was attributable to the portfolio's exposure to UK funds; in particular those funds with an income bias (e.g. Real Income Fund) or with an exposure to central London (West End of London PUT). Another positive contributor to performance over the quarter was the Lend Lease Real Estate Partnership 3, a closed-ended fund that invests in shopping malls and offices in Australia. Over the quarter, the portfolio’s European exposure did not materially detract from performance, however the manager does anticipate negative performance through 2013, particularly in the middle of the year when valuation declines are expected on some the European holdings.

The manager continues to maintain an overweight position to 'alternative' property and central London offices. Schroders expects that the central London office market will deliver strong rental growth from 2014 and continues to favour areas of the market where rents have rebased and offer the potential for growth. The manager also believes that the occupational market will remained subdued during the course of 2013 due to tenants waiting for signs of economic recovery before commiting to new space.

## Relative Quarterly and Relative Cumulative Performance




Source: [i] Fund Manager, Hymans Robertson, Investment Property Databank Limited

# Investec - Commodities

## HR View Comment & Rating


Investec Asset Management staff acquired around 15% of the shares in the asset management business from the parent company during the quarter. Around 40 senior staff are included in the share ownership deal and we see this as a positive move.

There were no other significant updates to report for the period.

## Performance Summary to 30 September 2012 [i]

| | 3 Months (%) | 12 Months (%) | Since Inception* (%) |
|---|---|---|---|
| Fund | 6.4 | 0.2 | 1.6 |
| Benchmark | 5.8 | 1.9 | 1.3 |
| Relative | 0.5 | -1.7 | 0.4 |

* Inception date 25 Feb 2010.

## 3 Year Relative Return

| Actual % p.a. | Target % p.a. |
|---|---|
| -1.0 | 0.0 |



## Performance Summary - Comment

The Investec commodities mandate outperformed its benchmark over the quarter, returning 6.4% against the benchmark return of 5.8%.

The manager's position in precious metals was a positive contributor to performance during the quarter mainly due to a platinum call option which benefited from production cut announcements in South Africa. The portfolio's position in palladium also helped performance as the metal rose 9.2% during the quarter on supply concerns over disruption in South Africa, reduced Russian stockpiles, and strong automobile sales data out of China suggesting continued demand growth.

The major detractors from performance over the quarter were the portfolio's positions in iron ore equity holdings which performed poorly in March. The manager's positions in the agriculture & softs subsector and the energy subsector also detracted from performance.

Source: [i] DataStream, Fund Manager, Hymans Robertson

# Harbourvest - Venture Capital

## HR View Comment & Rating


HarbourVest remains one of our favoured private equity fund of funds, being well placed to exploit any opportunities that may arise in the secondary market.

There were no significant business updates to report over the quarter.

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## Performance Summary - Comment

The HarbourVest mandate returned -0.7%, underperforming its benchmark return of 2.4%.

Given the volatility and pricing of this asset class, it can be misleading to place too much emphasis on short-term performance. The returns shown are sourced from Northern Trust.

## Performance Summary to 30 September 2012 [i]

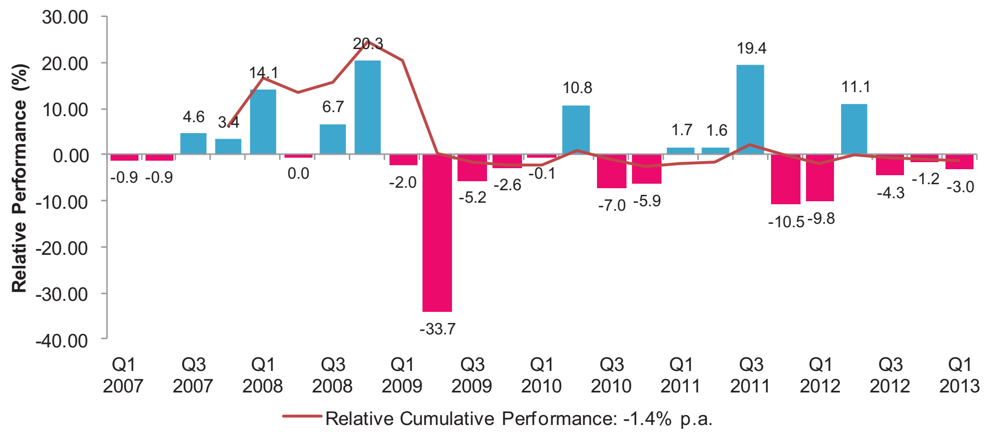
| | 3 Months (%) | 12 Months (%) | 3 Years (% p.a.) | Since Inception* (%) |
|---|---|---|---|---|
| Fund | -0.7 | 7.0 | 4.2 | 4.8 |
| Benchmark | 2.4 | 5.0 | 4.8 | 4.3 |
| Relative | -3.0 | 1.9 | -0.5 | 0.5 |

* Inception date 29 Jun 2006.

## 3 Year Relative Return

| Actual % p.a. | Target % p.a. |
|---|---|
| -0.5 | 5.0 |

## Relative Quarterly and Relative Cumulative Performance




Source: [i] DataStream, Hymans Robertson

# M&G - UK Companies Financing Fund

## HR View Comment & Rating


There have been no significant changes to the M&G investment team to report during the period.

## Performance Summary to 31 December 2012 [i]

| | 3 Months (%) | 12 Months (%) | Since Inception* (%) |
|---|---|---|---|
| Fund | 1.1 | 6.0 | 3.2 |
| Benchmark | 0.1 | 0.7 | 0.7 |
| Relative | 1.0 | 5.3 | 2.5 |

* Inception date 01 May 2010.

## 3 Year Relative Return

| Actual % p.a. | Target % p.a. |
|---|---|
| N/A | 0.0 |

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## Performance Summary - Comment

The UK Companies Financing Fund (UKCFF) returned 1.1% (as reported by Northern Trust), ahead of its LIBOR benchmark return of 0.1%, for the quarter.

The manager reports that all loans within the portfolio are performing as expected.  The weighted average credit rating of the portfolio was stable at BB, with an average maturity of six years. The weighted average credit spread was 443bp at the end of the quarter.

The manager believes that house builders should benefit from the government's recent housing proposals outlined in the Budget and that the low interest rate environment has been supportive for companies, enabling tight cost control to support earnings.

Source: [i] DataStream, Hymans Robertson

# Performance Calculation

## Geometric vs Arithmetic Performance

Hymans Robertson are among the investment professionals who calculate relative performance geometrically as follows:

( ( 1 + Fund Performance ) / ( 1 + Benchmark Performance ) ) - 1

Some industry practitioners use the simpler arithmetic method as follows:

Fund Performance - Benchmark Performance

The following example illustrates the shortcomings of the arithmetic method in comparing short term relative performance with the longer term picture:

| | | Arithmetic Method | | | Geometric Method | | Difference |
|---|---|---|---|---|---|---|---|
| Period | Fund Performance | Benchmark Performance | Relative Performance | Fund Performance | Benchmark Performance | Relative Performance | |
| Quarter 1 | 7.00% | 2.00% | 5.00% | 7.00% | 2.00% | 4.90% | **0.10%** |
| Quarter 2 | 28.00% | 33.00% | -5.00% | 28.00% | 33.00% | -3.76% | **-1.24%** |
| Linked 6 months | | | -0.25% | | | 0.96% | **-1.21%** |
| 6 Month Performance | 36.96% | 35.66% | 1.30% | 36.96% | 35.66% | 0.96% | **0.34%** |



### Using the arithmetic method

If fund performance is measured quarterly, there is a relative underperformance of 0.25% over the six month period.
If fund performance is measured half yearly, there is a relative outperformance of 1.30% over the six month period.

### Using the geometric method

If fund performance is measured quarterly, there is a relative outperformance of 0.96% over the six month period.
If fund performance is measured half yearly, an identical result is produced.

The geometric method therefore makes it possible to directly compare long term relative performance with shorter term relative performance.

| PENSIONS INVESTMENT COMMITTEE | | | |
|---|---|---|---|
| **REPORT TITLE** | Draft Pension Fund accounts – Year Ending 31 March 2013 | | |
| **KEY DECISION** | No | **Item No:** | 10 |
| **WARD** | N/A | | |
| **CONTRIBUTORS** | Executive Director for Resources & Regeneration | | |
| **CLASS** | Part 1 | **Date:** | 12 June 2013 |

## 1. PURPOSE

1.1 This report sets out the draft Pension Fund accounts for the financial year ending 31 March 2013.

1.2 Members are asked in accordance with best practice to note the draft accounts prior to them being signed off by the Chief Financial Officer as being available for external audit.

## 2. RECOMMENDATION

2.1 Members are recommended to note the draft Pension Fund accounts for the year ended 31 March 2013, as set out at Appendix 1.

## 3. DRAFT PENSION FUND ACCOUNTS

3.1 The Council as an administering authority under the Local Government Pension Scheme Regulations, is required to produce a separate set of accounts for the schemes financial activities and assets and liabilities.

3.2 The contents and format of the accounts are determined by statutory requirements and mandatory professional standards as established by the Chartered Institute of Public Finance (CIPFA) in their Statement of Recommended Practice (SORP).

3.3 The Pension Fund Accounts will be subject to a separate audit by the Council's external auditors, Grant Thornton, which must be completed by the 30 September 2013.

3.4 There is a related requirement for Councils to publish an annual report which incorporates elements of the financial accounts, before the 1 December 2013. This document will be the subject of a further report to this Committee when the audit is complete.

3.5 The accounts comprise two main statements with supporting notes. The main statements are:

- Dealings with Members Employers and Others which is essentially the Fund's revenue account

- The Net Assets Statement which can be considered as the Fund's balance sheet

3.6 The 'Dealings with Members Employers and Others' sets out the movement in the net worth of the Fund in the year by analysing the relevant financial transactions and movements in the market value of the investment portfolio.

The statement has two main sections:

- The financial transactions relating to administration of the Fund.

- The transactions relating to its role as an investor.

3.7 The administration section principally relates to the receipt of contributions from employers and active members and the payment of pensions. This section indicates that the Fund is cash negative, in that the benefits payable, exceed the contributions receivable by £3.9m.

3.8 The investment section details the income received from the investment portfolio and the impact of managers activities and investment markets on the value of investments.

3.9 The section indicates that the value of investments has increased by £90m as a result of improved conditions in investment markets. The performance of the portfolio and the investment is the subject of another report elsewhere on this agenda.

3.10 The net asset statement represents the net worth of the Fund as the 31 March 2013. The statement reflects how the transactions outlined in the other statement have impacted on the value of the Fund's assets.

3.11 Members should note that these accounts are draft and may be subject to change between now and the final sign off by the Chief Financial Officer. Any such changes will be detailed in working papers for presentation to the Council's external auditors, Grant Thornton.

## 4. FINANCIAL IMPLICATIONS

4.1 This entire report relates to the draft Pension Fund accounts for 2012/13, the details of which have been attached at Appendix 1.

## 5. LEGAL IMPLICATIONS

5.1 The Accounts and Audit Regulations (England) 2011 as amended, specify the process by which the Authority's accounts are initially approved and then examined by the external auditor. This process and the dates by which the various stages have to be achieved are set out in Regulations and are binding on the Authority.

## 6. CRIME AND DISORDER IMPLICATIONS

6.1 There are no crime and disorder implications directly arising from this report.

## 7. EQUALITIES IMPLICATIONS

7.1 The are no equalities implications directly arising from this report.

## 8. ENVIRONMENTAL IMPLICATIONS

8.1 There are no environmental implications directly arising from this report.

## BACKGROUND PAPERS

None

## APPENDIX

Appendix 1 – Draft Pension Fund Accounts 2012/13

## FURTHER INFORMATION

If there are any queries on this report or you require further information, please contact either:

Selwyn Thompson, Group Finance Manager Budget Strategy on 020 8314 6932

or

Shola Ojo, Principal Accountant, Budget Strategy on 020 8314 4778

# DRAFT
## PENSION FUND ACCOUNTS

## 2012/13

# PENSION FUND ACCOUNTS

## FOREWORD

This Pension Fund Statement of Accounts details the financial position and performance of the Lewisham Pension Fund for the year 2012/13.

The Pension Fund's value rose over the year by approximately £90m which is mainly due to an increase in stock valuation during the year.

The Fund underwent a major transition this year in moving from active management to passive management, with 78% of the fund being transitioned. This resulted in a change of some investment managers. RCM, Alliance Bernstein and UBS (active) were replaced by Blackrock and UBS (passive). The Fund also disinvested from the hedge fund of funds held with Fauchier Partners. The Pensions Investment Committee decided on this change in strategy due to the unsatisfactory performance of these managers. All resulting effects have been accounted for in these accounts.

## INTRODUCTION

The London Borough of Lewisham Pension Fund ('the Fund') is part of the Local Government Pension Scheme. The Fund is a contributory defined pension scheme administered by the London Borough of Lewisham to provide benefits to London Borough of Lewisham employees and former employees and admitted and scheduled bodies. These benefits include retirement allowances and pensions payable to former employees and their dependants, lump sum death gratuities and special short-term pensions. The Fund is financed by income from investments and contributions from employees, the Council and other admitted and scheduled bodies.

## ORGANISATION

The fund is governed by the Superannuation Act 1972. The fund is administered in accordance with the following secondary legislation:

- The Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (as amended)
- The Local Government Pension Scheme (Administration) Regulations 2008 (as amended)
- The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

Formal responsibility for investment management of the Pension Fund is delegated to the Council's Pensions Investment Committee (PIC), which monitors the external investment managers. Each investment manager has an individual performance target and benchmark tailored to balance the risk and return appropriate to the Fund. The investment managers also have to consider the PIC's views on socially responsible investments. Details of this policy are contained in the Statement of Investment Principles (see web address below).

A statement of the Fund's corporate governance, funding strategy and investment principles can be found on the authority's website, at the following address:

http://www.lewisham.gov.uk/mayorandcouncil/aboutthecouncil/finances/Pages/Pension-fund.aspx

**ACCOUNTING POLICIES**

The Pension Fund accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2012/13 which is based upon International Financial Reporting Standards (IFRS), as amended for the UK public sector.

The accounts summarise the transactions of the Fund and report on the net assets available to pay pension benefits. The accounts do not take account of the obligations to pay pensions and benefits which fall due after the end of the financial year. The actuarial present value of promised retirement benefits, valued on an International Accounting Standard (IAS) 19 basis, is disclosed in paragraph (m) below.

The Local Government Pension Scheme (Amendment) (No. 3) Regulations 2007 also requires administering authorities in England and Wales to prepare a Pension Fund Annual Report which must include the Fund Account and a Net Assets Statement with supporting notes prepared in accordance with proper practices. The Code summarises the Pension Code and the minimum disclosure requirements.

The date for publishing the Pension Fund Annual Report is on or before 1 December the following year, up to five months after a local authority must approve its Statement of Accounts. The Council will be taking its Annual Report to its Pensions Investment Committee in order to comply with this deadline.

A summary of the significant accounting policies and the basis of preparation of the accounts are shown below:

**(a)** Basis of Preparation - The accounts have been prepared on an accruals basis, i.e. income and expenditure attributable to the financial year have been included, even where payment has not actually been made or received, excepting Transfer Values which are prepared on a cash basis. The financial statements do not take account of liabilities to pay pensions and other benefits due after the period end; these are reported upon separately in the Actuary's report and reflected in the council's income and expenditure account. The accounts are prepared on a going concern basis for accounting purposes.

**(b)** Investments - Investments in the Net Assets Statement are shown at market value based on bid prices, as required by the 2012/13 Local Authority Code of Practice and the IAS 26 Retirement Benefit Plans. The market value of equity investments is based on the official closing data, in the main, with last trade data being used in a small number of countries. Unitised equities are quoted based on last trade or official closing price. Northern Trust, the Fund's custodian, sets out its pricing policies in a document entitled "Asset pricing guidelines" which details its pricing process and sets out preferred pricing sources and price types.

**(c)** The change in market value of investments during the year comprises all increases and decreases in market value of investments held at any time during the year, including profits and losses realised on sales of investments during the year.

**(d)** Private equity investments are valued in accordance with United States generally accepted accounting principles, including FAS 157, which is consistent with the International Private Equity and Venture Capital Valuation Guidelines. These guidelines set out that all investments are carried at fair value and they recommend methodologies for measurement. Due to timing differences in the valuation of this private equity investment, the value carried in the accounts as at 31st March 2013 is the actual fair value as at 31st December 2012 plus an estimated valuation for the period 1st January 2013 to 31st March 2013.

**(e)** Property – The Fund does not have any direct investments in property, but does use a property Fund of Funds manager, Schroders, to invest in pooled property funds. The Schroders funds are all currently valued at least quarterly. The majority of property assets to which the fund has exposure to are located in the UK. They are valued in accordance with the Royal Institution of Chartered Surveyors' Valuation Standards and are valued on the basis of their open market value (OMV).

The only non UK funds are the Continental European Fund 1 and Lend Lease Real Estate Partners 3. Their net asset values are derived from the net asset values of the underlying funds. Like the UK, the values of the underlying assets are assessed by professionally qualified valuers. Valuation practices will vary between countries according to local Generally Accepted Accounting Practices. The frequency of independent valuations does however vary. All the funds are independently valued on a rolling basis at least annually.

**(f)** The fair value of the M&G financial instruments is based on their quoted market prices at the statement of financial position date without any deduction for estimated future selling costs. Due to timing differences in the valuation of this investment, the value carried in the accounts as at 31st March 2013 is the actual fair value as at 31st December 2012, plus an estimated valuation for the period 1st January 2013 to 31st March 2013.

**(g)** The fair value of the Investec commodities is based on their quoted market prices at the Balance Sheet date. If a quoted market price is not available on a recognised stock exchange or from a broker/dealer for a non-exchange traded financial instrument, the fair value of the instrument is estimated using valuation techniques.

**(h)** Contributions – These represent the total amounts receivable from employers within the scheme in respect of their own contributions and any of their employees contributions who are members of the scheme.
There are seven employee contribution bands (revised annually in line with inflation) ranging from 5.5% for members earning under £13,500 a year to 7.5% for members earning over £85,300 a year.

| Full time pay for the post | Contribution rate |
|---|---|
| Up to £13,500 | 5.5% |
| £13,501 to £15,800 | 5.8% |
| £15,801 to £20,400 | 5.9% |
| £20,401 to £34,000 | 6.5% |
| £34,001 to £45,500 | 6.8% |
| £45,501 to £85,300 | 7.2% |
| More than £85,300 | 7.5% |

The employer's contribution is reviewed every three years and is determined by the fund's Actuary as the rate necessary to ensure that the Fund is able to meet its long-term liabilities. This is assessed at each triennial actuarial revaluation.

**(i)** Benefits -Benefits payable are made up of pension payments and lump sums payable upon retirement and death. These have been brought into the accounts on the basis of all valid claims approved during the year.

**(j)** Transfer Values – Transfer values are those sums paid to, or received from, other pension schemes relating to periods of previous pensionable employment. Transfer values are calculated in accordance with the Local Government Pension Scheme Regulations and have been brought into the accounts on a cash basis.

**(k)** Taxation – The fund is a registered public service scheme under section (1) of Schedule 36 of the Finance Act 2004 and as such is exempt from UK income tax on interest received and from capital gains tax on the proceeds of investments sold. Income from overseas investments suffers withholding tax in the country of origin, unless exemption is permitted. Irrecoverable tax is accounted for as an expense as it arises.

**(l)** VAT – By virtue of Lewisham Council being the administrating authority, VAT input tax is recoverable on fund activities. Any irrecoverable VAT is accounted for as an expense.

**(m)** Actuarial – The adequacy of the Fund's investments and contributions in relation to its overall and future obligations is reviewed every three years by an Actuary appointed by the Council. The council's Actuary, Hymans Robertson, assesses the Fund's assets and liabilities in accordance with Regulation 77 of the Local Government Scheme Regulations 1997. The contribution rate required for benefits accruing in future is assessed by considering the benefits which accrue over the course of the three years to the next valuation.

The most recent actuarial valuation carried out under Regulation 36 of the LGPS (Administration) Regulations 2008 was as at 31 March 2010.

The valuation was based on the projected unit valuation method. This assesses the cost of benefits accruing to existing members during the year following valuation and allowing for future salary increases. The resulting contribution rate is adjusted to allow for any difference in the value of accrued liabilities (allowing for future salary increases) and the market value of assets.

In order to value liabilities which have accrued at the valuation date and those accruing in respect of future service the Actuary has assumed that the Fund's assets will generate a return of 6.1% per annum (5.8% 2007). The Actuary set the employer contribution accordingly to recover the deficit over future periods.

Other financial assumptions made include:

| Financial assumption | Funding Basis (%pa) | Gilt Basis (%pa) |
|---|---|---|
| Discount Rate | 6.1 | 4.5 |
| Price Inflation | 3.3 | 3.3 |
| Pay Increases | 5.3 | 5.3 |
| Pension Increase: | | |
| Pension in excess of GMP | 3.3 | 3.3 |
| Post -88 GMP | 2.8 | 2.8 |
| Pre-88 GMP | 0.0 | 0.0 |
| Revaluation of Deferred Pension | 3.3 | 3.3 |
| Expenses | 0.6 | 0.6 |

The actuarial review carried out for 31 March 2010 resulted in an increase to the Council's contribution rate from 20% to 20.5%, with effect from 1st April 2011 and annual increases of 0.5% for the subsequent two years. The next actuarial valuation of the Fund will have an effective date of 1 April 2013, with new employer contribution rates taking effect from 2014/15.

The triennial valuation on the 31st March 2010 revealed that the Fund's assets, which at 31 March 2010 were valued at £715 million, were sufficient to meet 75.4% (87.4% 2007) of the liabilities valued at £949 million (£840 million 2007) accrued up to that date. The resulting deficit at the 2010 valuation was £234 million (£106 million 2007).

**Actuarial Present Value of Promised Retirement Benefits**

The Actuary has calculated the actuarial present value of retirement benefits (on an IAS 26 basis) to be £1,353 million as at 31st March 2013 (£1,158 million 31st March 2012).

**(n)** Investment Management and Administration - paragraph 42 of the Local Government Pension Scheme (Administration) Regulations 2008, permit the Council to charge the scheme's administration costs to the Fund. A proportion of relevant Council officers' salaries, including related on-costs, have been charged to the Fund on the basis of actual time spent on scheme administration and investment-related business. The fees of the Fund's general investment managers are charged on a quarterly basis and are generally calculated as a set percentage of the market value funds under management as at the end of those quarters. The Council's administrative costs are shown in the Fund Account as part of expenditure.

**(o)** Foreign currency transactions are made using the WM/ Reuters exchange rate in the following circumstances:

- Purchase and sales: the foreign exchange rate applicable on the day prior to the trade date is used.
- Stock holdings: the converted foreign exchange rate is used at stock valuation date.
- Dividend receipts: the rate applicable on the day prior to the date the dividend is received is used.

**(p) 2012/13 Financial Year Summary of the Fund's Market Value**

| Fund Manager | Assets | Assets Value 2012/13 £000 | Assets Value 2011/12 £000 | Proportion of the Fund 2012/13 (%) |
|---|---|---|---|---|
| **UBS** | Bonds | 0 | 138,140 | 0% |
| **Alliance Bernstein** | Global Equities | 0 | 165,816 | 0% |
| **RCM** | Global Equities incl.UK | 0 | 171,254 | 0% |
| **Schroders Property** | Property | 69,598 | 68,846 | 8% |
| **HarbourVest (*Incl Legacy Stock)** | Private Equity | 37,515 | 33,163 | 4% |
| **UBS** | UK Tracker fund | 0 | 128,474 | 0% |
| **UBS** | Passive Equity and Bonds | 340,486 | 0 | 39% |
| **Fauchier** | Hedge Fund of Funds | 0 | 21,077 | 0% |
| **Blackrock** | Passive Equity and Bonds | 338,769 | 0 | 39% |
| **Investec** | Commodities | 37,889 | 37,587 | 4% |
| **M&G** | Credit | 13,411 | 11,089 | 2% |
| **Securities Lending** | Securities Lending | 88 | 8 | 0% |
| **Unallocated Funds** | Cash | 29,836 | 0 | 3% |
| **Lewisham** | Cash and Net Current Assets | -43 | 2,010 | 0% |
| **Total Fund** | | **£867,549** | **£777,464** | **100%** |

## FUND ACCOUNT FOR THE YEAR

The fund account shows the surplus or deficit on the fund for the year.

| 2011/12 £'000s | FUND ACCOUNT FOR THE YEAR ENDED 31st MARCH 2013 | 2012/13 £000s | Note |
|---|---|---|---|
| | **DEALINGS WITH MEMBERS, EMPLOYERS AND OTHERS DIRECTLY INVOLVED WITH THE SCHEME** | | |
| | Contributions Receivable: | | |
| 26,992 | - from Employer | 26,934 | 1 |
| 8,979 | - from Employees | 8,612 | 1 |
| 1,951 | - Reimbursement for Early Retirement | 308 | |
| 2,896 | Transfer Values In | 3,083 | |
| 8 | Other Income | 10 | |
| **40,826** | **Sub-Total: Income** | **38,948** | |
| | Benefits Payable: | | |
| 30,038 | - Pensions | 32,857 | 2 |
| 8,826 | - Lump Sums: Retirement allowances | 5,413 | |
| 1,170 | - Lump Sums: Death grants | 1,249 | |
| | **Payments to and on account of leavers:** | | |
| 1 | - Refunds of Contributions | 1 | |
| 6,059 | - Transfer Values Out | 2,376 | |
| 1,002 | Administrative and other expenses borne by the scheme | 774 | 3 |
| **47,096** | **Sub-Total: Expenses** | **42,670** | |
| **(6,270)** | **Total Net additions (withdrawals) from Dealings with Scheme Members** | **(3,722)** | |

| | | | |
|---|---|---|---|
| | **RETURNS ON INVESTMENTS** | | |
| 10,667 | Investment Income | 10,544 | 4 |
| 13,855 | Change in market value of investments (Realised and Unrealised) | 85,404 | 5 |
| | **Investment Expenses:** | | |
| (3,045) | - Investment Management Fees* | (1,677) | 6 |
| (537) | - Tax on Dividends | (464) | |
| **20,940** | **Total Net Returns on Investments** | **93,807** | |
| 14,670 | NET INCREASE / (DECREASE) IN THE FUND DURING THE PERIOD | 90,085 | |
| 762,794 | OPENING NET ASSETS OF THE SCHEME | 777,464 | |
| **777,464** | **CLOSING NET ASSETS OF THE SCHEME** | **867,549** | |

* The investment management fees do not include fees for two managers totalling £184k which have been deducted by the managers at source, and are reflected in the end value of each investment.

## NET ASSETS STATEMENT

The Net Assets Statement shows the market value of the investments and other assets held by the Pension Fund as at 31 March 2013.

| 31st March 2012 £'000s | NET ASSETS STATEMENT AT 31 MARCH 2013 | 31st March 2013 £000s | Note |
|---|---|---|---|
| | **EQUITIES** | | 5 |
| 43,745 | Equities: UK | 5,861 | |
| 269,466 | Equities: Global | 11,499 | |
| **313,211** | | **17,360** | |
| | **MANAGED FUNDS** | | 5 |
| 66,993 | Property | 68,794 | |
| 151,513 | Equity | 510,346 | |
| 88,581 | Fixed Interest | 130,160 | |
| 49,552 | Index Linked | 26,496 | |
| 98,435 | Other Assets | 80,290 | |
| **455,074** | | **816,086** | |
| 6,196 | **CASH DEPOSITS** | 33,502 | 10 |
| | **DERIVATIVE CONTRACTS** | | 8 |
| 4 | Assets | 0 | |
| (21) | Liabilities | 0 | |
| | **OTHER INVESTMENT BALANCES** | | 9 |
| 2,164 | Debtors: Investment Transactions | 3,771 | |
| (1,174) | Creditors: Investment Transactions | (3,127) | |
| **775,454** | **TOTAL INVESTMENTS** | **867,592** | |
| | **NET CURRENT ASSETS AND LIABILITIES** | | |
| 765 | Debtors | 590 | 9 |
| (2,273) | Creditors | **(1,777)** | 9 |
| 3,518 | Cash in Hand | **1,144** | 10 |
| **777,464** | **TOTAL NET ASSETS** | **867,549** | |

The financial statements of the fund do not take account of the liability to pay pensions or benefits after 31st March 2013. This liability is included within the Authority's balance sheet.

## NOTES TO THE PENSION FUND ACCOUNTS

### 1. CONTRIBUTIONS RECEIVABLE

| Employer Contributions | 2012/13 £000s | 2011/12 £000s |
|---|---|---|
| Administering: Normal | 22,313 | 22,752 |
| Admitted: Normal | 1,026 | 974 |
| Scheduled | 3,595 | 3,266 |
| | **26,934** | **26,992** |

| Employee Contributions | 2012/13 £000s | 2011/12 £000s |
|---|---|---|
| Administering | 7,102 | 7,449 |
| Admitted | 328 | 325 |
| Scheduled | 1,181 | 1,205 |
| | **8,611** | **8,979** |

| 2. BENEFITS PAYABLE | 2012/13 £000s | 2011/12 £000s |
|---|---|---|
| Administering | 19,009 | 17,907 |
| Admitted | 224 | 192 |
| Scheduled | 946 | 730 |
| Dependants' Pensions | 1,259 | 1,226 |
| Pensions Increases | 11,418 | 9,983 |
| | **32,857** | **30,038** |

| 3. ADMINISTRATION COSTS | 2012/13 £000s | 2011/12 £000s |
|---|---|---|
| Lewisham Administration | 645 | 547 |
| Administrative Costs Incl. Audit Fees* | 124 | **452 |
| Bank Charges | 5 | 3 |
| | **774** | **1,002** |

*These costs include a net figure of £21k paid to Grant Thornton for external audit services in 2012/13. In 2011/12 £32.2k was paid to the Audit Commission for the same service.
**These costs include custodian and advisory fees in 2011/12

| **4. INVESTMENT INCOME** | **2012/13 £000s** | **2011/12 £000s** |
|---|---|---|
| Cash | 175 | 212 |
| Equity | 5,459 | 7,846 |
| Fixed Interest | 915 | 0 |
| Index Linked | 30 | 0 |
| Managed Funds Incl. Property | 3,875 | 2,467 |
| Securities Lending | 89 | 141 |
| Other* | 1 | 1 |
| | **10,544** | **10,667** |

* Includes Commodities, Hedge Fund, Venture Capital and Credit Mandates

## 5. INVESTMENT ANALYSIS

Individual Investment assets with a market value exceeding 5% of the total fund value are:

| Asset | Manager | 2012/13 Value £000 | 2012/13 % |
|---|---|---|---|
| UBS GBL Asset Life North America Equity Tracker | UBS | 97,683 | 12.0 |
| Aquila Life US Equity Index Fund | Blackrock | 97,671 | 12.0 |
| Aquila Life UK Equity Index Fund | Blackrock | 69,230 | 8.5 |
| UBS Global Life UK Equity Tracker Fund | UBS | 68,500 | 8.4 |

Investments exceeding 5% within each class of security are as follows:

| Asset | Manager | 2012/13 Value £000 | 2012/13 % |
|---|---|---|---|
| **UK Equities** | | | |
| Harbourvest GE PE Shares | Harbourvest | 5,861 | 100 |
| | | | |
| **Global Equities** | | | |
| Commonwealth Bank of Australia | UBS | 673 | 5.8 |
| BHP Billiton Ltd | UBS | 652 | 5.7 |
| Westpaac BKG Corp | UBS | 588 | 5.1 |
| | | | |
| **Property** | | | |
| Standard Life Pooled property Fund | Schroder | 8,271 | 11.8 |
| Schroder Uk Prop. | Schroder | 8,018 | 11.7 |
| Real Continental European Fund | Schroder | 6,183 | 9.0 |
| Hermes Property UT | Schroder | 5,944 | 8.6 |
| Legal and General Property Fund | Schroder | 5,927 | 8.6 |
| Rockspring Hanover Property Unit Trust | Schroder | 5,134 | 7.5 |
| Blackrock UK Fund | Schroder | 6,439 | 9.4 |

| | | | |
|---|---|---|---|
| Real Income Fund | Schroder | 4,407 | 6.4 |
| Hercules Unit Property | Schroder | 3,755 | 5.5 |
| | | | |
| **Managed Equities** | | | |
| Global AM Life Equity Tracker | UBS | 29,243 | 5.7 |
| UBS Global Life Nrth America | UBS | 97,662 | 19.1 |
| Life European Equity Index Fund | Blackrock | 31,791 | 6.2 |
| UBS Global Life UK Equity Tracker Fund | | 68,500 | 13.4 |
| Blackrock AM EM IDX Fund | Blackrock | 25,046 | 5.0 |
| Life UK Equity Index Fund | Blackrock | 69,599 | 13.6 |
| Aquila Life US Equity Index Fund | Blackrock | 97,671 | 19.0 |
| Aquila Life UK Equity Index Fund | Blackrock | 69,230 | 13.6 |
| Life US Index Fund | Blackrock | 97,572 | 19.0 |
| | | | |
| **Fixed Interest** | | | |
| UBS Global Asset Management Corporate Bond Fund | UBS | 25,647 | 19.7 |
| Blackrock Am Uk Corporate Bond Index | Blackrock | 26,188 | 20.1 |
| Aquila Life over 5 yrs Index Fund | Blackrock | 27,119 | 20.8 |
| Barclays Global Aquila Life | Blackrock | 26,441 | 20.3 |
| | | | |
| **Others** | | | |
| Global Commodities and Resources | Investec | 37,889 | 47.2 |
| Cayman Partnership Fund | Harbourvest | 12,593 | 15.7 |
| UK Companies Financing Fund | M&G | 12,835 | 16.0 |
| Cayman Buyout Fund | Harbourvest | 8,576 | 10.7 |
| Cayman Venture Fund | Harbourvest | 5,199 | 6.5 |

An analysis of investment movements is set out below:

| **5. INVESTMENT ANALYSIS** **Investments** | **Value at 31/03/2012 £000s** | **Purchases at Cost £000s** | **Sales Proceeds £000s** | **Change in Capital Value £000s** | **Change in Market Value £000s** | **Value at 31/03/2013 £000s** |
|---|---|---|---|---|---|---|
| UK Equities | 43,745 | 12,272 | (47,285) | 13 | (2,884) | 5,861 |
| Global Equities | 269,466 | 234,024 | (224,112) | (1,127) | (266,752) | 11,499 |
| Managed Equities | 151,513 | 51,554 | (33,429) | 0 | 340,708 | 510,346 |
| Property | 66,993 | 8,388 | (5,390) | 0 | (1,197) | 68,794 |
| Fixed Interest Securities | 88,581 | 83,801 | (76,709) | 0 | 34,487 | 130,160 |
| Index Linked Securities | 49,552 | 5,271 | (7,195) | 0 | (21,132) | 26,496 |
| Other* | 98,435 | 4,597 | (24,899) | 0 | 2,157 | 80,290 |
| Derivatives | (17) | 0 | 0 | 0 | 17 | 0 |
| | **768,268** | **399,907** | **(419,019)** | **(1,114)** | **85,404**** | **833,446** |
| Cash deposits | 6,196 | | | | | 33,502 |
| Other Investment Balances | 990 | | | | | 644 |
| | **775,454** | | | | | **867,592** |

* Includes Commodities, Hedge Fund, Venture Capital and Credit Mandates

** Due to the timing of the final valuation of Private Equity and the Financing Fund, adjustments were made to the valuations in the 2011/12 accounts based on information received during June 2013. The effect of these adjustments have been reversed this year through the change in market value as the true valuation has now been reflected in these accounts. The total of these adjustments is £2.191m.

The Pension Fund's bond investments are held with UBS and Blackrock in the form of pooled funds. The fund denoted Index Linked above is comprised wholly of UK Government index linked gilts. The remaining funds are comprised of various government and corporate bonds.

(The amounts in respect of derivative payments and receipts represent the cost at inception of the contract).

Apart from Global Equities and bonds, the only other overseas investments held by the Fund fall under the 'Others' category and are namely Private Equity £31.7m and Commodities £37.88m.

The fund held the following unlisted securities as at 31st March 2013: Equities (including managed equities) £341m, Index Linked Securities £176 and Other Assets £87m.

The fund held the following listed securities as at 31st March 2013: Equities (including managed equities) £127m, Fixed Interest Securities £26m and Index Linked Securities £10m.

As at 31st March 2012:

| **5. INVESTMENT ANALYSIS**<br><br>**Investments** | **Value at 31/03/2011**<br>**£000s** | **Purchases at Cost**<br>**£000s** | **Sales Proceeds**<br>**£000s** | **Change in Capital Value**<br>**£000s** | **Change in Market Value**<br>**£000s** | **Value at 31/03/2012**<br>**£000s** |
|---|---|---|---|---|---|---|
| UK Equities | 38,484 | 16,947 | (9,064) | 57 | (2,679) | 43,745 |
| Global Equities | 280,438 | 122,119 | (130,245) | (390) | (2,456) | 269,466 |
| Managed Equities | 149,430 | 1,830 | 0 | 0 | 253 | 151,513 |
| Property | 62,831 | 12,602 | (8,785) | (85) | 430 | 66,993 |
| Fixed Interest Securities | 82,110 | 0 | (3,855) | 0 | 10,326 | 88,581 |
| Index Linked Securities | 42,516 | 0 | (2,145) | 0 | 9,181 | 49,552 |
| Other* | 93,217 | 8,496 | (2,049) | 0 | (1,229) | 98,435 |
| Derivatives | (46) | 0 | 0 | 0 | 29 | (17) |
| | **748,980** | **161,994** | **(156,143)** | **(418)** | **13,855** | **768,268** |
| Cash deposits | 13,332 | | | | | 6,196 |
| Other Investment Balances | 556 | | | | | 990 |
| | **762,868** | | | | | **775,454** |

**Property Holdings**

| **Year ending 31 March 2012** | | **Year ending 31 March 2013** |
|---|---|---|
| £000 | | £000 |
| 62,831 | Opening balance | 66,993 |
| 12,602 | Additions | 8,388 |
| (8,785) | Disposals | (5,390) |
| 430 | Net increase in market value | (1,197) |
| (85) | Other changes in fair value | - |
| **66,993** | **Closing balance** | **68,794** |

There are no restrictions on the realisability of the property or the remittance of income or proceeds on disposal and the fund is not under any contractual obligations to purchase, construct or develop any of these properties. Nor does it have any responsibility for any repairs, maintenance or enhancements.

**FINANCIAL INSTRUMENTS**

The accounting policies describe how the different asset classes of financial instruments are measured, and how income and expenses are recognised. The following table analyses the carrying amounts of financial assets and liabilities by category. No financial assets were reclassified during the accounting period. All assets are held at fair value, therefore there is no difference between fair value and carrying value.

| 31st March 2012 | | | Financial Assets | 31st March 2013 | | |
|---|---|---|---|---|---|---|
| **Fair Value through Profit and Loss £'000** | **Loans and Receivables £'000** | **Financial Liabilities at Amortised Cost £'000** | | **Fair Value through Profit and Loss £'000** | **Loans and Receivables £'000** | **Financial Liabilities at Amortised Cost £'000** |
| 313,211 | | | Equities | 17,360 | | |
| | | | Managed Funds: | | | |
| 66,993 | | | Property | 68,794 | | |
| 151,513 | | | Equity | 510,346 | | |
| 88,581 | | | Fixed Interest | 130,160 | | |
| 49,552 | | | Index Linked | 26,496 | | |
| 98,435 | | | Other Assets | 80,290 | | |
| 4 | | | Derivative contracts | 49,199 | | |
| | 6,196 | | Cash deposits | | 33,502 | |
| | 1,680 | | Pending Trades | | 3,285 | |
| | 484 | | Dividends & Income | | 538 | |
| | 765 | | Contributions Due | | 538 | |
| | 3,518 | | Cash Balances | | 1,144 | |
| **768,289** | **12,643** | | **Total Financial Assets** | **888,506** | **38,955** | |
| | | | **Financial Liabilities** | | | |
| (21) | | | Derivative Contracts | (49,199) | | |
| | | (1,174) | Pending Trades | | | (3,127) |
| | | (290) | Unpaid benefits | | | (584) |
| | | (1,983) | Other current Liabilities | | | (1,193) |
| **(21)** | **0** | **(3,447)** | **Total Financial Liabilities** | **(49,199)** | **0** | **(4,904)** |
| **768,268** | **12,643** | **(3,447)** | **Net Financial Assets** | **839,307** | **39,007** | **(4,904)** |

## Net Gains and Losses on Financial Instruments

The following table shows net gains on financial instruments:

| 31 March 2012 | | 31 March 2013 |
|---|---|---|
| **£'000** | **Financial Assets** | **£'000** |
| 13,263 | Fair Value through Profit and Loss | 85,404 |
| 0 | Loans and Receivables | |
| | | |
| | **Financial Liabilities** | |
| (21) | Fair Value through Profit and Loss | 0 |
| | | |
| **13,242** | **Total** | **85,404** |

The fund also received bank interest totalling £8,050 during the year.

**Valuation of Financial Instruments carried at Fair Value**

The following table provides an analysis of the financial assets and liabilities of the pension fund grouped into Levels 1 to 3, based on the level at which the fair value is observable.

Level 1 consists of assets where the fair values are derived from unadjusted quoted prices in active markets for identical assets and liabilities e.g. quoted equities.

Level 2 consists of assets where quoted market prices are not available e.g. where an instrument is traded in a market that is not considered to be active.

Level 3 consists of assets where at least one input that could have a significant effect on the instrument's valuation is not based on observable market data.

| Values as at 31st March 2013 | Quoted Market Price<br>Level 1<br>£'000 | Using Observable Inputs<br>Level 2<br>£'000 | With Significant Unobservable Inputs<br>Level 3<br>£'000 | Total<br>£'000 |
|---|---|---|---|---|
| **Financial Assets** | | | | |
| Financial Assets at Fair Value through Profit and Loss | 66,559 | 784,431 | 31,654 | **882,644** |
| Loans and Receivables | 39,008 | | | **39,008** |
| **Total Financial Assets** | **105,567** | **784,431** | **31,654** | **921,652** |
| **Financial Liabilities** | | | | |
| Fair Value through Profit and Loss | (49,199) | | | **(49,199)** |
| Financial Liabilities at Amortised Cost | (4,904) | | | **(4,904)** |
| **Total Financial Liabilities** | **(54,103)** | **0** | **0** | **(54,103)** |
| **Net Financial Assets** | **51,334** | **784,431** | **31,654** | **867,549** |

| Values as at 31st March 2012 | Quoted Market Price<br><br>Level 1<br><br>£'000 | Using Observable Inputs<br><br>Level 2<br><br>£'000 | With Significant Unobservable Inputs<br>Level 3<br><br>£'000 | Total<br><br>£'000 |
|---|---|---|---|---|
| **Financial Assets** | | | | |
| Financial Assets at Fair Value through Profit and Loss | 313,215 | 426,388 | 28,686 | **768,289** |
| Loans and Receivables | 12,643 | | | **12,643** |
| **Total Financial Assets** | **325,858** | **426,388** | **28,686** | **780,932** |
| **Financial Liabilities** | | | | |
| Fair Value through Profit and Loss | (21) | | | **(21)** |
| Financial Liabilities at Amortised Cost | (3,447) | | | **(3,447)** |
| **Total Financial Liabilities** | **(3,468)** | **0** | **0** | **(3,468)** |
| **Net Financial Assets** | **322,390** | **426,388** | **28,686** | **777,464** |

**FINANCIAL RISK MANAGEMENT**

As an investment fund, the Lewisham Pension Fund's objective is to generate positive investment returns for a given level of risk. Therefore the Fund holds financial instruments such as securities (equities, bonds), collective investment schemes (pooled funds), and cash equivalents. In addition, debtors and creditors arise as a result of its operations. The value of these financial instruments is reflected in the financial statements at their fair value.

Responsibility for the fund's risk management strategy rests with the Pension Fund Investment Committee. Risk management policies are established to identify and analyse the risks faced by the Council's pension operations. Policies are reviewed regularly to reflect change in activity and in market conditions.

The main risks from the Fund's holding of financial instruments are market risk, credit risk and liquidity risk.

Market risk includes price risk, interest rate risk and currency risk. The Fund's investments are managed on behalf of the Fund by the appointed investment managers. Each investment manager is required to invest the assets managed by them in accordance with the terms of their investment guidelines or pooled fund prospectus.

Due to the performance of some managers, the Lewisham Pension Investment Committee (PIC) decided to move the fund towards a more passive rather than active management. This has been reflected in this statement of accounts.
The Committee has determined that the new investment management structure is appropriate and is in accordance with its revised investment strategy. The Committee, however, regularly monitors each investment manager, and its investment consultant (Hymans Robertson) advises on the nature of the investments made and associated risks.

The Fund's investments are held by Northern Trust, who act as custodian on behalf of the Fund. As the Fund adopts a long term investment strategy, the high level risks described below will not alter significantly during any one year unless there are significant strategic or tactical changes to the portfolio.

**i) Market Risk**

Market risk represents the risk that fair value of a financial instrument will fluctuate because of changes in market prices, interest rates or currencies. The Fund is exposed, through its investments in equities, bonds and investment funds, to all these market risks. The aim of the investment strategy is to manage and control market risk within acceptable parameters while optimising the return from the investment portfolio. In general, market risk is managed through the diversification of the investments held by asset class, investment mandate guidelines and investment managers. The risk arising from exposure to specific markets is limited by the strategic asset allocation, which is regularly monitored by the PIC.

**a) Market Price Risk**

Market price risk represents the risk that the value of a financial instrument will fluctuate as a result of factors other than interest rate or foreign currency movements, whether those changes are caused by factors specific to the individual instrument, its issuer or factors affecting the market in general. Market price risk arises from uncertainty about the future value of the financial instruments that the Fund holds. All investments present a risk of loss of capital, the maximum risk being determined by the fair value of the financial instruments. The investment managers mitigate this risk through diversification in line with their own investment strategies and mandate guidelines**.** The Council and its investment advisors also undertake appropriate monitoring of market conditions and benchmark analysis. The Fund has a long term view on expected investment returns which smoothes out short term price volatility.
Following analysis of historical data and expected investment return movement during the financial year, in consultation with the Fund’s advisors, the council has determined that the following movements in market price risk are reasonably possible for the 2012/13 reporting period.

| Asset Type | Potential Market Movement +/- (%p.a.) |
|---|---|
| UK Equities | 13.3 |
| Overseas Equities | 13.2 |
| UK Bonds | 6.5 |
| Index Linked | 8.6 |
| Cash | 0.0 |
| Other Assets | 6.5 |
| Property | 1.9 |

The potential volatilities are broadly consistent with a one standard deviation movement in the change in value of the assets over the latest three years. This can then be applied to the period end asset mix as follows:

| Asset Type | Final Market Value £'000 | Percentage Change | Value on Increase £'000 | Value on Decrease £'000 |
|---|---|---|---|---|
| UK Equities | 302,959 | 13.3 | 343,162 | 262,756 |
| Overseas Equities | 224,747 | 13.2 | 254,414 | 195,080 |
| UK Bonds | 130,160 | 6.5 | 138,555 | 121,765 |
| Index Linked | 26,496 | 8.6 | 28,761 | 24,231 |
| Cash | 33,502 | 0.0 | 33,509 | 33,495 |
| Other Assets | 80,290 | 6.5 | 85,501 | 75,079 |
| **Property** | 68,794 | 1.9 | 70,122 | 67,466 |
| **Total Assets*** | **866,948** | **8.0** | **936,130** | **797,766** |

* This figure excludes derivatives and other investment balances.

**b) Interest Rate Risk** is the risk to which the Pension Fund is exposed to changes in interest rates and relates to its holdings in bonds and cash. Based on interest received on bonds held on a segregated basis and cash held by investment managers, a 0.5% change in interest rates would result in an approximate change in income of £677k.

**c) Currency Risk** is the risk to which the Pension Fund is exposed to fluctuations in foreign currency exchange rates. The fund is exposed to currency risk on financial instruments that are denominated in any currency other than the functional currency of the fund (£UK). The fund's currency rate risk is routinely monitored by the council and its investment advisors. In practice, this is achieved by the use of futures and forward foreign exchange contracts, which entitle and oblige the seller and holder to exchange assets or currency on a future date at a predetermined price or rate. The former are tradable on exchanges, the latter are "over the counter" agreements, which neither the purchaser or the seller may transfer. As at 31 March 2013, forward foreign exchange contracts were the only derivative contracts held. There is no cost on entering into these contracts but the market value is established as the gain or loss that would arise at the settlement date from entering into an equal and opposite contract at the reporting date.

Following analysis of historical data in consultation with the Fund's advisors, the council considers the likely volatility associated with foreign exchange rate movements to be 6.2%.
This volatility is applied to the fund's overseas assets as follows:

| Asset Type | Asset Value @ 31/12/12 £'000 | +6.2% £'000 | -6.2% £'000 |
|---|---|---|---|
| Overseas Equities | 224,747 | 238,704 | 210,790 |
| Other Assets | 51,835 | 55,054 | 48,616 |
| Other Alternatives | 67,456 | 71,645 | 63,267 |
| **Total** | **344,038** | **365,404** | **322,672** |

**ii) Credit Risk** Credit risk represents the risk that the counterparty to a financial instrument will fail to meet an obligation and cause the Fund to incur a financial loss. This is often referred to as counterparty risk. The market values of investments generally reflect an assessment of credit in their pricing and consequently the risk of loss is implicitly provided for in the carrying value of the fund's financial assets and liabilities. The Fund is exposed to credit risk through its underlying investments (including cash balances) and the transactions it undertakes to manage its investments. The careful selection of and monitoring of counterparties including brokers, custodian and investment managers minimises credit risk that may occur through the failure to settle transactions in a timely manner. The Fund is also exposed to credit risk through Securities Lending. The Securities Lending (SL) programme is run by the Fund's custodian, Northern Trust, who assign four different risk management oversight committees to control counterparty risk, collateral risk and the overall securities lending programme. The minimum level of collateral for securities on loan is 102%, however more collateral may be required depending on the type of transaction. To further mitigate risks, the collateral held on behalf of the Pension Fund is ring fenced from Northern Trust. Securities lending is capped by investment regulations and statutory limits are in place to ensure no more than 25% of eligible assets can be on loan at any one time. The Fund's exposure through the securities Lending programme is now reduced as the fund is now passively managed and SL activity has greatly reduced. The Financing Fund is also exposed to credit risk. The fund gains exposure by investing in private placements. This risk is managed by assigning a credit analyst to all investments, who continually monitors the asset, its direct peers and its sector.

**iii) Liquidity Risk –** This is the risk that the Pension Fund will have difficulties in paying its financial obligations as they fall due, for example the pensioner payroll costs and capital commitments. The council therefore takes steps to ensure that it has adequate cash resources to meet its commitments. The fund holds a large proportion of assets in instruments which can be liquidated at short notice, normally three working days. As at the 31 March 2013 these assets totalled approximately £684m, with a further £33.5m held in cash by the custodian on behalf of the Fund and fund managers.

## 6. INVESTMENT MANAGEMENT FEES

| | 2012/13 £000s | 2011/12 £000s |
|---|---|---|
| Fund Managers' Fees | 1,387 | 3,045 |
| Custodian Fees* | 227 | 0** |
| Advisory Costs | 63 | 0** |
| | **1,677** | **3,045** |

*These fees include the cost of transition management
**These costs were classed as administration costs in 2011/12 (see note 3)

## 7. PRIOR YEAR ADJUSTMENT

No prior year adjustments have been made to these accounts.

## 8. DERIVATIVE CONTRACTS

As at 31 March 2013, forward foreign exchange contracts were the only derivative contracts held. Forward foreign exchange contracts are disclosed in the accounts at market value which is the gain or loss that would arise from closing out the contract at the balance sheet date by entering into an equal and opposite contract at that date.

| Foreign Exchange Gains | 31st March 2013 | | 31st March 2012 |
|---|---|---|---|
| Total Gains | 0 | | 4 |
| Foreign Exchange Losses | | | |
| Total Losses | 0 | | (21) |
| **Total Unrealised Gains/(Losses)** | **0** | | **(17)** |

## 9. DEBTORS & CREDITORS

These comprise the following amounts:

| **Debtors** | 2012/13 £000s | 2011/12 £000s |
|---|---|---|
| Contributions due from Admitted / Scheduled Bodies | 538 | 765 |
| Equity Dividends / Income from Managed Funds | 711 | 484 |
| Interest and Other Income | 390 | 0 |
| VAT | 52 | 0 |
| Pending Trades | 2,670 | 1,680 |
| | **4,361** | **2,929** |

**Pension Fund Accounts**

| **Creditors** | **2012/13 £000s** | **2011/12 £000s** |
|---|---|---|
| Fund Manager and Custody Fees | (171) | (516) |
| Consultancy / Advisory Fees (Inc Audit Fee) | (94) | (27) |
| Pension Payments Due to Employees | (586) | (289) |
| Taxes Due | 0 | 0 |
| Pending Trades | (3,127) | (1,174) |
| **LB Lewisham** | **(926)** | **(1,441)** |
| | **(4,904)** | **(3,447)** |

The pending trades relate to purchases and sales by managers which have yet to be the subject of cash settlement. Pending trade sales and purchases at the year end are treated as investment debtors and creditors.

## 10. CASH DEPOSITS

The Northern Trust Company is the fund's global custodian and the cash is held in an interest bearing account to meet the cash flow requirements of the fund and its managers. Part of the cash held this year was in relation to the closure of the Hedge Fund of Funds with Fauchier Partners. The total cash held as at 31st March 2013 was £33.5m (£6.19m as at 31st March 2012). Approximately £20m of the cash held was from the closure of the Fauchier Partners investment during the year. Suitable reinvestment of these funds is currently being considered. £7m of the cash is being held to meet the ongoing cashflow requirements of the fund, £4m is the residual cash from the transition and £2m is held for Schroders.

**Cash in Hand**
The Lewisham cash balance represents uninvested cash held in the Pension Fund bank account as at 31st March 2013. The cash in hand figure includes a figure of £926K to be paid by the Fund to the Council for items described in note 13a below.

## 11. TRANSACTION COSTS

The following direct costs were incurred in relation to individual investment transactions:

| | **2012/13** £000s | **2011/12** £000s |
|---|---|---|
| Total Purchases | 261 | 199 |
| Total Sales | 148 | 144 |
| **Total transactions** | **409** | **343** |

## 12. POST YEAR END EVENTS

There have been no events since March 2013, and up to the date when these accounts were prepared, that require any adjustment to these accounts.

## 13. COMMITMENTS

The Pension Fund was committed to the following capital contributions as at the 31st March 2013

**Harbourvest**

| **Fund** | **Amount** | **Translated £** |
|---|---|---|
| Harbourvest Partners VIII – Cayman Venture Fund L.P | \$1,852,500 | 1,224,317 |
| Harbourvest Partners VIII – Cayman Buyout Fund L.P | \$4,995,000 | 3,301,195 |
| Harbourvest International Private Equity Partners V – Cayman Partnership Fund L.P | €2,362,500 | 1,991,115 |
| Harbourvest International Private Equity Partners V – Cayman Direct Fund L.P | €180,000 | 151,704 |
| **Total** | | **6,668,331** |

(The Harbourvest commitments have been translated from either Euros or Dollars using exchange rates as at 31st March 2013). Total Harbourvest commitments as at 31st March 2012 were £8,909,007.

## 14. RELATED PARTY TRANSACTIONS

There have been no material transactions with related parties in the financial year. There were no provisions for doubtful debt and amounts written off in the period.

Eight Councillors sit on the Pensions Investment Committee which oversees the Fund. Four Councillors of this Committee are members of the pension scheme. At each meeting of the Pensions Investment Committee, Councillors are asked to make declarations of interest which are minuted at the meeting.

During the year the following declarations were made:

- Cllr Maslin declared an interest in UBS. He is a Director of Hales Gallery of which UBS is an occasional customer. Cllr Maslin has not taken part in any of the decisions taken during the year involving UBS.

- Councillor Fletcher declared that her brother in law had recently been employed as a finance director for Bryden International which is part of the Melrose Group.

- Councillor Muldoon declared a personal interest in the February 2013 meeting, as a friend of Sir Paul Judge, the Chair of Schroder Income Growth Fund plc.

No other trustees or Council chief officers with direct responsibility for pension fund issues have undertaken any declarable transactions with the Pension Fund.

The Council, the administering body, had dealings with the Fund as follows:

a) Recharges from the Council for the in-house administration costs and other expenses, such as interest payable on balances, borne by the scheme were transacted for £606k (see note 3). (Some cash transactions relating to pension activities are currently effected through the Council's bank account and consequently pension fund cash balances are held by the Council from time to time and vice versa.)

b) The salary of the Executive Director for Resources and Regeneration has been disclosed in the Council's full set of accounts.

**15. ADDITIONAL VOLUNTARY CONTRIBUTIONS (AVCs)**

Contributing members have the right to make additional voluntary contributions (AVCs) to enhance their pension. There are currently 48 'open' AVC contracts for LGPS members (i.e. excluding members with AVC contracts who have left Lewisham and now have preserved benefits). Some of these 'open contracts' will be for members who have paid AVCs in the past but who have suspended payments to the scheme for the time being.
The fund has two AVC providers: Clerical Medical and Equitable Life. The value of AVC investments is shown below, the contributions are held by the providers and do not form part of the Lewisham fund's assets in accordance with regulation 4(2)(b) of the Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009.

| **2012/3** | **Total £000s** | **Equitable £000s** | **Clerical Medical £000s** |
|---|---|---|---|
| **Value at 1 April 2012** | 1,519 | 535 | 984 |
| Contributions and Transfers Received | 203 | 4 | 199 |
| Investment Return | 85.5 | 0.5 | 85 |
| Paid Out | (312) | (12) | (300) |
| **Value at 31 March 2013** | **1,495.5** | **527.5** | **968** |

| **2011/12** | **Total £000s** | **Equitable £000s** | **Clerical Medical £000s** |
|---|---|---|---|
| **Value at 1 April 2011** | 1,441 | 535 | 906 |
| Contributions and Transfers Received | 248 | 5 | 243 |
| Investment Return | 52 | 20 | 32 |
| Paid Out | (222) | (25) | (197) |
| **Value at 31 March 2012** | **1,519** | **535** | **984** |

## 16. SCHEDULED BODIES

The following are scheduled bodies to the fund as at 31st March 2013:

Christ The King Sixth Form College
Haberdashers' Aske's Knights Academy
Lewisham Homes
St Matthew Academy
Tidemill Academy

## 17. ADMITTED BODIES

The following are admitted bodies to the fund as at 31st March 2013:

National Car Parks Ltd
Excalibur Tenant Management Project
PLUS
Housing 21
Lewisham Nexus Services
Lewisham Way Youth and Community Centre
SAGE Educational Trust
CIS Securities
Wide Horizons
Phoenix
INSPACE
T Brown & Sons
Quality Heating
Blenheim CDP
RSM Tenon formerly RSM Bentley
Jennison
Broomleigh Housing Association
Penrose
Skanska
One Housing
Fusions Leisure Management
3 C's Support
Children's Society
Pre-School Learning Alliance
Chequers Contract Services

## 18. STOCK LENDING

The Statement of Investment Principles permits the Fund to enter into stock lending (whereby the Fund lends other bodies stocks in return for a fee and collateral whilst on loan). Equities and fixed income assets held in segregated accounts in custody may be lent. The Fund actively lends in 50 different equity and fixed income markets worldwide. Northern Trust conducts this activity on behalf of the Fund.

The economic benefits of ownership are retained when securities are on loan. The Fund has its full entitlements at all times to any income due, or rights on its securities on the anticipated date of the entitlement, so that no economic benefits are foregone as a result of securities lending activity.

Northern Trust pays income to the Fund on a contractual basis (i.e. pay date) for contractual income markets. For non-contractual income markets, Northern Trust pays income to the Fund once income is received from the local sub custodian. Therefore, income is paid at the same time as income is paid for in-custody positions. Northern Trust is responsible for collecting dividend and interest income on loaned securities from borrowers. The right to vote moves with the securities.

There was a large reduction in stock lending activity towards the end of the year due to the fund restructure and move to passive investments, as the fund is unable to lend units in pooled funds.

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As at the 31st March 2013, the value of aggregate stock on loan was £0.98m (£25.5m as at 31st March 2012). These have been carried in the accounts at this value. There are no liabilities associated with these assets.

**Collateral**

The collateral held versus securities on loan cannot be sold or repledged in absence of default by the borrower.
The council entered into stock lending transactions during the financial year earning £89k net of direct expenses (£0.10m as at 31st March 2012). The value of collateral held was £1.064m (£27.2m as at 31st March 2012).

## 19. MEMBERSHIP

| | **Active Members 2012/13** | ***Active Members 2011/12*** | **Deferred Benefits 2012/13** | ***Deferred Benefits 2011/12*** | **Retired Former Members 2012/13** | ***Retired Former Members 2011/12*** |
|---|---|---|---|---|---|---|
| **Admin. Authority** | 5,322 | *5,035* | 7,284 | *6,958* | 6,530 | *6,448* |
| **Scheduled Bodies** | 655 | *666* | 303 | *243* | 127 | *106* |
| **Admitted Bodies** | 180 | *162* | 92 | *66* | 43 | *39* |
| **Totals** | **6,157** | ***5,863*** | **7,679** | ***7,267*** | **6,700** | ***6,593*** |

**20.** These accounts were authorised on the xxxxx by the Executive Director for Resources and Regeneration.