



PENSION FUND INVESTMENTS PANEL

**MONDAY 3 JULY 2006
6.00 PM**

**PANEL AGENDA
(LICENSING AND GENERAL PURPOSES)**

**COMMITTEE ROOM 5
HARROW CIVIC CENTRE**

MEMBERSHIP (Quorum 3)

Chairman: Councillor David Ashton

Councillors:

Richard Romain

**Mano Dharmarajah
Thaya Idaikkadar**

**Trade Union Observer(s): Mr R Thornton
(Non-voting) Mr H Bluston
Mr J Rattray (alternate)**

Reserve Members:

**1. Tony Ferrari
2. John Anderson
3. Robert Benson**

**1. Keith Ferry
2. Nizam Ismail**

**Issued by the Democratic Services Section,
Legal Services Department**

**Contact: Zoe Crane, Committee Administrator
Tel 020 8424 1883 E-mail: zoe.crane@harrow.gov.uk**

***NOTE FOR THOSE ATTENDING THE MEETING:
IF YOU WISH TO DISPOSE OF THIS AGENDA, PLEASE LEAVE IT BEHIND AFTER THE MEETING.
IT WILL BE COLLECTED FOR RECYCLING.***

HARROW COUNCIL

PENSION FUND INVESTMENTS PANEL

MONDAY 3 JULY 2006

AGENDA - PART I

1. **Appointment of Chairman:**

To note the appointment of Councillor David Ashton at the Special Meeting of Licensing and General Purposes on 5 June 2006 as Chair of the Pension Fund Investments Panel for the Municipal Year 2006/2007.

2. **Attendance by Reserve Members:**

To note the attendance at this meeting of any duly appointed Reserve Members.

Reserve Members may attend meetings:-

- (i) to take the place of an ordinary Member for whom they are a reserve;
- (ii) where the ordinary Member will be absent for the whole of the meeting; and
- (iii) the meeting notes at the start of the meeting at the item 'Reserves' that the Reserve Member is or will be attending as a reserve;
- (iv) if a Reserve Member whose intention to attend has been noted arrives after the commencement of the meeting, then that Reserve Member can only act as a Member from the start of the next item of business on the agenda after his/her arrival.

3. **Declarations of Interest:**

To receive declarations of personal or prejudicial interests, arising from business to be transacted at this meeting, from:

- (a) all Members of the Committee, Sub Committee, Panel or Forum;
- (b) all other Members present in any part of the room or chamber.

4. **Arrangement of Agenda:**

To consider whether any of the items listed on the agenda should be considered with the press and public excluded on the grounds that it is thought likely, in view of the nature of the business to be transacted, that there would be disclosure of confidential information in breach of an obligation of confidence or of exempt information as defined in the Local Government (Access to Information) Act 1985.

5. **Appointment of Vice-Chairman:**

To appoint a Vice-Chairman of the Pension Fund Investments Panel for the Municipal Year 2006/2007.

6. **Minutes:**

That the minutes of the meeting held on 20 March 2006, having been circulated, be taken as read and signed as a correct record.

- Enc. 7. **Terms of Reference of the Pension Fund Investments Panel:** (Pages 1 - 2)
To note the terms of reference of the Pension Fund Investments Panel.
8. **Public Questions:**
To receive questions (if any) from local residents or organisations under the provisions of Committee Procedure Rule 15 (Part 4B of the Constitution).
9. **Petitions:**
To receive petitions (if any) submitted by members of the public/Councillors under the provisions of Committee Procedure Rule 15 (Part 4B of the Constitution).
10. **Deputations:**
To receive deputations (if any) under the provisions of Committee Procedure Rule 16 (Part 4B of the Constitution).
- Enc. 11. **Merrill Lynch Property Fund of Funds:** (Pages 3 - 12)
Report of the Director of Financial and Business Strategy.
- Enc. 12. **Update on Tenders for Private Equity and Currency Management:**
(Pages 13 - 16)
Report of the Director of Financial and Business Strategy.
13. **Any Other Urgent Business:**
Which cannot otherwise be dealt with.

AGENDA - PART II

14. **Fund Managers' Presentations:**
The purpose of this item is to receive a presentation from the Fund Managers, UBS and Merrill Lynch Investments Managers on their fixed interest and property portfolios.
- Enc. 15. **Performance of Fund Managers 2005/06:** (Pages 17 - 36)
Report of the Director of Financial and Business Strategy.

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PENSION FUND INVESTMENTS PANEL – TERMS OF REFERENCE

The Pension Fund Investments Panel has the following powers and duties:

- (a) To administer all matters concerning the Council's pension investments in accordance with the law and Council policy;
- (b) To establish a strategy for the disposition of the pension investment portfolio;
- (c) To determine the managers' delegation of powers of management of the fund.

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| | |
|----------------------|---|
| Meeting: | Pension Fund Investments Panel |
| Date: | 3 July 2006 |
| Subject: | Merrill Lynch Fund of Funds |
| Responsible Officer: | Myfanwy Barrett (Director of Financial and Business Strategy) |
| Contact Officer: | Myfanwy Barrett |
| Portfolio Holder: | Cllr D. Ashton (Business Development) |
| Key Decision: | No |
| Status: | Part 1 |

The Panel is will be receiving a presentation by Merrill Lynch UK on their Property Fund of Funds and the relevant presentation is attached together with a Fact Sheet from MLUK

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Merrill Lynch UK Property Fund of Funds

As at 7 April 2006

Overview and Investment Advisor's Report

Market Overview

The UK commercial property market has continued to produce strong returns into 2006 with a total return of 4.5% for Q1 as measured by the IPD Monthly Index. On a 12 month basis the total return is 20.9%, ahead of the 19.1% annual return for 2005, and the highest twelve-month return since October 1994. The average initial yield for all property has fallen to 5.00% from 5.16% at the end of 2005, its lowest level on record. This together with modest rental value growth has boosted capital values.

At sector level, offices are leading the way with a quarterly total return of 5.5%, over 100 basis points ahead of retail and industrials. The Central London office market is now the best performing segment of the UK market, ahead of retail warehousing which has been ranked top for a number of years. Employment growth in financial and business services in London together with limited supply has initiated some modest rental value growth while investor demand appears to be as strong as ever, which has continued to push yields down.

MLIM is expecting returns to be just over 15% for 2006 and single digit thereafter as yield compression eases significantly across all sectors and the financial arbitrage to swap rates narrows. Offices should be the strongest sector over the next five years, while retail and industrial are anticipated to lag the market, as retailers suffer from price deflation and weak consumer spending and industrials suffer from current high availability and fairly weak demand. In its favour, the industrial sector does still offer the highest yield across the sectors providing a solid defensive income return.

Performance and Fund Structure

MLUKPFoF achieved a total return of 4.5% for the first quarter of 2006 against the benchmark return of 4.7%. Over the 12 month period to March 2006 the Fund has returned 19.3% against the benchmark return of 21.0%, while since inception (18 August 2004) the Fund's total return now stands at 29.2% (source: MLIM Internal).

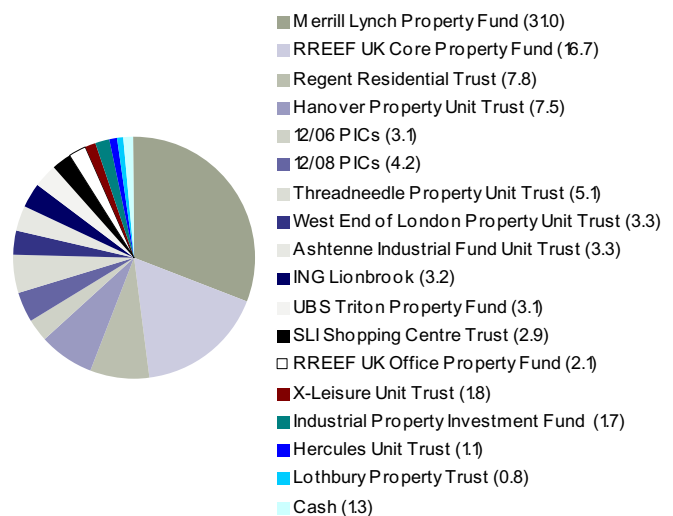
A number of the Fund's holdings have performed particularly well during the quarter. Of particular note are the two office funds, WELPUT and the RREEF Office Property Fund, and the two specialist industrial funds, the Ashtenne Industrial Fund and the Industrial Property Investment Fund. These four funds together account for 10.4% of the net asset value of the Fund at the end of Q1 2006, and each delivered quarterly total returns in excess of 6.5%.

The Fund is well diversified and currently comprises 15 individual fund holdings of which seven are designated as core funds accounting for 67.3% by value and eight are specialist funds accounting for 24.1% of net asset value. The Fund also holds two Property Index Certificates representing 8.7% of net asset value. At the end of Q1 2006 the Fund's core-satellite weightings were 75% and 25% respectively. The direct cash balance at the end of the quarter was £1.8 million, equivalent to just 1.3% of net asset value.

Fund Structure

| | Fund NAV (£m) | Value of Holding (£m) | Est. Historic Net Yield (%) |
|-------------------------------------|-----------------|-----------------------|-----------------------------|
| Merrill Lynch Property Fund | 1,881.3 | 43.2 | 3.4 |
| RREEF UK Core Property Fund | 1,098.2 | 23.3 | 3.7 |
| Regent Residential Trust | 92.2 | 10.8 | 3.2 |
| Hanover Property Unit Trust | 480.3 | 10.5 | 4.7 |
| PICs (12/06 & 12/08) | | 10.3 | 5.5* |
| Threadneedle Property Unit Trust | 322.6 | 7.0 | 5.3 |
| WELPUT | 382.9 | 4.7 | 2.1 |
| Ashtenne Industrial Fund Unit Trust | 545.9 | 4.6 | 6.9 |
| ING Lionbrook Property Fund | 678.0 | 4.4 | 3.6 |
| UBS Triton Property Fund | 2,125.4 | 4.2 | 4.1 |
| SLI Shopping Centre Trust | 1,725.7 | 4.1 | 3.5 |
| RREEF UK Office Property Fund | 337.8 | 3.0 | 4.5 |
| X-Leisure Unit Trust | 319.3 | 2.5 | 4.8 |
| IPIF | 737.4 | 2.4 | 5.4 |
| Hercules Unit Trust | 1,839.0 | 1.6 | 1.7 |
| Lothbury Property Trust | 480.5 | 1.1 | 3.1 |
| Cash | | 1.8 | 4.5 |
| Total | 13,046.5 | 139.5 | 4.0 |

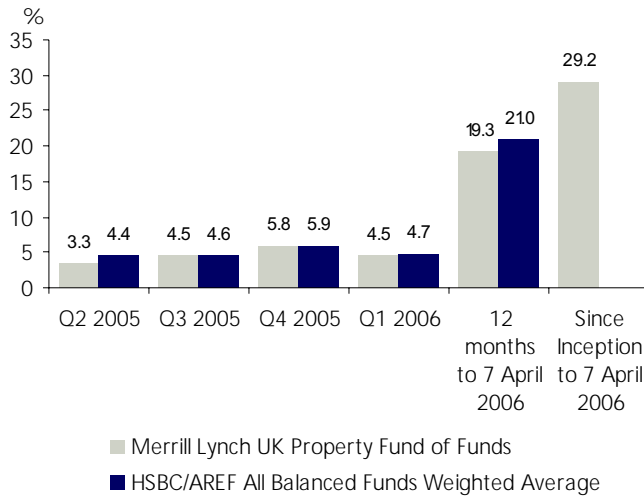
Percentage of Total Fund Value (%)



Source: HSBC/ AREF Pooled Property Fund Indices Q1 2006/ IPD/MLIM Internal
 * IPD Annual Index income return for 2005 less 0.15% management fee.

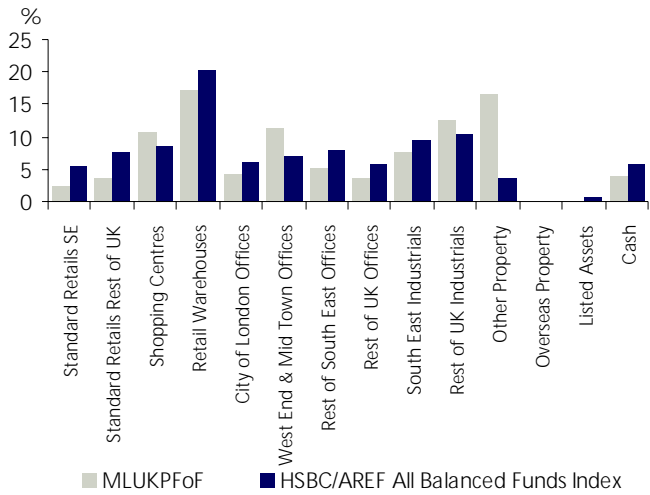
Performance and Fund Characteristics

Merrill Lynch UK Property Fund of Funds Performance to 7 April 2006

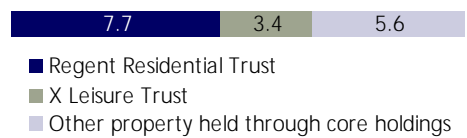


Source: HSBC/AREF Pooled Property Fund Indices, MLIM Internal.
 (MLUKPFoF performance is net of all fees and charges, gross paid income reinvested.
 HSBC/AREF Pooled Property Fund Indices Benchmark performance is net of all fees and charges, gross declared income reinvested).
 Inception date 18 August 2004. Past performance is not a guide to future performance.

Merrill Lynch UK Property Fund of Funds Sector Spread as at 7 April 2006 (Gross Asset Value)



Breakdown of Other Property (%)



Source: HSBC/AREF Pooled Property Fund Indices, MLIM Internal

Activity

During the first quarter, the Fund made a net investment of £11.6 million into five funds: the Standard Life Shopping Centre Trust, the RREEF UK Office Property Fund, the Hercules Unit Trust, the Lothbury Property Trust and the ING Lionbrook Property Fund. These investments were in line with the investment advisor's strategy of accessing prime shopping centres, increasing allocations to London offices and retail warehouses and increasing the number of core funds. The Fund now has secure positions in a range of core funds which ultimately increases the Fund's ability to be successful in subscribing to new units when these vehicles open to investment.

Overall MLUKPFoF has a below-average retail exposure with investments concentrated in retail warehouses and shopping centres. At sector level, office weighting is slightly below average, with a favourable bias towards the Central London office market where weighting is above that of the benchmark. The Fund's industrial allocation remains in line with the benchmark. The other property segment comprises the Regent Residential Fund and leisure assets held in the X-Leisure Unit Trust and through our collection of balanced core funds. While elements of the retail sector are suffering, consumers are still spending on leisure activities and the investment advisor is comfortable with the current overweight position to the leisure sector.

Q1 Transactions

| Date | Fund | £m | Rationale |
|--------|-------------------------------------|-----|---|
| Jan-06 | Standard Life Shopping Centre Trust | 4.0 | Sector allocation requirement |
| | RREEF UK Office Property Fund | 3.0 | Sector allocation requirement |
| Feb-06 | Lothbury Property Trust | 1.0 | Swap for MLPF Units – maintaining core exposure |
| | The Hercules Unit Trust | 1.6 | and fulfilling sector allocation requirement |
| Mar-06 | ING Lionbrook Property Fund | 4.6 | Building diversified core holdings |

Contact Us

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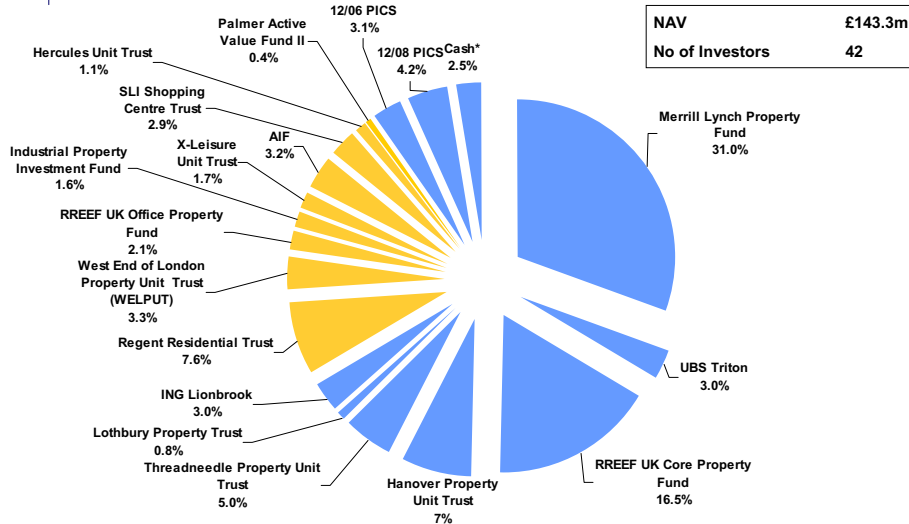
Merrill Lynch UK Property Fund of Funds

MLUKPFoF – Philosophy & Approach

- Research driven process
 - Seeks to avoid the “mistakes”
 - Risk adjusted “active bets”
 - Manager diversification neutralises style bias
 - Performance not reliant on active switching
 - Qualitative manager appraisal
- Leveraging MLIM’s “Alternative” skills
 - Complementary to Merrill Lynch Property Fund
 - MLIM real estate track record in indirect products
 - Utilise MLIM real estate market expertise

MLUKPFoF Portfolio Composition as at 8 May 2006

Portfolio holdings as percentage of NAV

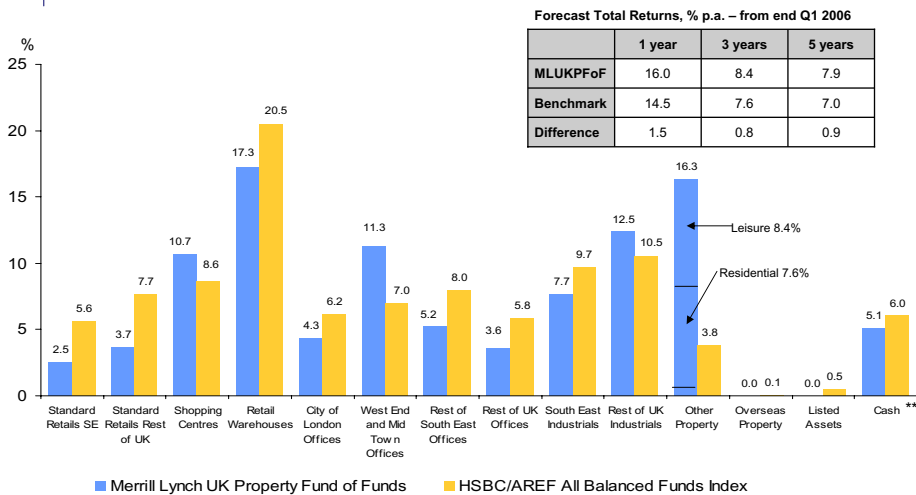


NAV £143.3m
No of Investors 42

Source: MLIM Internal (including transactions post pricing date)
* Direct Cash holding only and does not include underlying exposure to cash in Pooled Vehicles.

MLUKPFoF – Sector Spread as at 8 May 2006

(portfolio weightings per cent gross value)



Forecast Total Returns, % p.a. – from end Q1 2006

| | 1 year | 3 years | 5 years |
|------------|--------|---------|---------|
| MLUKPFoF | 16.0 | 8.4 | 7.9 |
| Benchmark | 14.5 | 7.6 | 7.0 |
| Difference | 1.5 | 0.8 | 0.9 |

Source: HSBC/AREF Pooled Property Fund Indices. Association of Real Estate Funds, AREF (Formerly APUT) ** Cash position includes indirect exposure through underlying holdings. No assurance or guarantee can be given that the forecast returns will be achieved.

MLUKPFoF – Investment Process in Action



180-183 Fleet Street, London EC4

Source: RREEF, MLIM Internal

- Tactical requirement to increase weighting to Central London Offices
- Specialist fund acquisition to enhance balanced managers “slower” re-weighting
- RREEF UK Office Property Fund
 - Specialist office play
 - High & rising Central London Office exposure
 - Well regarded Manager
 - Exit liquidity
- Acquired £3 million of units in December 2005
- 1.8% out-performance in Q1 (6.5% vs 4.7%)

MLUKPFoF – Transaction Activity in Q1 2006

| Date | Fund | £m | Rationale |
|---|-------------------------------------|-----|--|
| Jan 06 | Standard Life Shopping Centre Trust | 4.0 | Sector allocation requirement |
| Feb 06 | Lothbury Property Trust | 1.0 | Swap for MLPF Units – maintaining core exposure and fulfilling sector allocation requirement |
| | Hercules Unit Trust | 1.6 | |
| April 06 | ING Lionbrook | 4.6 | Building diversified core holdings |
| 25 April | Palmer Active Value Fund II | 5.0 | Satellite diversified opportunistic play 12% of £5m commitment invested at fund close |
| Total investment activity equivalent to 12.4% of Fund January 2006 NAV | | | |

- Direct cash balance as at 7 April was 1.3%
- Direct cash balance as at 8 May is 2.5% (unit creation)

MLUKPFoF – Investment Capacity and Pipeline

- MLUKPFoF has capacity and a strong pipeline
- The Plan's proposed £40 million allocation could be invested over approximately 2 quarters
- As the Plan's bonds are sold, the proceeds could be invested on a phased basis
- Communication is key

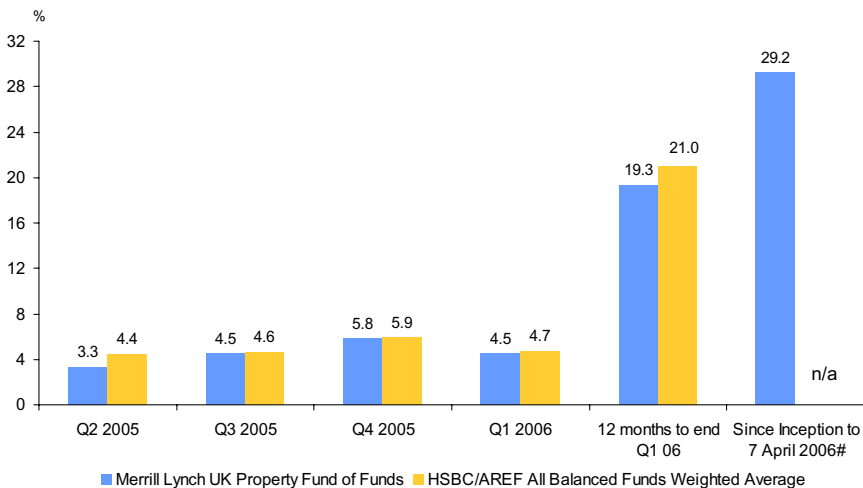
| Immediate Plans and / or Existing Commitments | | |
|---|---------------|---|
| Fund | £m | Rationale |
| Palmer Active Value Fund II | 4.4 | Satellite diversified opportunistic play Drawdown of £5 commitment |
| Regional Hotel Fund | 7.5 (minimum) | Income play |
| Current Opportunities (Selection) | | |
| Core Funds | | Specialist Funds |
| ING Lionbrook Property Fund | | Cordea Savills Student Accommodation Fund |
| Lothbury Property Trust | | The Industrial Trust |
| UBS Triton Property Fund | | The Junction |
| RREEF UK Core Property Fund | | Hercules |
| Hanover Property Unit Trust | | ING Central London Fund |
| Threadneedle Property Unit Trust | | APIA Regional Office Fund |
| Protego UK Property Fund | | RREEF UK Office Property Fund |

London Borough of Harrow Pension Fund 05.06

 Merrill Lynch Investment Managers

7

MLUKPFoF – Total Return on a NAV Basis per cent to 7 April 2006 (net of all fees and charges)



Source: MLIM Internal MLUKPFoF performance is net of all fees and charges, gross paid income reinvested).
HSBC/AREF Pooled Property Fund Indices (Benchmark performance is net of all fees and charges, gross declared income reinvested).
Inception date 18 August 2004. Past performance is not a guide to future performance.

London Borough of Harrow Pension Fund 05.06

 Merrill Lynch Investment Managers

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9. Subject to the express requirements of any client-specific investment management agreement or provisions relating to the management of a fund, we will not provide notice of any changes to our personnel, structure, policies, process, objectives or, without limitation, any other matter contained in this document.

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Any investment objective and performance benchmark will be treated as a target only and should not be considered as an assurance or guarantee of performance of the Merrill Lynch Property Fund or any part of it.

A new benchmark, the HSBC/APUT All Balanced Funds Weighted Average Index was adopted for MLPF from 1 January 2004 reporting performance on a NAV to NAV basis. Returns have been rebased accordingly.

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| | |
|----------------------|---|
| Meeting: | Pension Fund Investments Panel |
| Date: | 3 July 2006 |
| Subject: | Update on Tenders for Private Equity and Currency |
| Responsible Officer: | Myfanwy Barrett (Director of Financial and Business Strategy) |
| Contact Officer: | Myfanwy Barrett |
| Portfolio Holder: | Cllr D. Ashton (Business Development) |
| Key Decision: | No |
| Status: | Part 1 |

Section 1: Summary

Decision Required

The Panel is asked to note the report

Reason for report

To provide the Panel with an update on the tender process on Private Equity and Active Currency Management as part of its responsibilities for Pension Fund investments.

Benefits

The use of Private Equity and Currency Management was considered by the Panel at its meeting in March 2006 to be part of the Pension Fund's future investment policy and which would add value to the assets of the Fund.

Cost of Proposals

Should be minimal, however the value of investments may alter over time.

Risks

The risk associated with a change in investment strategy could be a fall in investment values thereby affecting the financial integrity of the Pension Fund.

Implications if recommendations rejected

This report is for information only.

Section 2: Report

Brief History

1. At their meeting of 20 March 2006 the Panel agreed that Active Currency Management and Private Equity be used in the management of the Fund. It was agreed that this change would be actioned by inviting tenders which would be a long term process with Member consideration. An update was requested for the July meeting.

Progress Update

2. Hymans Robertson, the Funds Investment Advisors, were engaged to assist in the tender and evaluation process. Throughout the process Hymans will answer manager questions and liaise with them over the procedure and details of the mandates. They will also provide advice on investment aspects of the Investment Management/Partnership Agreements. The following arrangements are now in process:
 - Issue of OJEU notices for both private equity and currency managers;
 - Assess expressions of interest from managers, prepare long lists for each mandate and recommend managers who should receive a detailed questionnaire;
 - Prepare and send out detailed questionnaires to selected managers;
 - Assess detailed submissions from the managers and prepare reports including a recommended short list of managers to interview for both mandates;
 - Prepare papers for the final manager selection meetings;
 - A programme of meetings have been arranged between the officers and Hymans to review expressions of interest, shortlist for each contract, carry out the final evaluation with Members for each contract, and report the outcome of this process to this Panel at the 13 November 2006 meeting.

Consultation

3. None.

Financial Implications

4. This is a report of the Director of Financial and Business Strategy and deals with financial matters throughout.

Legal Implications

5. The Pension Fund is managed under the Local Government Pension Scheme regulations S1 1995 No 1019. The Trustees of the Pension Fund have a number of common law duties including fidelity and prudence. In addition, the trustees are subject to a statutory duty of care under the Trustee Act 2000 when carrying out their functions.

Equalities Impact

6. No direct implications.

Section 17 Crime and Disorder Act 1998 Considerations

7. None.

Section 3: Supporting Information/ Background Documents

- Appendices: none
- No further information is on deposit in Group Offices, on the web or available for inspection at the meeting.
- Pension Fund Panel meeting of 20 March 2005

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