REPORT FOR: Pension Fund Committee

Date of Meeting:	25th June 2013
Subject:	Infrastructure and Local Investing
Responsible Officer:	Simon George, Director of Finance and Assurance
Exempt:	No
Enclosures:	.Aon Hewitt Report

Section 1 – Summary and Recommendations

Infrastructure and local / impact investing are topical issues and offer the potential for greater diversification of the investment portfolio and some positive local benefit from investing. There are many challenges and the proposal is that a watching brief is maintained for developed proposals in particular the Pension Infrastructure Platform.

Recommendation:

The Panel is invited to agree to monitor future opportunities.

Section 2 – Report

1. This note and the attached Aon Hewitt report address two topical issues – infrastructure and local / impact investing. These were highlighted at the last meeting as 'new opportunities' worthy of a brief discussion.

2. Should the Committee be interested in further developing the issues, a more detailed paper will be developed.

Infrastructure

3. The definition of infrastructure is imprecise but tends to relate to investments that derive their income from the use of physical assets, such as a rental charge. Examples include water utilities, energy and communication transmission, transport facilities (ports, airports, roads and bridges) etc. PFI contracts in which Government pays for use of a hospital or school are also examples. Classic characteristics are a usage related fee, barriers to entry through the costs of developing the assets, potentially fees set by a regulator, inflation linked income and long contracts etc.

4. The characteristics of infrastructure appear ideal for pension schemes, in particular the inflation linked long term income streams and these types of assets are often seen as an alternative to index linked bonds as matching scheme liabilities. Investor interest with infrastructure projects has soared since 2000 with sovereign wealth funds joining pension and insurance funds and many opportunities are already held in specialist funds, somewhat diminishing the attractiveness of the sector.

5. Investments to date have mainly been in large global funds that buy existing in-use assets. Pension schemes have as a whole avoided the risk of investing in new build assets. In particular, the uncertainties of construction cost and the future revenue that will be generated all make new build less appealing than existing assets. Examples of new build investments that incurred a loss include the Channel tunnel (construction cost over-runs) and the M6 toll road (low usage). When Government encourage investment in infrastructure, it tends to be in new build, which is the segment of the market that pension funds have avoided.

6. One response to the Government's wish to see more pension fund investment in infrastructure, is the Pension Infrastructure Platform (PIP) jointly led by the National Association for Pension Funds and Pension Protection Fund, that aims to raise a fund of £2bn to invest in "core infrastructure, and in projects free of construction risk and on an availability basis so as to avoid excessive GDP [usage] risk. Investments will be inflation-linked and the fund is seeking long-term cash returns of RPI +2% to 5%." Although initially the fund is seeking large 'founder' schemes to commit £100 million each, it is planned to open to all schemes. However, the start date has been delayed as details of the proposed government guarantee to protect against construction and usage risk await finalisation.

7. PIP and other similar projects being discussed do offer the possibility of interesting opportunities. It is suggested that if the Committee is primarily interested in UK rather than global infrastructure, that it monitors the

initiatives currently underway rather than investigate the traditional infrastructure fund space.

Local / Impact Investing

8. A potentially much more challenging area is investments that target the local community or possibly help to address Council priorities, while at the same time meeting the income needs of the fund. The term growth investment is also used to highlight the aim of delivering a positive local economic impact.

9. What this actually means in practice is somewhat vague as few examples, even those on the drawing board, exist. In recent months the following initiates have appeared in the press:

   a) Manchester Council and their pension fund are planning to build mixed use housing on land owned by the Council.

   b) Five large Councils in Yorkshire, Merseyside and Manchester have agreed to jointly contribute £250 million to an 'investing for growth initiative'. They are seeking expressions of interest from asset managers. A wide range of investments will be considered and will include those with beneficial social, economic and environmental impact and could include infrastructure, resource management and business development projects.

   c) Strathclyde pension has hired an investment manager to lead a greater focus on local investing.

10. Other than the first example involving housing, no actual investments are known. Harrow's housing team has been examining opportunities for construction of social or affordable housing and a pension fund involvement is one funding opportunity being considered.

11. For these types of opportunities to work, they must meet most of the following conditions:

    - An expectation of market or close to market returns,
    - Some guarantee or mitigation of risk while approaching market level returns,
    - Liquidity which helps reduce perceived risk,
    - Robust measurement and evidence of the returns generated by the investment,
    - Larger sized investment opportunities, for example pooled funds, and
    - Fund managers with a track record.

12. It is suggested that the only realistic approach is in tandem with other London boroughs and involving skilled investment managers. If the panel is interested and wishes to act now the suggested steps are:

    a) Develop an objective on the lines of 9 (b) above,
    b) Identify a Harrow commitment level and a minimum collective fund size,
    c) Approach other London boroughs seeking partners, and

d) Depending on the level of interest determine if the project is deliverable.

13. Harrow is not resourced to drive such a project and we would need support, potentially incurring project feasibility costs. Alternatively, the Committee can monitor opportunities and express interest if suitable ones arise. In reality, this is probably the better approach.

Financial Implications

14. Widening the scope of investments offers the possibility of greater diversification and higher returns. Including non financial factors in the decision making may compromise the long term funding level.

Risk Management Implications

15. Risk included on Directorate risk register? No

16. Separate risk register in place? No

17. Setting risk tolerances and measuring outcomes is central to the strategy.

Equalities implications

18. Was an Equality Impact Assessment carried out? Yes

19. There are no direct equalities implications relating to the pension fund.

Corporate Priorities

20. Corporate Priorities are not applicable to the Pension Fund as it does not have a direct impact on Council resources.

Legal Implications

21. The report has been reviewed by Legal Department and comments received are incorporated into the report.

Section 3 - Statutory Officer Clearance

Name: Simon George Date: 10 June 2013	√	Chief Financial Officer
Name: Matthew Adams Date: 10 June 2013	√	Monitoring Officer

Section 4 - Contact Details and Background Papers

Contact: George Bruce (Treasury and Pension Fund Manager) Tel: 020-8424-1170 / Email: george.bruce@harrow.gov.uk

Background Papers: Papers and training material provided to the PFIP meetings on 12 October 2011, 15 November 2011 and 25 June 2012 and 27 November 2012.

If appropriate, does the report include the following considerations?

1.	Consultation	N/A
2.	Corporate Priorities	N/A