

Pensions Committee

2.00 p.m., Monday, 27 June 2016

Annual Investment Update – Scottish Homes Pension Fund

Item number	5.10
Report number	
Executive/routine	
Wards	All

Executive summary

Over the twelve months to 31 March 2016, the Scottish Homes Pension Fund produced a return of 1.7%. The Fund's estimated funding level (the ratio of assets to liabilities) has increased to 92.3% at 31 March 2016 from 88.8% at the last formal valuation date of 31 March 2014.

Changes to the Fund's asset allocation based on funding level progress were agreed by the Pensions Committee in December 2014. During 2015/16, there were a number of changes to asset allocation reflecting the evolution in the funding level. The equity strategic allocation was increased over the year from 27.5% to 30%.

In March 2016, the results of an investment strategy review were reported to Committee. Committee approved the recommendation that the Executive Director of Resources conclude an updated funding agreement with Scottish Government, in consultation with the Actuary, Investment Strategy Panel and Convener of the Pensions Committee. Further engagement with the Scottish Government is ongoing and progress will be reported to Pensions Committee in due course.

Links

Coalition pledges

Council outcomes [CO26](#)

Single Outcome Agreement

Annual Investment Update – Scottish Homes Pension Fund

Recommendations

- 1.1 That Committee invites the Pension Board to raise any relevant matters or concerns which the Committee should consider.
- 1.2 That the Committee notes the performance, funding update and asset allocation of the Scottish Homes Pension Fund.

Background

- 2.1 The City of Edinburgh Council took over the administration of the deferred and pensioner liabilities of Scottish Homes in July 2005. An agreement between the Scottish Government and the City of Edinburgh Council ('the Guarantee') was put in place in June 2005. The Scottish Government acts as the 'Guarantor' for the Fund liabilities.
- 2.2 The Guarantee and the investment strategy are designed to reduce investment risk as the Fund is closed to new members and the liabilities will mature over the time.
- 2.3 The investment strategy is set at the broad asset class level of equities, bonds and property, which are the key determinants of investment risk and return. The strategy changes the allocation to equities, bonds and property dependent on the development of the actuary's estimate of the funding level.
- 2.4 The Target Funding Level (TFL), as set out in the Guarantee, was 91.5% at 31 March 2014, the date of the last formal actuarial valuation. The actual funding level was below target at this date. Therefore Scottish Government will pay a contribution of £675,000 p.a. from April 2015 to March 2018.
- 2.5 The results of the review of the Scottish Homes Pension Fund investment strategy were reported to Committee in March 2016. Committee approved the recommendation that the Executive Director of Resources concludes an updated funding agreement with Scottish Government, in consultation with the Actuary, Investment Strategy Panel and Convener of the Pensions Committee. Discussions regarding potential changes to the funding agreement have been held with the Scottish Government reviewing options to change the funding approach, including an option where contributions would be determined by fund cash flows rather than funding level. Work is currently ongoing and progress will be reported to Pensions Committee in due course.

- 2.6 Pending further engagement with the Scottish Government, Committee approved a change to the investment strategy in December 2014 whereby the equity and bond allocations are adjusted depending on the funding level in accordance with the following table:

Equity Allocation %	Funding level	Note [1]
35	89.5%	2011 TFL
30	91.5%	2014 TFL
25	93.0%	2017 TFL
20	94.5%	2020 TFL
15	95.5%	2023 TFL
10	96.5%	2026 TFL

[1] TFL: Target Funding Level

- 2.7 The purpose of the report is to provide an update on the investment and funding position of the Scottish Homes Pension Fund to 31 March 2016.
- 2.8 The investment performance of the Fund has a significant impact on the funding level and potentially on the contributions required from the Scottish Government.

Main report

Investment Performance to 31 March 2016

- 3.1 The Fund's investment objectives agreed in December 2013 are:
- Over long-term economic cycles (typically 5 years or more), the achievement of the same return as that generated by the strategic allocation;
 - Over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.
- 3.2 The Fund's annualised performance over the year and longer-term periods is shown in the table below. The Fund has performed broadly in line with its benchmark over all time periods. The slight negative over the last year reflects a small overweight position in equities, which produced a negative return. The Fund's equity and bond assets are currently managed passively.

% per annum	1 Year	5 Years	10 Years
Scottish Homes Pension Fund	+1.7	+9.6	+8.6
Benchmark	+1.9	+9.6	+8.4
Relative	-0.2	0.0	0.2

- 3.3 Over one and five year periods, broad indices of global equities returned -1% and +8% per annum; UK fixed income gilts +3% and +7% per annum; UK index-linked gilts +1% and +7% per annum; and UK property +12% and +10% per annum.

Funding Level and Investment Strategy

- 3.4 The funding level is monitored regularly by the internal team using an on-line system provided by the Fund's actuary. The progression of the estimated funding level since 31 March 2014 is shown below.



Source: Hymans Robertson

- 3.5 The funding level at 31 March 2016 was estimated to be 92.3%, very similar to the estimate of 92.8% at 31 March 2015. The last point on the graph above is the estimate at 13 May 2016, which is 92.7%.
- 3.6 The actuary's estimate of the funding level affects the asset allocation of the Fund. As a result of changes to interest rates and asset prices affecting the funding level over the year to 31 March 2016, the strategic equity allocation was first decreased from 27.5% to 25% and then increased in two stages from 25% to 30%. The bond allocation adjusted in the opposite direction when these changes were made. The changes in investment strategy over 2015/16 are summarised in the table below:

Scottish Homes Pension Fund Evolution of Strategy 2015/16				
Asset Class	Strategy Allocation 31 March 2015 %	Strategy Allocation 30 April 2015 %	Strategy Allocation 14 Oct 2015 %	Strategy Allocation 15 Feb 2016 %
Equities	27.5	25	27.5	30
Bonds	67.5	70	67.5	65
Property	5	5	5	5
TOTAL	100	100	100	100

- 3.7 Over the year, assets are withdrawn from the investment manager(s) to pay pensions. The amount withdrawn over 2015/16 was £6.2m.
- 3.8 The Fund's actual allocation to each manager and asset class at 31 March 2016 is shown in the table below, together with the strategic allocation at 31 March 2016.

Asset Class	Manager	Actual Allocation 31 March 2016 %	Strategy Allocation 31 March 2016 %
Equities			
UK	State Street	6.8	6.8
US	State Street	9.2	9.1
Europe Ex-UK	State Street	6.0	6.0
Asia Pacific	State Street	2.4	2.4
Japan	State Street	3.3	3.3
Emerging Markets	State Street	2.5	2.4
Subtotal		30.2	30.0
Bonds			
Index-linked gilts	In-house	40.3	41.0
Index-linked gilts	State Street	10.9	10.9
Fixed income gilts	State Street	13.3	13.1
Subtotal		64.5	65.0
Property			
Property	Schroders	5.3	5.0
Subtotal		5.3	5.0
Cash		0.0	0.0
TOTAL		100.0	100.0

Conclusions

- 3.9 The absolute performance of Scottish Homes Pension Fund is positive over the 12 month period to 31 March 2016 with a return of 1.7%. Five year performance is 9.6% per annum.
- 3.10 The returns for Scottish Homes Pension Fund since inception to 31 March 2016 and over the last five years are in line with the benchmark, and over one year the return is slightly behind the benchmark.
- 3.11 Funding levels are monitored by the Fund regularly. The estimated actual funding level has improved over the year and was 92.3% at 31 March 2016, which is broadly in-line with the current target funding level.
- 3.12 Work is ongoing to update the funding agreement in consultation with the Scottish Government. Progress will be reported to Committee in due course.

Measures of success

- 4.1 The City of Edinburgh Council's primary requirement is to ensure appropriate funding arrangements for the Scottish Homes Pension Fund to ensure there are, or will be, sufficient assets to pay the liabilities.

- 4.2 The investment performance of the fund is crucial to the achievement of the required investment return which impacts on the funding level and employer contributions. The objectives for the investments are:
- Over long-term economic cycles (typically 5 years or more), the achievement of the same return as that generated by the strategic allocation;
 - Over shorter periods, the Fund should perform better than the strategic allocation if markets fall significantly.

Financial impact

- 5.1 This report details the investment performance and funding level of the Scottish Homes Pension Fund. The investment performance has a significant impact on the funding level and potentially on the contributions required from the Scottish Government.
- 5.2 The financial impact for the Scottish Government is a key consideration. The proposed change to the funding guarantee could provide greater certainty for the contributions required from the Scottish Government, but with a more volatile funding level.

Risk, policy, compliance and governance impact

- 6.1 Investment strategy is a key determinant of funding level, risk and volatility of employer contribution rates.
- 6.2 There is no governance impact as a result of this report. Committee delegates the implementation of investment strategy to the Executive Director of Resources, who takes advice from the Investment Strategy Panel. The Panel is an important element of the governance of the pension fund investments.

Equalities impact

- 7.1 There are no equalities implications as a result of this report.

Sustainability impact

- 8.1 The Statement of Investment Principles (covered elsewhere on the agenda) sets out the Funds' approach as responsible asset owners, and details how voting, engagement and other Environmental, Social and Governance activity will be undertaken. Compliance with it is expected to contribute to the sustainability of the Funds' investments.

Consultation and engagement

- 9.1 The Pension Board, comprising employer and member representatives, is integral to the governance of the Funds.
- 9.2 Regular updates are provided to Scottish Government with ongoing liaison and consultation.

Background reading/external references

None

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Links

Coalition pledges

Council outcomes CO26 - The Council engages with stakeholders and works in partnerships to improve services and deliver agreed

Single Outcome Agreement

Appendices None