Putting the Community First

BARNET LONDON BOROUGH

MEETING **PENSION FUND COMMITTEE**
DATE AND TIME **MONDAY 21 MARCH 2011** **AT 7.00PM**
VENUE **HENDON TOWN HALL, THE BURROUGHS, HENDON NW4 4BG**

TO: MEMBERS OF THE COMMITTEE (Quorum 3)

Chairman: Councillor John Marshall
Vice Chairman: Councillor Mark Shooter

Councillors:

Alex Brodkin	Geof Cooke	Rowan Turner	Susette Palmer

Substitute Members:

Jack Cohen	Anthony Finn	Andrew Harper	Geoff Johnson
Monroe Palmer	Ansuya Sodha		

You are requested to attend the above meeting for which an agenda is attached.
Aysen Giritli – Democratic Services Manager

Democratic Services contact: Maria Lugangira 020 83592761

Media Relations contact: Chris Palmer 020 8359 7408

To view agenda papers on the website: http://committeepapers.barnet.gov.uk/democracy

CORPORATE GOVERNANCE DIRECTORATE

ORDER OF BUSINESS

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12.	MOTION TO EXCLUDE THE PRESS AND PUBLIC:- That under Section 100A (4) of the Local Government Act 1972 the public be excluded from the meeting for the following item of business on the grounds that they involve the likely disclosure of exempt information as defined in paragraph 3 of Part 1 of Schedule 12A of the Act (as amended): EXEMPT AGENDA — Exemption category 3	
X2.	ANY OTHER EXEMPT ITEMS THAT THE CHAIRMAN DECIDES ARE URGENT	

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AGENDA ITEM: 6 Pages nos: 1 - 7

Meeting	Pensions Fund Committee
Date	21 March 2011
Subject	**One Barnet Programme – Establishing a Local Authority Trading Company for Adult Social Care and Barnet Homes**
Report of	Deputy Chief Executive
Summary	This report informs the Committee on the business case for the creation of a Local Authority Trading Company (LATC) and the pension implications associated with this. It seeks to inform PFC of the proposed Designated Body status for the LATC to support the finalisation of the business case for consideration by Cabinet Resources Committee on the 21st of April 2011.
Officer Contributors	Kate Kennally, Director of Adult Social Services and Health Richard Harrison, Project Manager
Status (public or exempt)	Public
Wards affected	All
Enclosures	Appendix A – LATC Corporate Structure Considerations
For decision by	Pension Fund Committee
Function of	Council
Reason for urgency / exemption from call-in	Not applicable

Contact for further information: Kate Kennally, Director of Adult Social Services and Health, 020 8359 4808.

1. RECOMMENDATIONS

1.1 That the Pensions Fund Committee note the proposal to establish a Local Authority Trading Company (LATC) incorporating Barnet Homes for the transfer of Adult Social Services in house provision and staff.

1.2 That the Pensions Fund Committee note that it is proposed the LATC is 100% owned by the council and further agreement will be sought from CRC that should the LATC enter financial difficulty, staff will transfer back to the council.

1.3 That the Pension Fund Committee note the Designated Body Status proposed for the LATC.

1.4 That the Pension Fund Committee approve in principle Admission Body Status in the event the LATC does not meet the Designated Body Status criteria.

2. RELEVANT PREVIOUS DECISIONS

2.1 The Council views Barnet Homes as a potential vehicle for providing additional services on its' behalf, as well as extending its role as a provider of housing related services. The Housing Strategy was agreed by Cabinet on 12 April 2010 (decision item 8), and we will explore options for progressing this through the One Barnet programme.

2.2 The One Barnet Scrutiny panel considered a presentation outlining the key points of the options appraisal on 11 August 2010 (decision item 10). The Panel supported the option for Adult Social Services to be transferred to a Local Authority Trading Company however they were wanted the long-term future of Barnet Homes be carefully assessed when exploring options for establishing a Local Authority Trading Company which incorporated Barnet Homes.

2.3 On 29 November 2010, Cabinet approved the initiation of the development of a full business case (decision item 8), to support the findings of the high level options appraisal, which recommended the transfer of Adult Social Services in house provision and staff to a newly established Local Authority Trading Company (LATC) and, subject to legal constraint, incorporating Barnet Homes. Cabinet requested that the report be brought to Cabinet on the viability of the recommendation upon completion of the full business case.

3. CORPORATE PRIORITIES AND POLICY CONSIDERATIONS

3.1 The proposals to establish a Local Authority Trading Company form part of the One Barnet programme and supports the achievement of the Corporate Plan objective of 'Better Services with Less Money' through establishing alternative service delivery bodies who are better placed to respond to changing market conditions. As the workforce of the Council changes it is necessary to ensure that the integrity of the Pension Fund is maintained and that that staff transferring out of the Council are offered the opportunity to remain within the Local Government Pension Scheme (LGPS) or join a pension scheme that provides benefits certified by the Government Actuary's Department (GAD) as being broadly comparable to those benefits provided by the public sector scheme in which the transferring employees formerly participated.

3.2 The proposal to establish a Local Authority Trading Company to manage in-house adult social care services supports the One Barnet objective of "a new relationship with citizens" and the corporate plan priority of 'Sharing Opportunities and Sharing Responsibilities.' This change will promote choice and independence for residents as service users will be able to purchase services currently managed by the Council with a Direct Payment.

3.3 In turn this will leave the council free to focus on becoming a commissioner of Adult Social Services as the core business of the authority in order to ensure a relentless drive for efficiency with the services through commissioning arrangements.

4. RISK MANAGEMENT ISSUES

4.1 The ongoing viability of the pension fund is dependent on maximising pension fund membership. All scheduled/designated or admission bodies are subject to reviews and actuarial assessments to ensure compliance with Regulations and the maintenance of appropriate employer contribution levels in order to mitigate against any risk to the financial viability of the pension fund.

4.2 Should there be a need for the LATC staff to return in-house, as a designated body any pension fund deficit that may be incurred will rest with the Pension Fund. If transferee admission body status is awarded to the LATC any pension fund deficit will remain with the LATC. Any additional early retirement costs on the pension fund arising from the LATC's insolvency will be offset against the indemnity bond, if a bond is in place.

4.3 The LGPS provides for enhanced benefits on compulsory early retirement or redundancy. Early retirements (especially on enhanced terms) require the employer to pay additional contributions, to avoid putting an actuarial strain on the fund. An insolvent organisation is unlikely to be able to pay such additional contributions. In recognition of this, for a transferee admission body, the LGPS Administration Regulations requires the Council to assess, on actuarial advice, whether it is necessary for a LATC seeking admission body status to put in place a third-party bond or indemnity with a bank or insurance company to protect against the risk of insolvency during the life of the admission agreement. Under this arrangement, the issuer of the bond guarantees the payment of all or part of the admission body's liabilities to the relevant LGPS fund should it become insolvent and unable to meet the liabilities itself. Although the Council must assess whether a bond or indemnity is needed, there is no requirement for a bond to be in place as a condition for LGPS admission, unless the level of risk identified is such as to require it.

4.4 As part of the development of the business case for consideration by CRC on the 21st of April 2011, questions have been raised by both Barnet Homes staff and Adult Social Care staff and the Trade Unions about whether the establishment of an LATC will affect Barnet Homes scheduled body status and whether adult social care staff will be able to remain in LGPS. This paper seeks comments and views from the Pension Fund Committee in order to be able to complete the development of the business case which will set out a proposed governance structure for the LATC.

5. EQUALITIES AND DIVERSITY ISSUES

5.1 An equalities impact assessment has been conducted for the project. The impact was 'neutral'. By protecting the pension fund for all staff TUPE transferred to the LATC this will contribute to providing best value services for all of Barnet's communities.

6. USE OF RESOURCES IMPLICATIONS (Finance, Procurement, Performance & Value for Money, Staffing, IT, Property, Sustainability)

6.1 To be able to join the LGPS, an employee must be employed by an employer who participates in the LGPS. There are four types of Employer who are able to participate.

- Scheduled Body
  This is a statutorily defined body within Part 1 of Schedule 2 of the LGPS Administration Regulations and has a statutory obligation to participate in the LGPS. A London Borough Council is one such employer.

- Designated Body
  This is a statutorily defined body within Part 2 of schedule 2 of the LGPS Administration Regulations and it has the power to designate which of its employees may join the LGPS. A company under the control of a body listed in Part 1 of Schedule 2 is one such employer (The LATC under the control of Barnet Council)

- Transferee Admission Body
  This is a body that provides a service of a Scheme Employer by means of a contract and satisfies the requirement of Regulations 6 of the of the LGPS Admissions Agreement. This body can be admitted to the Barnet Pension fund by an admissions agreement approved by the Committee. The Admitted Body may be required to provide an Indemnity Bond as determined by the pension scheme actuary.

- Community Admission Body
  This is a body that can be a company under the control of a body listed in Part 1 of Schedule 2 (other than a local authority). The LATC under the control of a housing arms length management organisation would meet this test.

6.2 The designated or admission body status will ensure the continuing local authority membership for the transferring staff and the continuing viability of the Pension Fund.

6.3 As the employees are due to be transferred from the London Borough of Barnet to a LATC, the Pension Fund will be in receipt of appropriate employer and employee contributions to cover the liability associated with the transferring staff.

7. LEGAL ISSUES

7.1 The pension scheme regulations govern whether the LATC can become a schedule body, a designated body or an admission body. The LATC would need to satisfy a "control" test set out under legislation. The "control" test for designated body status is met in any of the following four ways. These are where the LATC is a subsidiary of the council, or where the council can control the majority of votes at LATC meetings, or where the council can appoint or remove the majority of directors of the LATC. Where the LATC is a subsidiary of another company that the council controls the test is also met. The proposed 100% ownership of the LATC by the council would satisfy the "control" test for designated body status.

7.2 Should the proposed ownership position of the council change so that the "control" test under paragraph 7.1 cannot be met then the LATC can seek admission to the Pension Fund as an admission body. Once the level of control that Barnet Council will have over the LATC has been established, the pension fund status of the LATC fund will be determined as either a designated body or an admitted body. This will be reported to the next Pension Fund Committee.

8. CONSTITUTIONAL POWERS

8.1 Constitution – Part 3 Responsibility for Functions – Section 2 – Responsibility for Council Functions delegated to the Pension Fund Committee, as set out in the Pension Fund Governance Compliance Statement.

9. BACKGROUND INFORMATION

9.1 Since 2007 work has been undertaken to prepare the Adult Social Care in house provider services for transfer to an arms length organisation. To build on the work conducted, a High Level Options Appraisal was commissioned by the council in April 2010 to consider the future options for the Adults In-House Service provision as a part of the One Barnet Programme. Care and Health Solutions were appointed to undertake the options appraisal because of their track record and experience of transferring social care provider services into new delivery vehicles in response to the personalisation agenda, most notably in Essex with the creation of Essex Cares. The options identified were:

- Closure and the non provision or reprovision of service
- Remain In-House
- Tender (or trade sale)
- Social Enterprise
- Local Authority Trading Company (LATC)
- Local Authority Trading Company incorporating the LBB Arms Length Management Organisation (Barnet Homes)
- Joint venture Company (with other independent organisations or other partners)

9.2 The recommended option was a Local Authority Trading Company incorporating the LBB Arms Length Management Organisation (Barnet Homes). The proposed entity will be 100% council owned to ensure the council remained in control of the service. This option also creates an opportunity to generate savings in line with the MTFS relating to reduced back office costs building on the existing Barnet Homes infrastructure. Cabinet agreed to the initiation of a full business case on 29 November 2011 to further build the case for change.

9.3 The aim of the proposal to implement a Local Authority Trading Company (LATC) is a strategic fit with the personalisation agenda to roll out personal budgets and direct payments as identified as an objective in the Corporate Plan.

9.4 A number of structures for the LATC have been explored. These are set out in appendix A. The proposed structure will be presented as part of the full business case to CRC on 21 April 2011 for approval to proceed to implementation. CRC approval will confirm the proposed structure. Further analysis will be undertaken to confirm the level of control to report back to the Pensions Fund Committee in June 2011.

10. LIST OF BACKGROUND PAPERS

10.1 None.

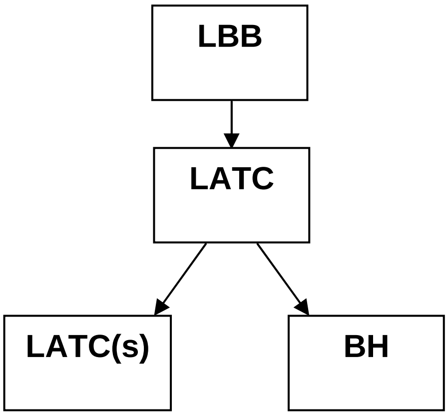
Legal – PJ
CFO – MC

Appendix A – LATC CORPORATE STRUCTURE CONSIDERATIONS

1. Proposed Corporate Structure

Drawing on legal advice commissioned by LBB and provided by Trowers and Hamlins LLP (Situation Report, December 2010), subject to further tax advice it will be recommended to CRC that the company is structured as follows:

1.1 Structure 1 (Proposed Option)



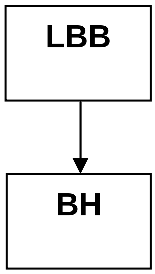
1.1.1 The structure illustrated places a new company at the head of a wider corporate structure. This company will be the trading company. This changes Barnet Homes from a wholly owned company to an operating subsidiary.

A new Board for the LATC holding company will need to be formed, comprising membership of both Barnet Homes and the Adults Social Care LATC. This is to ensure both Housing Management and Adult Social Care representation at parent company level. This Board will be focused on the commercial aspects of the LATC, recommended to meet quarterly, and will hold the subsidiary companies account for delivery of the business plan.

There will be further work to determine the exact membership of the above mentioned boards. This work will be conducted during the Transition phase of the project.

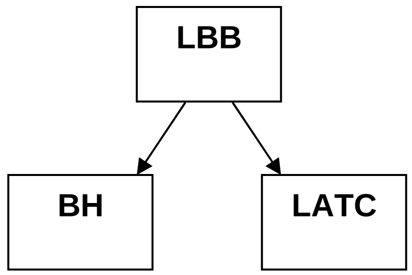
Alternative Structures Considered

2.1 Structure 2



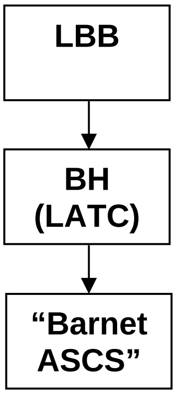
2.1.1 Structure 2 uses Barnet Homes as the trading vehicle which incorporates the Adults Social Services in scope.

Structure 3



2.1.2 This structure involves a separate LATC being formed. Barnet Homes continues unaffected.

2.2 Structure 4



2.2.1 This structure meets the Council objectives to integrate the Adult Social Care Service (ASCS) with Barnet Homes, but unlike structure 2, it provides for a specific subsidiary to be set up for delivery of those services.

3 All the above structural options assume 100% ownership by the council.

AGENDA ITEM: 7 Page nos: 8 - 24

Meeting	Pension Fund Committee
Date	21 March 2011
Subject	**Property Portfolio**
Report of	Deputy Chief Executive
Summary	This report asks the Committee to note the recommendations regarding the property portfolio and agree to liquidate the property portfolio.

Officer Contributors	John Hooton, Assistant Director of Strategic Finance Karen Bannister, Interim Treasury Manager
Status (public or exempt)	Public
Wards affected	None
Enclosures	Appendix A – Property Investments
For decision by	Pension Fund Committee
Function of	Council
Reason for urgency / exemption from call-in (if appropriate)	Not applicable

Contact for further information: Karen Bannister – Treasury Manager Tel: 0208 359 7119

1. RECOMMENDATIONS

1.1 That the Committee note the recommendations and agree to liquidate the property portfolio.

1.2 That the Committee delegate to liquidation of property portfolio to the Deputy Chief Executive.

2. RELEVANT PREVIOUS DECISIONS

2.1 Council – 11th September 2007 – Minute 64.

2.2 Pension Fund Committee – 26 March 2008 – Dec. 1 – Exempt

2.3 Pension Fund Committee – 10 September 2008 – Dec 11 & exempt.

2.4 Pension Fund Committee – 4 February 2010 – Dec 6

2.5 Pension Fund Committee – 15 September 2010

3. CORPORATE PRIORITIES AND POLICY CONSIDERATIONS

3.1 To ensure that the pension fund is being invested prudently and to the best advantage in order to achieve the required funding level. Effective monitoring of the Pension Fund will provide support towards the Council's corporate priorities in providing better services, with less money.

4. RISK MANAGEMENT ISSUES

4.1 The primary risk is that of poor investment performance. Fund manager's performance is monitored by the committee every quarter. If fund manager performance is considered inadequate, the fund manager can be replaced.

4.2 The value of the pension fund assets at any point in time is determined by the market and a large movement in the markets could have a significant impact on the surplus or deficit of the fund.

5. EQUALITIES AND DIVERSITY ISSUES

5.1 Ensuring the long term financial health of the pension fund will benefit everyone who contributes to the fund.

6. USE OF RESOURCES IMPLICATIONS (Finance, Procurement, Performance & Value for Money, Staffing, IT, Property, Sustainability)

6.1 The property portfolio as a whole has under performed the specified benchmark over the longer term. JLT Investment Consulting are therefore recommending that we liquidate the property portfolio.

6.2 Whilst there will be costs involved in liquidation of the portfolio this, in part, would be offset against the risk of further underperformance.

7. LEGAL ISSUES

7.1 None other than contained in the body of the report and appendices.

8. CONSTITUTIONAL POWERS

8.1 Constitution – Part 3 Responsibility for Functions – Section 2 – Responsibility for Council Functions delegated to the Pension Fund Committee through the Pension Fund Governance Compliance Statement.

9 BACKGROUND INFORMATION

9.1 History

9.1.1 The Superannuation Act 1972 makes provision for local authorities to operation pension funds for their employees and employee of other employers who have either a statutory right or an admission agreement to participate in the funds. The London Borough of Barnet's Pension Scheme Fund (The Fund) is set up under the Local Government Pension Scheme (Administration) Regulations 2008 (SI 2008/239); (ii) the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (SI 2007/1166); and (iii) The Local Government Pension Scheme (Transitional Provisions) Regulations 2008.

9.2 Property Investments

9.2.1 The recommendations of The Fund's investment advisors, JLT Investment Consulting are attached at appendix A.

10. LIST OF BACKGROUND PAPERS

10.1 None.

Legal: TE
CFO: AT

Property Investments

London Borough of Barnet Pension Fund

JLT INVESTMENT CONSULTING

Executive Summary

The London Borough of Barnet Pension Fund ("the Fund") has an internally managed property portfolio internally which makes up around 4% of the Fund's assets; this property portfolio has historically underperformed its benchmark.

Manager	Schroder Exempt Property Unit Trust (SEPUT)	Hermes Property Unit Trust (HPUT)	Rockspring Hanover Property Unit Trust (RHPUT)	BlackRock UK Property Fund (BUKPF)
Valuation of Fund's holding as at 31 Dec 201	£5.926m	£8.667m	£2.383m	£6.007m

As investment advisors we have not previously been asked to comment on these assets, and whilst the performance of this portfolio has only a very marginal impact on the Fund performance as a whole, it is now appropriate to consider this property allocation. This is because the Fund's recent Diversified Growth (DGF) mandates will mean that Fund's managers, Schroders and Newton, will make active property allocations within their respective DGFs. Therefore it could be argued that a separately managed, internal property portfolio is no longer required.

In this short paper we discuss the property asset class and comment on its relevance for pension funds in general, and then detail the individual property managers held by the Fund. We then discuss some specific considerations for the Fund and make some recommendations.

Contents

Section One - Introduction

One of the distinguishing features of property is that it exhibits both equity and bond-like characteristics.

The income stream from rental payments on property investments is a similar feature to that of coupon payments received from bond assets. Hence, property investments can also be used by pension schemes, in conjunction with income from bonds, to pay cash outflows such as pensions in payment.

The returns on property investment are real, due to rental growth being correlated to economic growth, with long-term return expectations tending to be greater than other yield-returning asset classes such as gilts and corporate bonds. As a result of the correlation between rental and economic growth, property can also be used to match active liabilities as part of a pension scheme's growth assets. Property exhibits equity-like characteristics with a reduced level of price volatility from one month to the next due to the infrequency and subjectivity of valuations.

Property investments can also be used for diversification purposes, with only modest correlations exhibited between property and equities or bonds.

Illiquidity

One of the main disadvantages of property investments is its illiquidity. The process of buying and selling property can take a long time, meaning it is difficult to sell holdings in property at short notice at a fair price. Also property investments are discrete buildings and so the cashflows from asset transactions are, by their very nature, "lumpy" and can lead to significant cash holdings.

Should there be a sudden investor sentiment to sell out of the asset class, investors within a pooled fund may not be able to immediately relinquish units, as the manager would have to sell properties to raise cash. This may lead to the managers being forced to sell properties for below fair price.

In order that the manager can sell properties at a fair price, they can put in place a notice period, whereby investors have to give advanced notice of their intention to sell. Further, it may be that a redemption queue exists until disinvestment can take place, providing the manager sufficient time to sell out of properties (or, more cynically, allow the manager to retain assets for longer).

This was the case for most pooled funds in 2008, with investors unable to realise their assets in a period where property returns were sharply negative. We then saw the opposite effect during 2009 and the first half of 2010, with subscription queues forming with managers looking for suitable properties to purchase as the market started to pick up.

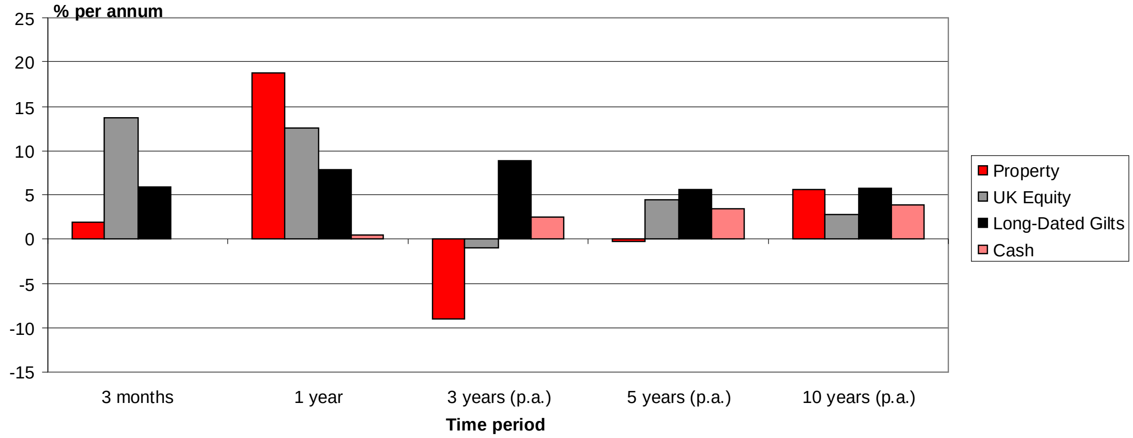
Transaction costs

Another disadvantage of property investment is the transaction costs involved. The typical bid/offer spread on a pooled property fund, i.e. the difference between the price paid to buy units and price received when selling units, is significantly higher than that of investing in equities or bonds (which are much less than 1%). Typical bid/offer spread on property funds are approximately 6% - 7%, the vast majority (4%) of which is stamp duty. For the above reasons, pension schemes should consider property as a long-term investment, with a low expectation of having to regularly manage cashflows in and out of the asset class.

However, when there are investor inflows into property funds there is the potential that sales of property fund units could be "matched" against an investor entering the fund. This is where the fund managers matches the disinvestment against an investor purchase and the value of the sale is calculated at the (higher) mid-price.

Section Two - Current Market Conditions

The chart below shows the performance of property, together with equities, gilts and cash, over various periods to September 2010.



Source: Thomas Reuters, Investment Property Databank (IPD), JLT

In recent years, property values have been falling sharply, with many investors seeking to exit positions they held in the asset class. However, following an uptick in the last half of 2009, one year returns for property are now positive, over the last 10 year period it has outperformed equities and cash.

The improving economic confidence and wider rebound in financial markets have helped sentiment and seen demand for property increase. This was initially largely driven by overseas investors, with UK institutions becoming increasingly active in the market towards the end of 2009. There is much debate amongst commentators as to whether the recent upturn in commercial property values has been driven by fundamentals or from the large flows into the asset class by mainly overseas investors taking advantage of the weakness of sterling. The property market historically has tended to lag the wider economy as the upturn in an economy takes time to feed through to occupier demand and rental growth.

Outlook

The consensus forecasts that we are currently seeing from investment managers suggest that property returns will be relatively modest over the next 12 months, with capital values flattening (or even falling in some areas), and any return coming through income, with average yields close to 6.5% (though the actual return would be expected to be lower, once voids, cash holdings, rental tax and other factors are taken into consideration. There are likely to be disparities between different regions, with City offices holding up very well, with extremely limited office space following the freeze on any developments over the past few years. In contrast, "secondary" markets such as in Northern England, and other areas particularly reliant on the public sector may well suffer as government cuts are made.

The returns that are being seen in the market for property derivatives can also give us some good information about how the market is expecting property to perform in the future. The returns implied by property derivatives suggest that 2011 returns are expected to be low, with returns in 2012 and 2013 expected to be stronger.

Section Three - The Fund's Property Managers

Manager/Fund	Schroder Exempt Property Unit Trust (SEPUT)	Hermes Property Unit Trust (HPUT)	Rockspring Hanover Property Unit Trust (RHPUT)	BlackRock UK Property Fund (BUKPF)
Fund Manager	Ian Mason	Chris Mathew	Neal Shegog (Fund Director) Mischa Davies (Fund Manager)	BlackRock (Channel Islands) Limited
Years at manager/ in the business	Fund Manager since April 2008. 26 years industry experience	8 years at Hermes and 15 in the industry.	Neal - 16 years at Rockspring, 22 year in the industry Mischa - joined Rockspring November 2010, 12 year of industry experience	1988 inception.
Size of Fund	£1.2bn	£723.6m	£422.1m	£1,957m
Size of total funds run by the property team	Total property assets under management as at 30 September 2010 was £9.3 billion (Source: Schroders, 30 September 2010)	£4.8bn as at 30 September 2010	£422.1m	$13.4bn
Performance target (net of fees)	to provide a return of 0.5% per annum (net of fees) above its benchmark (Investment Property Databank UK Pooled Property Fund Indices – All Balanced Property Funds Median) over rolling 3 year periods.	To outperform the IPD Balanced PUT Index by 0.5% per annum on a 3 year rolling basis (net of fees).	The Trust seeks to beat its benchmark (IPD Balanced Property Unit Trust Index Median). (net of fees)	To out perform the IPD All Balanced Fund Weighted Average. (net of fees)
Number of properties in the fund	58	Direct 45 Indirect 4	37 direct properties + 4 indirect fund investments	83
% of fund in top 5 properties	24.2%	29.0%	37.5%	36.6%
Number of tenants	761	266	2292	880 (approx.)
% of fund in top 5 tenants	16.1%	19.0%	16.2%	13.2%
Number of investors	393	128	111	435

Manager/Fund	Schroder Exempt Property Unit Trust (SEPUT)	Hermes Property Unit Trust (HPUT)	Rockspring Hanover Property Unit Trust (RHPUT)	BlackRock UK Property Fund (BUKPF)
% of fund held by biggest investor	3.5%	8.8%	8.0%	2.0%
Level of Gearing (and max allowed)	9.9%. The recommended range for on and off balance sheet gearing is 0-20% of NAV, although we target 0-10% gearing.	1.9% / Max 40% of gross asset value	13.6% for direct and 18.4% including indirects. 50% gearing level permitted	8.6% of GAV at YE, max of 33% allowed.
% of fund held in indirect investments (and max allowed)	19.8%. Expect the indirect exposure to be 10% or less in the medium term following the repositioning of the portfolio.	11% / Max of 30% of gross asset value to be held in investments alongside other investors, and of this, not more than 20% of gross asset value to be held alongside other Hermes clients.	18.03% Not more than 20% of Net Asset Value may comprise units in an individual collective investment fund.	16.1% of NAV at YE, 50% allowed
% of fund held in speculative developments (and max allowed)	0%. Maximum is 15%	0% / Max 10% of gross asset value.	1.3% Not more than 30% of Net Asset Value may consist of property which is undergoing speculative substantial development, redevelopment or refurbishment.	0% (25% Max)
Void Rate	6.7%	4.9%	13.3%	5.2%
Yield	Net Initial Yield - 5.8%	4.7% Calculated using NAV	6.5%	4.1%
Level of Cash holding	5.7%	5.0%	1.7%	7.9%
Average lease length	8.0 years	8.2 years	9.5 years	8.6 years

Section Four - Performance of the Fund's Property Managers

	Q4 2010	1 year	3 years (p.a.)	5 years (p.a.)	10 years (p.a.)
Schroder	2.5	12.9	-8.1	-2.6	n/a
Benchmark	2.1	12.3	-4.2	0.0	n/a
Relative	*+0.4*	*+0.6*	*-3.9*	*-2.6*	-
Hermes	3.0	13.7	-4.3	0.9	n/a
Benchmark	2.0	12.1	-7.1	-1.9	n/a
Relative	*+1.0*	*+1.6*	*+2.8*	*+2.8*	-
Rockspring*	2.7	10.1	-9.8	-3.2	4.6
Benchmark	2.4	12.9	-5.8	-0.4	5.6
Relative	*+0.3*	*-2.8*	*-4.0*	*-2.8*	*-1.0*
BlackRock	1.4	11.5	-5.4	-0.4	6.1
Benchmark	1.9	12.2	-5.7	-1.1	5.5
Relative	*-0.5*	*-0.7*	*+0.3*	*+0.7*	*+0.6*

Source: Investment managers, net of fees. *Unaudited figures.

Discussion

The different funds all have different benchmarks; however, it is possible to discern that Rockspring Hanover Property Unit Trust has underperformed its specific benchmark over 1, 3, 5 and 10 year periods, and has provided the lowest absolute return over these periods too. This underperformance combined with poor performance from Schroder and marginal performance from BlackRock has led to the long term underperformance of the Fund's property portfolio as a whole.

Section Five - Recommendations

The underperformance discussed in the previous section can be combined with a number of sound reasons why the Members of the Pension Committee should consider the future of the Fund's property portfolio and reallocating the proceeds:-

- it is relatively insignificant in size and potential impact it could have on the funding position
- it takes up a disproportionate amount of officer time in its monitoring
- its diversifying role has been superseded by the Fund's DGF investments

Transactions costs

The magnitude of the bid / offer spread should be considered with respect to the timing of any planned liquidation. Currently the spread and therefore the full cost of exiting the funds is likely to be incurred by the Fund on exiting, as the outlook for property is not encouraging and therefore there may not be any incoming investors with whom to match the disinvestment.

Allocation of any property fund proceeds

The Pension Committee will have to make the decision on where to invest any proceeds from a sale of the Fund's property portfolio.

Recommendations

- We recommend the Pension committee should consider the future of its property portfolio. We do not believe there is any compelling reason as to why the Fund should have a separate, internally managed property portfolio.
- Whilst this is not a historically optimal time to exit property portfolios we would recommend that the Pension Committee does not attempt to "market-time" the exit (the potential upside is marginal and the downside risk of underperformance is much larger).
- Instead, we would recommend that the property fund managers are instructed to sell the Fund's holdings immediately, with one caveat.
- If there is the potential that this sale could be matched against an investor entering the fund then we would recommend that the fund manager has latitude on the timing of the disinvestment in order to match it against a purchase and value the sale at the (higher) mid-price.

Appendix A - Property specific considerations for fund selection

Gearing

This is the amount of borrowing within a fund. For example, a fund which is 100% geared would have twice the amount of money to invest compared to the funds it had received from investors, with the additional amount coming from borrowing. Geared funds tend to produce much more volatile returns than ungeared funds, with overstated peaks in times of bull markets and overstated troughs in bear markets. We prefer funds with no or low gearing for UK pension schemes as geared funds can be very illiquid especially in weaker market conditions.

Active management

In equity and bond investment, active management refers to the manager taking bets by holding more or less of a given stock than its weighting in the relevant index. These bets allow the manager to try to beat the performance of the index.

In commercial property, active management means the work done by the manager to maximise the value of their property assets, for example refurbishing, finding better / more profitable uses for existing properties, seeking longer term leases, seeking better quality tenants at higher rates. All managers will actively manage their property portfolios to some extent, but the degree to which this is done does vary between managers.

Amount of cash held

Managers will need to hold cash to allow them to make new purchases and to meet redemptions. Also as property market expectations change over time, then the cash holding may increase or decrease accordingly as a result of tactical decisions made by a manager.

However, in general the manager is being paid to manage property, so we would expect the cash position to be maintained at a relatively low level in the longer term.

Yield

Part of the return from property comes from appreciation of capital value and part comes from the running rental income on the portfolio. The yield of a portfolio is the ratio of the rental income to the property value, and the higher the yield, the higher the rental income relative to the value of the fund.

Void rate

At any one time, a proportion of the properties within a fund will be vacant. This proportion is the void rate, and the higher the void rate the lower the income that is being generated by a portfolio.

Lease length

Holding a long lease on a property at an attractive yield will be more beneficial for returns than holding one that is shortly up for renewal (unless there is a very strong demand in that particular sector, which would drive the rent in the re-leased property up).

Speculative investment

Speculative investments are generally considered to be those where a high level of risk involved. There are various stages in building a property from new, from sourcing the land, planning, demolition (if required) of existing property, construction, fitting out and letting. In times of rising markets, speculative development and 'new builds' gave substantial rewards. However in bear markets, the lack of potential tenants or reduced rental income from tenants has resulted in such developments being mothballed or heavily loss making.

Whilst some managed funds have taken the decision to stay away from speculative development, others have the ability to allow a small degree, or to focus on refurbishments or redevelopments of existing properties rather than full new-builds.

Indirect investments

Indirect investments – i.e. investing in funds of another manager or in other property vehicles, allow a manager to get greater diversification through measured exposure to a wider range of properties, or to much larger developments such as large scale retail parks, than could be supported through their own asset base.

Indirect investments often have a higher level of gearing, and this gearing is also outside the control of the manager. Also, some of the large indirect vehicles in which managers invest have been subject to issues with redemptions recently.

Policy on redemptions

The redemption policy is the approach a manager takes when clients ask to withdraw their money.

The general principle is that it would be unfair to remaining investors if clients seeking to redeem their assets meant that properties had to be sold quickly on terms that were unfavourable. Managers therefore usually set a redemption period, whereby the client gives notice of its intention to withdraw assets and the manager pays the client the required money at the end of the set redemption period. This allows the manager to control its cashflows.

Some managers maintain a cash holding out of which small redemptions can be made without triggering a redemption period.

Size of fund and size of manager

Generally speaking, we would look for a manager of reasonable scale. This is because they will have good experience of running property funds, good processes and teams in place for managing the assets, they will have good market presence so that they have access to forthcoming deals, the ability to negotiate on prices, the ability to deal on a nationwide basis, the ability to deal with and influence nationwide tenants.

However, managers often operate several property mandates, and whilst some managers have a large property book, the pooled fund may be relatively small. There is no particular rule for assessing whether a particular fund size is preferable. A large fund is likely to be able to access a wider range and diversification of properties, and also a greater size of individual property. However, with very large funds it can be difficult to rebalance the fund from one sector to another (e.g. retail to industrial). For smaller funds, rebalancing can be achieved by the buying or selling of a smaller number of properties. Also, smaller funds can achieve diversification through investing in smaller size properties.

Use of derivatives

There are derivative investments available which provide the return, or a return over or under a given property index in exchange for an agreed series of payments.

Whilst the pooled funds we consider should mainly be seeking to make their returns from investing in bricks and mortar, where a manager believes there is an anomaly in the pricing of these derivatives, we would support their controlled use as a way of adding value.

Diversification of properties / tenants / sectors

Consider an extreme scenario - a fund had only one property - a Central London office, all held by one tenant. If the tenant goes out of business and there is no demand for the empty office space, then the fund is in serious trouble.

Generally speaking pooled funds will look to diversify their portfolio by holding a wide range of different properties, in different sectors (e.g. Industrial, Retail, Office, Central London etc), different locations, and with a wide variety of tenants.

Bid/Offer spreads

The typical bid/offer spread on a pooled property fund (i.e. the difference between the price paid to buy units and price received when selling units) is significantly higher than that of investing in equities or bonds, at around 6% - 7%. This reflects the costs of buying and selling properties, including stamp duty and legal fees.

During the recent period of poor liquidity, some property funds imposed very severe redemption penalties on their funds.

Therefore when investing in a property fund, it is important to see if matching opportunities are available, whereby a buyer is matched with a seller to minimise costs. Unfortunately, this is unlikely to be possible at the current time for any of the funds under consideration as all of the funds are seeing net inflows. This makes it unlikely that the Scheme will be able to cross units with an investor exiting the fund (therefore saving on transaction costs).

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AGENDA ITEM: 8 Page nos: 25 - 38

Meeting	Pension Fund Committee
Date	21 March 2011
Subject	**Benchmark Setting**
Report of	Deputy Chief Executive
Summary	This report asks the Committee to note and comment on the recommendations regarding the setting of benchmarks.

Officer Contributors	John Hooton, Assistant Director of Strategic Finance Karen Bannister, Interim Treasury Manager
Status (public or exempt)	Public
Wards affected	None
Enclosures	Appendix A – Setting Benchmarks
For decision by	Pension Fund Committee
Function of	Council
Reason for urgency / exemption from call-in (if appropriate)	Not applicable

Contact for further information: Karen Bannister – Treasury Manager Tel: 0208 359 7119

1. RECOMMENDATIONS

1.1 That the Committee note and comment on the recommendation to adopt a composite Equity benchmark for the Return Seeking (Diversified Growth Fund) proportion of the portfolio consisting of 60% FTSE All Share index and 40% the Sterling FT AWI (ex UK).

1.2 That the Committee note and comment on recommendation to adopt a composite benchmark for the Duration (Bonds) proportion of the portfolio split between UK Government Over 15 year index and the UK Government Index-Linked (over 5 years) 3% index.

1.3 That the Committee agree to accept a further report on benchmarks at the next Committee meeting.

2. RELEVANT PREVIOUS DECISIONS

2.1 Council – 11th September 2007 – Minute 64.

2.2 Pension Fund Committee – 26 March 2008 – Dec. 1 – Exempt

2.3 Pension Fund Committee – 10 September 2008 – Dec 11 & exempt.

2.4 Pension Fund Committee – 4 February 2010 – Dec 6

2.5 Pension Fund Committee – 15 September 2010

3. CORPORATE PRIORITIES AND POLICY CONSIDERATIONS

3.1 To ensure that the pension fund is being invested prudently and to the best advantage in order to achieve the required funding level. Effective monitoring of the Pension Fund will provide support towards the Council's corporate priorities in providing better services, with less money.

4. RISK MANAGEMENT ISSUES

4.1 The primary risk is that of poor investment performance. Fund manager's performance is monitored by the committee every quarter. If fund manager performance is considered inadequate, the fund manager can be replaced.

4.2 The value of the pension fund assets at any point in time is determined by the market and a large movement in the markets could have a significant impact on the surplus or deficit of the fund.

5. EQUALITIES AND DIVERSITY ISSUES

5.1 Ensuring the long term financial health of the pension fund will benefit everyone who contributes to the fund.

6. USE OF RESOURCES IMPLICATIONS (Finance, Procurement, Performance & Value for Money, Staffing, IT, Property, Sustainability)

6.1 The funding objective of the London Borough of Barnet Pension Fund is to ensure the solvency of the Fund and ensure the sufficient funds are available to meet all the benefits as they fall due.

6.2 Therefore it is necessary to measure the performance not only of the investment managers but also of the Fund as a whole to ensure the investment strategy is fit for purpose.

7. LEGAL ISSUES

7.1 None other than contained in the body of the report and appendices.

8. CONSTITUTIONAL POWERS

8.1 Constitution – Part 3 Responsibility for Functions – Section 2 – Responsibility for Council Functions delegated to the Pension Fund Committee through the Pension Fund Governance Compliance Statement.

9 BACKGROUND INFORMATION

9.1 History

9.1.1 The Superannuation Act 1972 makes provision for local authorities to operation pension funds for their employees and employee of other employers who have either a statutory right or an admission agreement to participate in the funds The London Borough of Barnet's Pension Scheme Fund (The Fund) is set up under the Local Government Pension Scheme (Administration) Regulations 2008 (SI 2008/239); (ii) the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (SI 2007/1166); and (iii) The Local Government Pension Scheme (Transitional Provisions) Regulations 2008.

9.2 Setting Benchmarks

9.2.1 The recommendations of The Fund's investment advisors, JLT Investment Consulting are attached at appendix A.

10. LIST OF BACKGROUND PAPERS

10.1 None.

Legal: TE
CFO:

Setting Benchmarks

London Borough of Barnet Pension Fund

JLT INVESTMENT CONSULTING

Executive Summary

In this short paper we discuss the use of benchmarks for pension funds and for fund managers. We then discuss what the most appropriate benchmark should be for the London Borough of Barnet Pension Fund.

The investment strategy of any pension scheme is designed to ensure that the scheme is able to meet its liabilities over the short and long term. We believe that the optimum use of a benchmark for a pension scheme is to provide a measure of the likelihood of that specific pension fund being able to meet those liabilities. Therefore we recommend that a Liability Benchmark, as the prime measurement objective, is applied to the London Borough of Barnet Pension Fund, rather than a peer group benchmark.

We also consider the use of benchmarks when applied to an asset class and to a fund manager. When applied to an asset class it should represent the investable universe for that asset class, and we provide our recommendations for the two main portfolios of the London Borough of Barnet Pension Fund. Finally, we discuss how an individual fund manager's performance should be judged against their agreed benchmark. This benchmark should reflect the implementation of appropriate investment policies consistent with the manager's defined targets and prudent risk limits; this is because that benchmark will be used to judge the implementation of the investment strategy and the resulting risk-adjusted return achieved by that manager.

Contents

Section One - Introduction

1.1 The overall investment strategy of a pension scheme is, in general, designed to ensure that, over time, the scheme is able to meet its liabilities as they become due and that, taking into account contributions and any deficit payments, the scheme remains solvent.

1.2 For the London Borough of Barnet Pension Fund (the "Fund") a critical element of investment strategy is to ensure that both the assets in which the Fund invests and the investment firms who manage assets on a day to day basis achieve the level of results required to ensure that there are enough monies to meet liabilities. Benchmarks are a vital tool in the monitoring and governance of the Fund.

1.3 The key purpose of investment benchmarks is to allow the measurement of the performance of the assets (and indeed the liabilities) and the effectiveness of strategies and decisions as time progresses, to ensure that the fund is effectively and efficiently managed.

1.4 However, no single benchmark can monitor the investment aims of a pension scheme and simultaneously measure the performance of the investment managers, unless the manager has also been given the responsibility for asset allocation against the liabilities.

1.5 Therefore it is necessary to separate the various levels (or layers) of assessment required.

1.6 It is the view of JLT Investment Consulting that the assessments required fall in three key layers:

- The Fund benchmark
- The Asset portfolio benchmark
- The Manager benchmarks

1.7 The remainder of this report looks at each of these areas in turn, making suggestions as to potential benchmarks in each layer.

Section Two - The Fund Benchmark

Peer group benchmarks

2.1 It has been traditional for schemes to benchmark the investment performance of the scheme against the return achieved by a peer group, such as the CAPs or WM pension scheme universes.

2.2 However, such a benchmark does not reflect the unique characteristics of a particular scheme. The scheme may have a very different age distribution to the peer group in terms of both the average age of members and the numbers in each 5-year age band and the proportion of pensioners may also be very different. In addition, the funding deficits may vary significantly from scheme to scheme. Additionally, the Investment Committee from one scheme to another is likely to have very different attitudes to the levels of risk they are prepared to take or volatility they will accept.

2.3 The investment strategy, and hence the asset distribution, adopted for each scheme in the universe will reflect these characteristics and the asset distribution of the universe as a whole will be very different to that of many schemes in the universe.

2.4 If the scheme has a very different asset structure to that of the universe, the returns will, almost inevitably, be very different reflecting the relative proportions of bond and growth assets (equities, property etc).

2.5 The measurement of the investment performance of a scheme against such a benchmark does not, therefore, provide any useful information against which to assess the scheme's performance relative to other schemes or the funding objective.

2.6 In many cases, the investment performance of the fund managers is also measured against this benchmark. However, this can affect the investment strategy, which is a matter of particular concern.

2.7 As far as an asset manager is concerned, they are assessed on performance relative to the benchmark and would be taking a major risk position by going 15% overweight in any asset position. The manager's only concern is to outperform the benchmark at an appropriate level of risk - they have no interest in whether the strategy is appropriate for the scheme as that is the responsibility of somebody else.

2.8 Superficially, benchmarking the performance of a scheme against a peer group return may appear to be appropriate but it does not take any account of the liabilities and can have an adverse effect on investment strategy.

Fund specific benchmarks

2.9 The funding objective of the London Borough of Barnet Pension Fund ('Fund') is to ensure the solvency of the Fund and ensure that sufficient funds are available to meet all the benefits as they fall due.

2.10 Within this funding objective, the investment return is to be maximised for an appropriate level of risk and the need to minimise employer contribution rates.

2.11 To meet these objectives, the overall benchmark for the assets of the Fund should be that changes in the value of the assets should reasonably mirror changes in the value of the liabilities. The Fund needs, therefore, to set an overall Fund benchmark that takes full account of changes to the liabilities of the Fund.

2.12 In terms of deciding how the liabilities will behave, the building blocks for measurement of the liabilities are contained within the draft 2010 actuarial valuation results from the Scheme Actuary.

2.13 The principal assumptions that affect the behaviour of the liabilities (from an investment perspective) within the draft 2010 valuation commissioned by Barnett Waddingham are:-

- The discount rate(s) assumed for members both pensioner and non-pensioner liabilities is 6.7%. This is a risk adjusted discount rate.
- The rate of increase for pensions is at the annual rate of RPI inflation less 0.5% per annum, where RPI inflation is assumed to be the difference between the yields on fixed and index-linked Government bonds.
- pensionable salaries are assumed to increase at an annual rate of 1.5% per annum above the assumed rate of RPI inflation described above.

2.14 Monitoring would also have to take into account the fact that the existing deficit (which is not matched by any assets) will change as interest rates change.

Recommendation

2.15 Measurement of the progress of the London Borough of Barnet Fund, as a whole, can only be properly done against changes in the value of the liabilities – a Liability Benchmark. From such a benchmark it will be clear to see progress against:

- The funding position
- The impact of decisions in the areas of asset strategy and manager selection
- The impact of advice received on strategy from advisors

2.16 Importantly, by setting a Fund specific benchmark, the London Borough of Barnet ensures that it meets with best practice under the CIPFA guidelines and Myners Principles and can be clearly seen to be meeting Good Governance standards.

2.17 As an example, all things being equal and ignoring the impact of matured and new liabilities, the value placed on the liabilities would be expected to increase over a year by the discount rate, 6.7% in this case. However, there are additional factors involved which will affect the value of the liabilities such as changes in the discount rate, which will change with changes in long term interest rates, and changes in the future expectation of inflation, which is also based on market conditions. Comparing how the Fund's assets have performed against the estimated change in the liabilities as a result of these factors will allow for a better assessment of the success, or otherwise, of the investment strategy.

Section Three - The Asset Portfolio Benchmark

3.1 The asset portfolio of any pension arrangement broadly falls into two parts:

- The Return Seeking portfolio
- The Duration portfolio

3.2 The Return Seeking portfolio is typified by investment such as Equities and Property but can include a wide variety of assets ranging from Commodities, through Hedge Funds to High Yield Debt and Currency.

3.3 The purpose of such a portfolio is to do what is in its name – seek Returns.

3.4 The Duration portfolio on the other hand has a totally different role. Its role is primarily to provide the Fund with sensitivity to changes in interest yields.

3.5 This sensitivity is particularly important within the framework of the actuarial valuation of liabilities (as was in part discussed in section two) and is a topic that was require discussed when the current investment strategy was reviewed and amended.

3.6 The Duration portfolio, also performs a second function. This is to provide a counter balance to the Return Seeking portfolio, as the assets typically held in this area are Gilts (both conventional and index-linked) and good quality Corporate Bonds. Typically these provide a strong behavioural contrast to investments such as equities.

The Return Seeking Benchmark

3.7 Given that often the assets for the Return Seeking portfolio are equities, the starting point for defining a benchmark for this area is invariably a Global Equity index.

3.8 The weightings between the UK and Overseas Equity markets is a topic for debate and agreement but such discussion helps formulate the rationale behind investment strategy decisions and therefore clarifies what the strategy in this area is trying to achieve and why.

3.9 Over the last few years, we have seen the usage of two other benchmarks for this area.

3.10 Firstly, the use of either inflation or Libor basis plus a margin for expected outperformance of up to 6%. Secondly, there are benchmarks that are specific to the assumptions within the actuarial valuation (particularly in relation to the assumption for pre-retirement members). This would normally be shown as a Bond yield plus a margin of outperformance (often around 2%).

The Duration Benchmark

3.11 The impact of duration on the liabilities of the Fund is firmly linked to the discount rate assumptions underpinning both the Pre and Post retirement discount rates, and inflation increases.

3.12 In the case of the London Borough of Barnet Pension Fund, these are the yield on UK Government Over 15 year stock and the yield on UK Government Index-Linked (Over 5 years) 3% inflation stock.

Recommendation

3.13 For the Return Seeking portfolio, the benchmark should be a Composite Equity benchmark consisting of 60% UK Equities and 40% Overseas Equities.

3.14 The UK Equity portion should be based on the FTSE All Share index, with the Overseas component being the Sterling FT AWI (ex UK).

3.15 For the Duration portfolio, the benchmark should be based on the returns on the UK Government Over 15 year index and the UK Government Index-Linked (over 5 years) 3% index. The proportions between these will require some additional work on the breakdown of the liabilities.

Section Four - The Manager Benchmarks

4.1 Benchmarks for managers are the ones with which Panel members are most likely to be familiar.

4.2 When appointing a portfolio manager, the Fund will have agreed an investment mandate that meets the needs of the Fund for a particular asset class.

4.3 The mandate will take into account the risk appetite of the Fund, such as maximum exposures to individual counterparties/sectors, the use of derivatives etc. The investment performance of the investment manager will then be measured against a benchmark index that reflects the agreed investment mandate and any significant constraints.

4.4 The manager will then seek to outperform the benchmark index and will not normally be concerned about absolute return.

4.5 There are a plethora of indices available allowing almost any brief to be covered. For equity, property and other growth assets, the fund manager’s performance can be measured against an appropriate index.

4.6 For a UK gilt and corporate bond managers, the most common benchmarks include the FTSE Government Fixed Interest and FTSE Government Index-Linked Gilt Indices and the iBoxx (Corporate Bond) Indices for the most relevant maturity dates.

4.7 To a large extent, the benchmark can be easily tailored to meet the risk requirements of a portfolio – for example to match the Fund’s required duration profile, the benchmark return might be (⅓ return on the iBoxx 10-15 yr Index plus ⅔ return on the iBoxx Over15 yr Index). Similarly if the Fund does not wish to hold corporate bonds with a BBB-rating, an appropriate composite benchmark index can be derived.

Recommendation

4.8 Measurement of manager portfolios should be judged against indices appropriate to the brief for the manager mandate. We include information on each of the Fund's current manager portfolios in the Appendix.

4.9 The exact benchmark indices to be used should be agreed as the final piece in the investment structure.

Appendix

Summary of current funds

Manager	Fund	Date of Appointment	Management Style	Monitoring Benchmark	Target
Newton Investment Management Limited (Newton)	Real Return	December 2010	Active, pooled	1 month LIBOR plus 4% p.a.	To achieve significant real rates of return in sterling terms predominantly from a portfolio of UK and international securities and to outperform the benchmark over rolling 5 years
Newton	Corporate Bond	December 2010	Active, pooled	Merrill Lynch Non Gilt Over 10 Years Investment Grade Index	To outperform the benchmark by 1% p.a. over rolling 5 years
Schroder Investment Management Limited (Schroder)	Diversified Growth	December 2010	Active, pooled	Retail Price Index plus 5% p.a.	To outperform the benchmark over a market cycle (typically 5 years)
Schroder	All Maturities Corporate Bond	December 2010	Active, pooled	Merrill Lynch Sterling Non-Gilts All Stocks Index	To outperform the benchmark by 0.75% p.a. (gross of fees) over rolling 3 years
Legal and General Investment Management (L&G)	World (ex UK) Equity Index Fund	September 2008	Passive, pooled	FTSE AW World (ex UK) Index	Track within +/- 0.5% p.a. the index for 2 years in every 3
L&G	Active Corporate Bond – All Stocks	December 2008	Active, pooled	iBoxx Sterling Non-Gilts All Stocks Index	Outperform by 0.75% p.a. (before fees) over rolling 3 years
Internal	Property	N/a	Active, property unit trust portfolio	UK IPD Property Index	Outperform the index

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AGENDA ITEM: 9 Page nos: 39 - 69

Meeting	Pension Fund Committee
Date	21 March 2011
Subject	**Barnet Council Pension Fund Performance for Quarter October to December 2010**
Report of	Deputy Chief Executive
Summary	This report advises the Committee of the performance of the Pension Fund for the quarter October to December 2010

Officer Contributors	John Hooton, Assistant Director of Strategic Finance Karen Bannister, Interim Treasury Manager
Status (public or exempt)	Public
Wards affected	None
Enclosures	Appendix A – WM Performance Results for 12 months Appendix B – WM Performance Results for 3 years Appendix C - Pension Fund Market Value of Investments Appendix D – Property Unit Trust Portfolio Appendix E - Image Report Quarterly Update 31 December 2010
For decision by	Pension Fund Committee
Function of	Council
Reason for urgency / exemption from call-in (if appropriate)	Not applicable

Contact for further information: Karen Bannister – Interim Treasury Manager Tel: 0208 359 7119

1. RECOMMENDATIONS

1.1 That having considered the performance of the Pension Fund for the quarter to December 2010, the Deputy Chief Executive be instructed to address any issues that the Committee consider necessary.

2. RELEVANT PREVIOUS DECISIONS

2.1 Council – 11th September 2007 – Minute 64.

2.2 Pension Fund Committee – 26 March 2008 – Dec. 1 – Exempt

2.3 Pension Fund Committee – 10 September 2008 – Dec 11 & exempt.

2.4 Pension Fund Committee – 4 February 2010

3. CORPORATE PRIORITIES AND POLICY CONSIDERATIONS

3.1 To ensure that the pension fund is being invested prudently and to the best advantage in order to achieve the required funding level. Effective monitoring of the Pension Fund will provide support towards the Council's corporate priorities in providing better services, with less money.

4. RISK MANAGEMENT ISSUES

4.1 The primary risk is that of poor investment performance. Fund manager's performance is monitored by the committee every quarter with reference to reports from the WM Company Ltd, a company that measures the performance of pension funds. If fund manager performance is considered inadequate, the fund manager can be replaced.

5. EQUALITIES AND DIVERSITY ISSUES

5.1 Good governance arrangements and monitoring of the pension fund managers will benefit everyone who contributes to the fund.

6. USE OF RESOURCES IMPLICATIONS (Finance, Procurement, Performance & Value for Money, Staffing, IT, Property, Sustainability)

6.1 The financial issues are set out in the body of the report.

7. LEGAL ISSUES

7.1 This report is based on the provisions of (i) the Local Government Pension Scheme (Administration) Regulations 2008 (SI 2008/239); (ii) the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (SI 2007/1166); and (iii) The Local Government Pension Scheme (Transitional Provisions) Regulations 2008 (SI 2008/238) which have their basis in the Superannuation Act 1972.

7.2 Other statutory provisions are referred to in the body of this report.

8. CONSTITUTIONAL POWERS

8.1 Constitution – Part 3 Responsibility for Functions – Section 2 – Responsibility for Council Functions delegated to the Pension Fund Committee through the Pension Fund Governance Compliance Statement.

9 BACKGROUND INFORMATION

9.1 History

9.1.1 The Superannuation Act 1972 makes provision for local authorities to operate pension funds for their employees and employees of other employers who have either a statutory right or an admission agreement to participate in the funds. The London Borough of Barnet's Pension Scheme Fund (The Fund) is set up under the Local Government Pension Scheme (Administration) Regulations 2008 (SI 2008/239); (ii) the Local Government Pension Scheme (Benefits, Membership and Contributions) Regulations 2007 (SI 2007/1166); and (iii) The Local Government Pension Scheme (Transitional Provisions) Regulations 2008. The Regulations provide for retirement pensions, grants on age or ill-health retirement, short service grants, death grants, injury allowances and widows' pensions.

9.2 Tax Status

9.2.1 The Fund is an exempt approved fund under the Finance Act 1970, and is therefore exempt from Capital Gains Tax on its investments. At present all Value Added Tax is recoverable, but the fund is not able to reclaim the tax on UK dividends.

9.3 Operation and Administration

9.3.1 The Fund is operated and administered by the London Borough of Barnet. Day to day investment management of the Fund's assets is delegated to expert investment advisors in accordance with the Local Government Pension Scheme (Management and Investment of Funds) Regulations 1998 (as amended). The Fund is managed on a balanced (excluding property and cash) basis. The current fund managers are Schroder Investment Management Ltd and Newton Investment Management Limited.

9.3.2 At the Pension Fund Committee meeting held on the 4th of February 2010, the Committee agreed to implement a 70/30 diversified growth and bonds portfolio using the existing managers. Implementation of the new investment strategy commenced on Friday the 19th of November and is now fully completed.

9.3.3 Actuarial services are provided by Barnett Waddingham and the fund receives investment advice from an JLT Investment Consulting.

9.4 **Scheme Governance**

9.4.1 The Council is statutorily responsible for the management of the Fund and for making strategic decisions that govern the way the Fund is invested. In this respect, the Council delegates responsibility for making investment decisions and monitoring arrangements to the Pension Fund Committee. The Pension Fund Committee's responsibilities include reviewing and monitoring the Fund's investments; selecting and deselecting investment managers and other relevant third parties; and establishing investment objectives and policies.

The Fund's investment objectives and policies are published in a Statement of Investment Principles, details of this statement can be found on the Council's Web Site (www.barnet.gov.uk/pensions/pensions-investments.htm).

9.5 **Funding**

9.5.1 The Fund is financed by employer and employee contributions and from income derived from investments. Every three years the Fund Actuary carries out a valuation, which determines the level of employer contributions. The last triennial valuation took place as at 31 March 2010 and the final report will be signed off on the 31st of March 2011.

9.6 **Investment Performance & Benchmark**

9.6.1 The performance of the pension fund is measured by using the WM Local Authority Universe. WM Company compile pension fund statistics from a total of 54 local authority pension funds. The portfolio mandates of the local authority funds in the universe vary both in size and management style i.e. active or passive.

9.6.2 The fund managers are obliged by their contract to endeavour to meet the following performance standard: 1% above WM Local Authority Average Fund over 3 years and no lower than 3% below the WM Local Authority Average Fund over any rolling 12 month period.

9.6.3 Appendix A shows the performance of the fund over the last 12 months and Appendix B shows the performance over the last three rolling years. The table below shows the performance of the fund against benchmark over the most recent measured quarter October to December 2010.

	Benchmark	**Performance**	**Relative return**
Fund	1.9	3.5	1.6

9.6.4 The value of the fund at 31 December 2010 was £665.05m compared to £638.49m at 30 September 2010, the graph in Appendix C shows how the market value of the fund has appreciated since 2005.

9.7 **Internally managed funds**

9.7.1 The property unit trust portfolio accounts for 5% of the total market value of the fund and was valued at £33.58m as at the 31st of December 2010. Appendix D shows the value of the individual units held in the portfolio and the movement in market value since the last quarter.

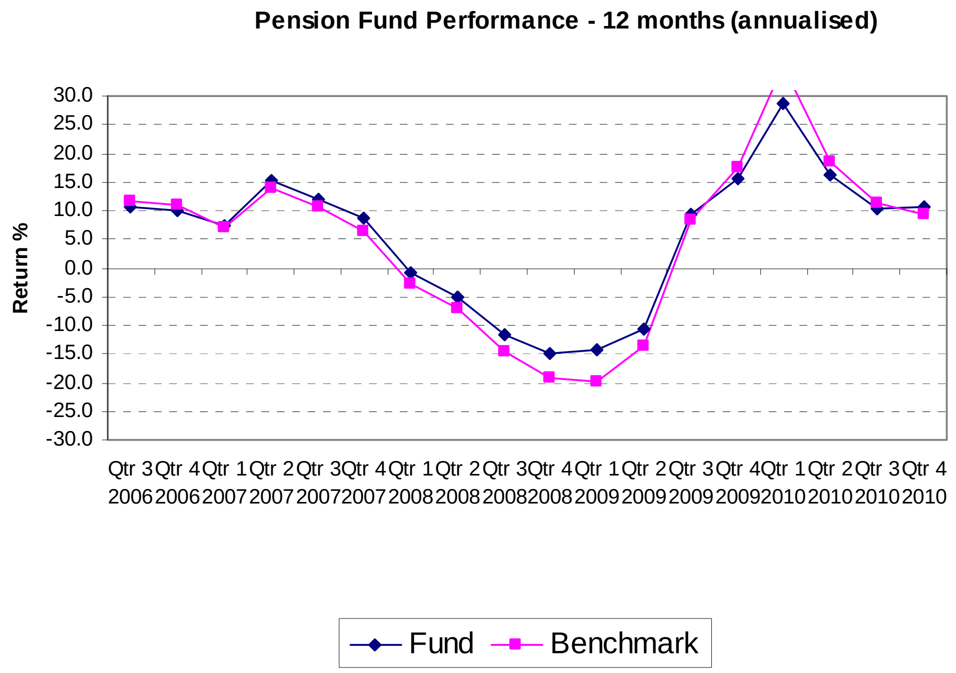
The performance of property fund is measured against the IPD All Properties Index, performance for the last quarter and the 12 months to 31 December 2010 are detailed in Appendix E.

10. LIST OF BACKGROUND PAPERS

10.1 None.

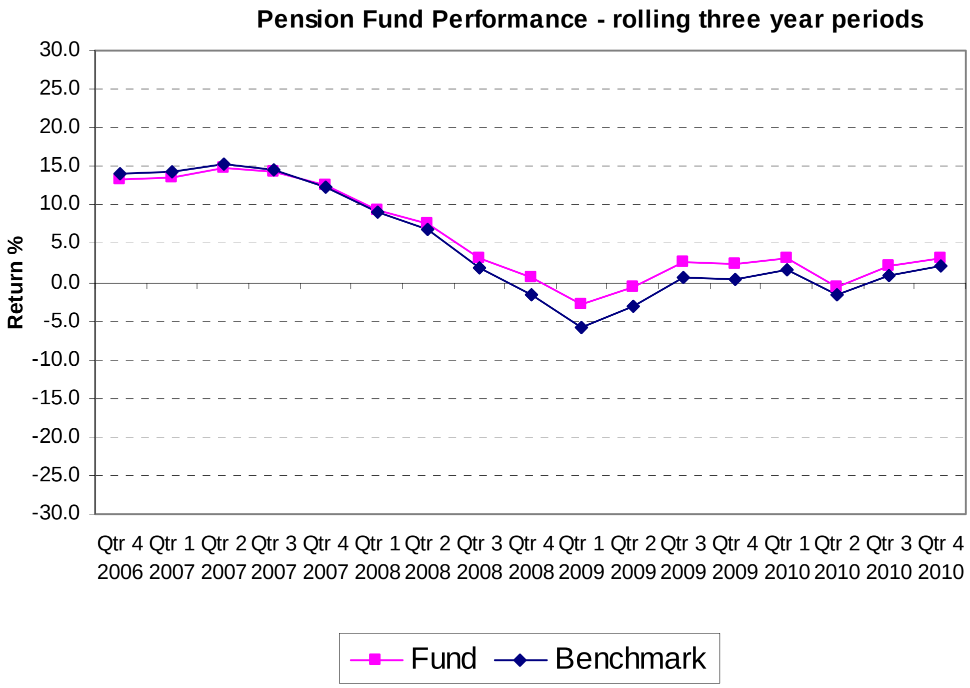
Legal: TE
CFO: AT

Appendix A:

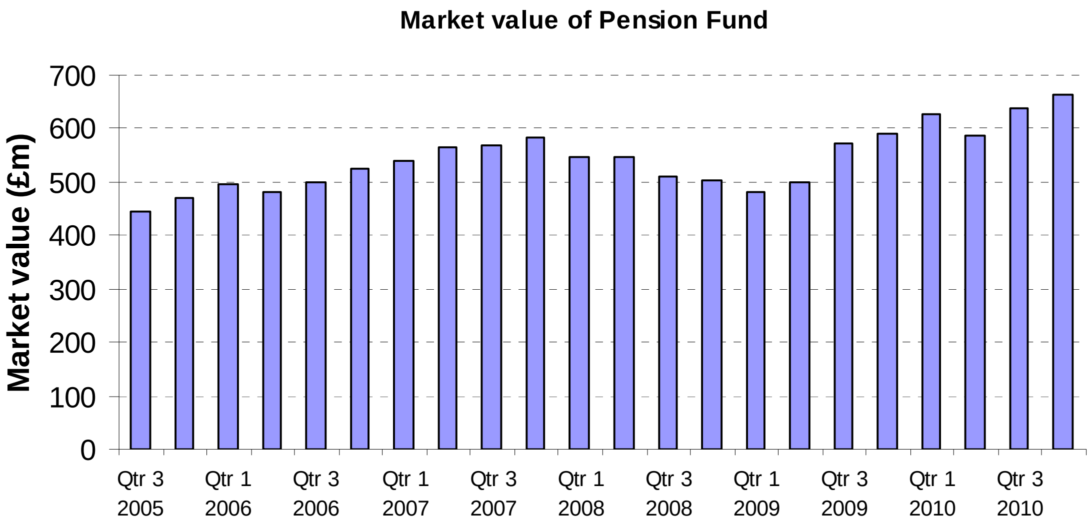


Pension Fund Performance - 12 months (annualised)
Return %
30.0
25.0
20.0
15.0
10.0
5.0
0.0
-5.0
-10.0
-15.0
-20.0
-25.0
-30.0
Qtr 3 2006
Qtr 4 2006
Qtr 1 2007
Qtr 2 2007
Qtr 3 2007
Qtr 4 2007
Qtr 1 2008
Qtr 2 2008
Qtr 3 2008
Qtr 4 2008
Qtr 1 2009
Qtr 2 2009
Qtr 3 2009
Qtr 4 2009
Qtr 1 2010
Qtr 2 2010
Qtr 3 2010
Qtr 4 2010
Fund
Benchmark

Appendix B


Pension Fund Performance - rolling three year periods
Return %
30.0
25.0
20.0
15.0
10.0
5.0
0.0
-5.0
-10.0
-15.0
-20.0
-25.0
-30.0
Qtr 4 2006
Qtr 1 2007
Qtr 2 2007
Qtr 3 2007
Qtr 4 2007
Qtr 1 2008
Qtr 2 2008
Qtr 3 2008
Qtr 4 2008
Qtr 1 2009
Qtr 2 2009
Qtr 3 2009
Qtr 4 2009
Qtr 1 2010
Qtr 2 2010
Qtr 3 2010
Qtr 4 2010
Fund
Benchmark

Appendix C



Market value of Pension Fund
Market value (£m)
700
600
500
400
300
200
100
0
Qtr 3 2005
Qtr 1 2006
Qtr 3 2006
Qtr 1 2007
Qtr 3 2007
Qtr 1 2008
Qtr 3 2008
Qtr 1 2009
Qtr 3 2009
Qtr 1 2010
Qtr 3 2010

Appendix D

Property Unit Trust Portfolio

Description	Holding	Book Value	Bid	Market Value 31 December 2010	Market Value 30 September 2010
		£	£	£	£
Rockspring Hanover Property Unit Trust	206	1,868,514	11,450	2,358,700.00	2,354,580.00
Hermes Property Unit Trust	2,002,700	5,891,532	4.328	8,667,685.60	8,483,437.00
Blackrock UK Property Fund	180,300	4,987,991	35.2504	6,355,647.12	6,032,297.00
Schroder Exempt Property Unit Trust	190,433	4,954,405	31.12	5,926,274.96	5,796,781.00
Cash				10,267,140.32	10,085,488.00
Total				**33,575,448.00**	**32,752,583.00**

IMAGE Report - Quarterly Update
31 December 2010

London Borough of Barnet Superannuation Fund

JLT INVESTMENT CONSULTING

Contents

Jignasha Patel, MMath (Hons) IMC
Investment Consultancy Analyst

John Finch, ASIP FCII
Divisional Director

March 2011

Section One – Market Update

Introduction

This summary covers the key market data for the three months to the end of December 2010.

Market statistics

Market Returns Growth Assets	3 Mths %	1 Year %
UK Equities	7.4	14.5
Overseas Equities	9.6	17.2
USA	11.5	18.8
Europe	5.1	6.6
Japan	12.8	19.0
Asia Pacific (ex Japan)	8.3	23.9
Emerging Markets	8.1	23.6
Property	2.2	14.5
Hedge Funds	4.8	11.3
Commodities	14.1	12.5
High Yield	2.8	17.5
Cash	0.1	0.5

Market Returns Bond Assets	3 Mths %	1 Year %
UK Gilts (>15 yrs)	-3.5	8.8
Index-Linked Gilts (>5yrs)	1.1	9.0
Corporate Bonds (>15yrsAA)	-3.7	9.6
Non-Gilts (>15 yrs)	-3.9	9.5

Change in Sterling	3 Mths %	1 Year %
Against US Dollar	-0.6	-3.0
Against Euro	1.1	3.7
Against Yen	-3.5	-15.5

Yields as at 31 December 2010	% p.a.
UK Equities	2.89
UK Gilts (>15 yrs)	4.14
Real Yield (>5 yrs ILG)	0.49
Corporate Bonds (>15 yrs AA)	5.42
Non-Gilts (>15 yrs)	5.40

Absolute Change in Yields	3 Mths %	1 Year %
UK Gilts (>15 yrs)	0.3	-0.3
Index-Linked Gilts (>5 yrs)	0.0	-0.2
Corporate Bonds (>15 yrs AA)	0.5	-0.2
Non-Gilts (>15 yrs)	0.4	-0.3

Change in inflation Indices	3 Mths %	1 Year %
Price Inflation - RPI	1.4	4.8
Price Inflation - CPI	1.7	3.7
Earnings Inflation *	0.1	2.3

* is subject to 1 month lag

Statistical highlights

- During the quarter, the rate of CPI inflation increased from 3.1% to 3.7% and it remains persistently above the Bank of England's 2% target level.
- The Bank of England's Monetary Policy Committee again kept interest rates on hold at 0.5%, and unveiled no new quantitative easing measures. The last change in interest rates was in March 2009 (a reduction from 1.0%). There is a difference of opinion with one member now voting in favour of increasing interest rates, another voting for an extension of the policy of quantitative easing and the other members voting for no change.
- The latest economic figures have increased concerns that the rate of economic growth will slow further in 2011 as a result of the impact of the government's £85 billion spending cuts, VAT rising to 20% from 17.5% on 4 January 2011.
- The political and financial situation in Europe remains uncertain with speculation that further international bailouts will be required. Sterling appreciated by 1.1% against the Euro over the quarter as the Euro was adversely affected by increasing concerns about sovereign debt problems within the peripheral Eurozone countries.
- At the beginning of the quarter, US stocks benefited from expectations that the US Federal Reserve would unveil another round of quantitative easing in order to help maintain the economic recovery. The Federal Reserve duly announced a further $600 billion of US Treasury purchases in November and encouraging economic data towards the end of the fourth quarter led to an improvement in market confidence.
- Equities continued their positive run over Q4 2010 with all major equity markets producing strong positive returns. In Sterling terms, each region posted a positive return over the quarter. The Japanese market posted the strongest return over the quarter (+12.8%) closely followed by USA (+11.5%), Asia Pacific (ex Japan) (+8.3%) and Emerging Markets (+8.1%).
- The majority of fixed interest assets produced negative returns over the fourth quarter with, for example, long-dated gilts producing a return of -3.5%.

Section Two – Total Scheme Performance

Fund values

		Start of Quarter		Net New Money	End of Quarter	
Manager	Fund	Value £	Proportion of Total %	£	Value £	Proportion of Total %
Newton Investment Management Limited (Newton)	Balanced	281,131,922	44.0	-	292,613,258	44.0
Schroder Investment Management Limited (Schroder)	Balanced	280,047,393	43.9	(36,530)	291,750,133	43.9
Legal and General Investment Management (L&G)	World (ex UK) Equity Index	30,264,722	4.7	-	33,295,171	5.0
L&G	Active Corporate Bond – All Stocks	13,960,176	2.2	-	13,669,495	2.1
Internal	Property	32,944,000	5.2	-	33,575,448	5.0
Internal	Cash	142,670	0.0	-	143,048	0.0
ASSET SPLIT						
Bond assets*		118,744,874	18.6		187,200,803	28.1
Bond Plus assets		519,746,009	81.4		477,845,750	71.9
TOTAL		**638,490,883**	**100.0**	**(36,530)**	**665,046,553**	**100.0**

Source: Investment managers, bid values.

* The Bond assets do not include any fixed interest assets held as part of the Newton and Schroder "growth" portfolios.

Net new money is the net inflows and outflows of each manager. We do not have details of the movements into and out of the Property and Cash funds.

Over the quarter, both Newton and Schroders restructured their multi-asset portfolios. Each mandate is made up of 70% in a "diversified growth" fund, aiming to capture an "absolute" return, and 30% in a Corporate Bond portfolio. Please note that as the objectives for each mandate have changed (contained within the Appendix), the managers' benchmarks have also changed and as of next quarter performance will no longer be shown against the WM universe.

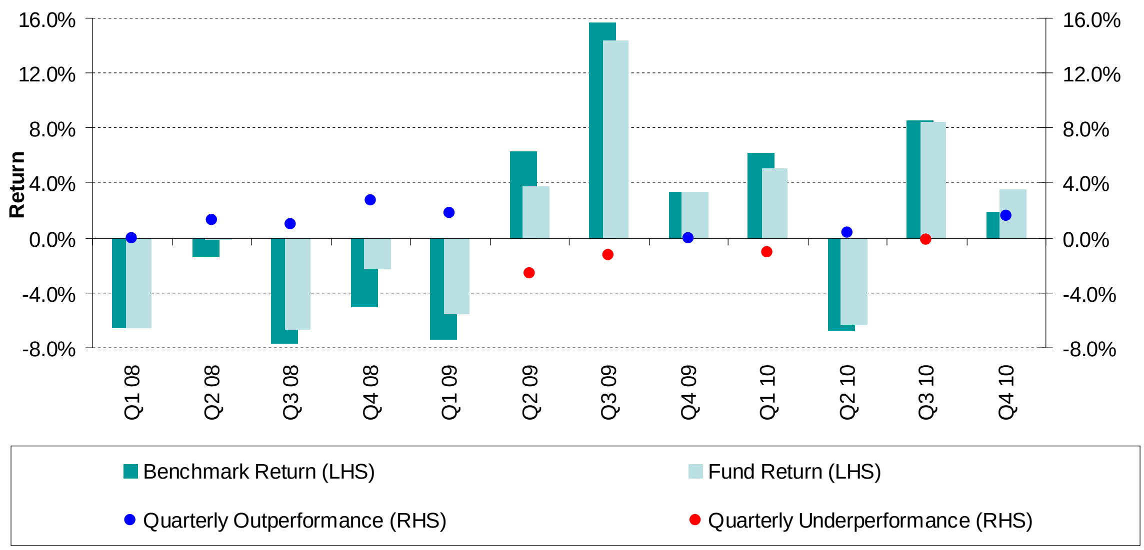
Total Scheme Performance

Manager/Fund	Portfolio Return 4Q 2010 %	Benchmark Return 4Q 2010 %	Portfolio Return 12 months to 31/12/10 %	Benchmark Return 12 months to 31/12/10 %
Newton Multi-asset	4.4	2.8	10.8	10.2
Schroder Multi-asset	2.3	0.3	10.1	7.3
Internal Property*	1.9	2.2	6.4	14.5
Legal and General – Equity	10.0	10.0	16.7	16.5
Legal and General – Fixed Interest	-2.1	-2.4	8.8	8.4
Combined Portfolio	**3.5**	**1.9**	**10.5**	**9.4**

Source: Investment managers, Thomson Reuters. Benchmark returns taken from investment managers and are estimates. For the Schroders return (both fund and benchmark), we have combined the performance of the "old" portfolio with the "new" portfolio, assuming the 70/30 split for the new portfolio.

* Estimate portfolio returns based on asset value over asset value.

Portfolio returns are as stated in the investment managers' quarterly reports except for the internal property which is an estimate.



Source: Investment managers, Thomson Reuters.

The Scheme achieved a return of 3.5% over the quarter and outperformed the estimated benchmark return of 1.9%. Over the year to 31 December 2010, the Scheme outperformed the estimated benchmark by 1.1%.

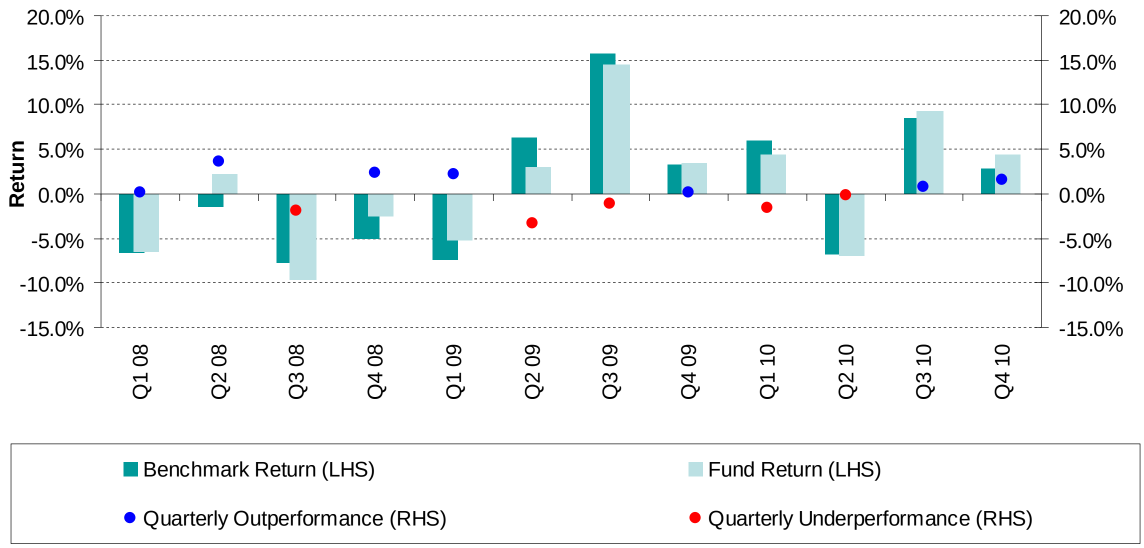
Over both the 3 month and the 1 year periods, four of the five portfolios have outperformed the benchmark. The only portfolio to underperform was the Internal Property fund. However, in absolute terms only the L&G Fixed Interest fund performance was negative.

Over the quarter, Schroders and Newton transitioned their portfolios to the new 70% growth / 30% corporate bond splits.

As of next quarter, the performance of Schroders and Newton will no longer be benchmarked against WM figures but rather versus the respective benchmarks of the individual growth and bond strategies they manage.

Section Three – Manager Performance

Newton - Multi-Asset Portfolio - performance relative to benchmark



Source: Investment manager.

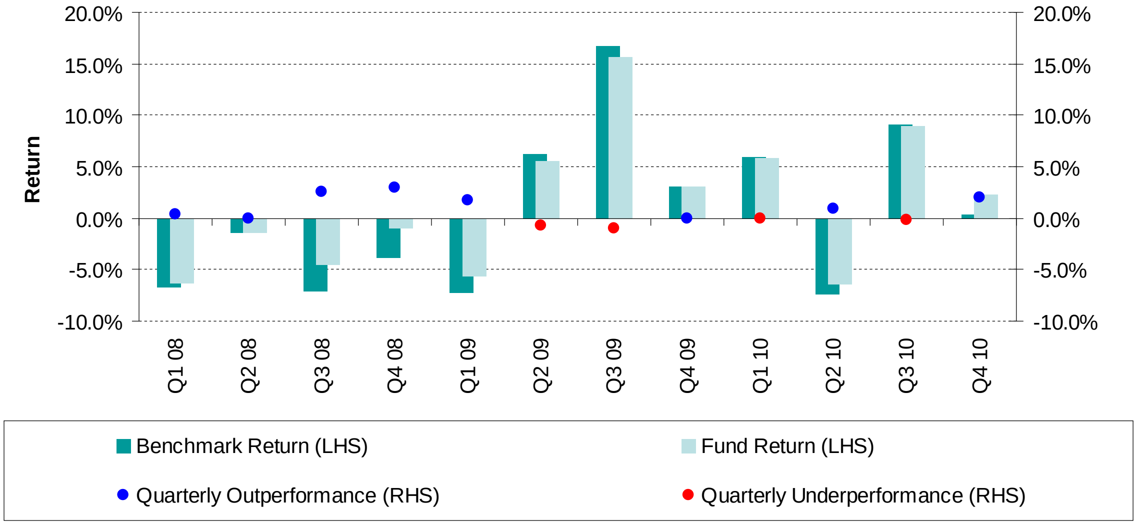
The portfolio return was 4.4% compared with the estimated benchmark return of 2.8%.

Over the quarter, Newton transitioned the portfolio from the "balanced" structure to the 70% growth / 30% corporate bond split. This was completed on 10 December 2010.

Over the year to 31 December 2010, the portfolio has produced a return of 10.8% compared with the benchmark return of 10.2%.

Over the three year period, Newton produced a return of 2.3% p.a. compared with the benchmark return of 2.2% p.a. The portfolio has outperformed in seven quarters over the last three years.

Schroder - Multi-Asset Portfolio - performance relative to benchmark



Source: Investment managers.

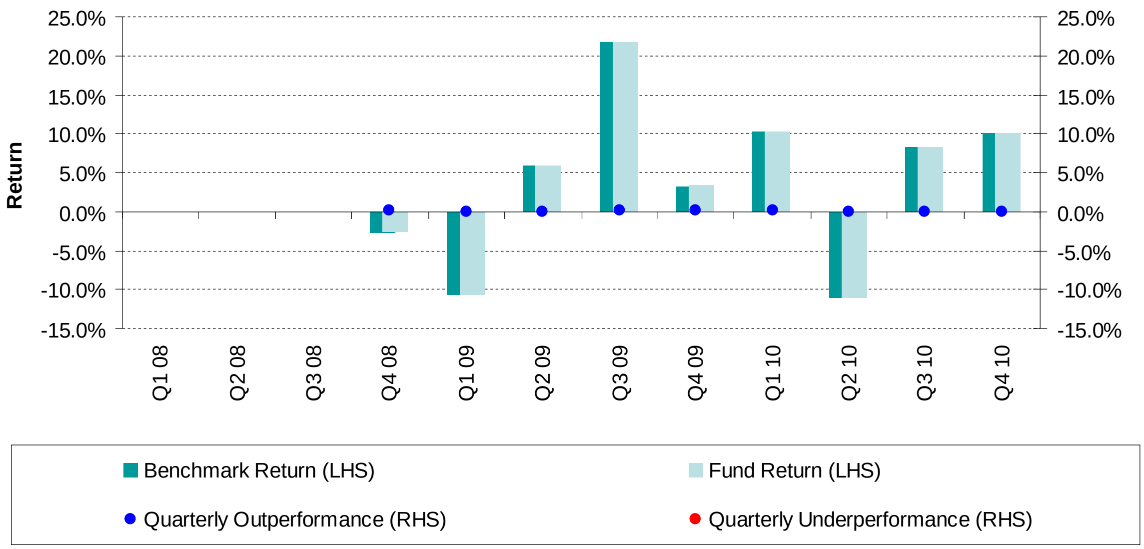
The return on the portfolio over the quarter was 2.3% compared with the estimated benchmark return of 0.3%.

Over the quarter, Schroders transitioned the portfolio from the "balanced" structure to the 70% growth / 30% corporate bond split. This was completed in early December.

Over the year to 31 December 2010, the portfolio has produced a return of 10.1% compared with the benchmark return of 7.3%.

Over the three year period, Schroders has performed well in absolute terms returning over 4% p.a. The portfolio has outperformed in seven quarters over the last three years.

L&G – Equities



Source: Investment manager.

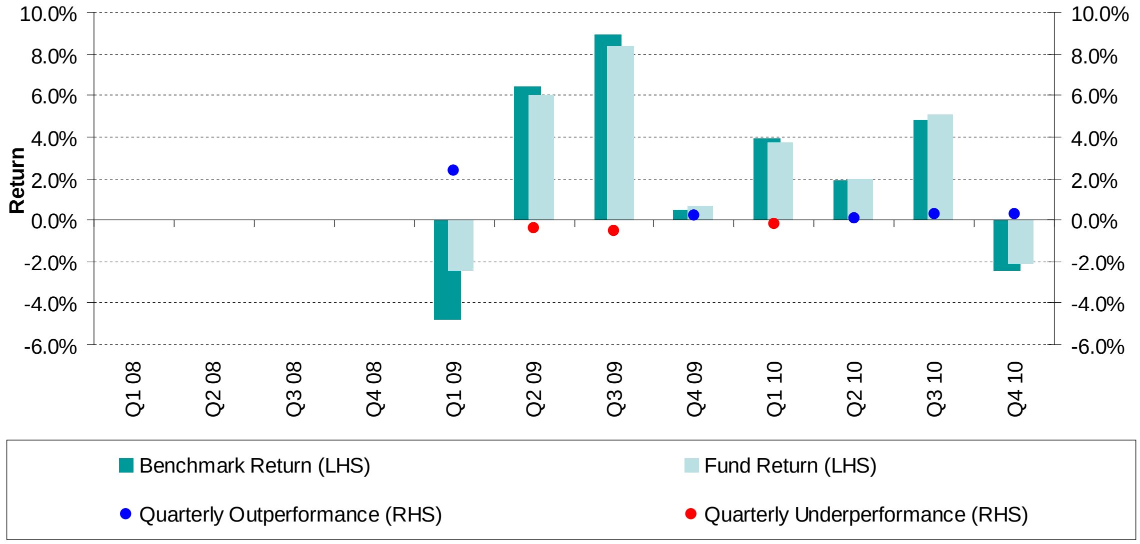
The first investment in the L&G World (ex UK) Equity Index Fund was made on 23 September 2008.

Over the fourth quarter of 2010, the Fund return was 10.0% in line with the benchmark return; all the equity regions performed much in line with their respective benchmarks.

Over the year, the Fund return was 16.7% compared with the benchmark return of 16.5%.

This Fund has achieved its target of matching the relevant indices over both the quarter and year.

L&G – Fixed Interest



Source: Investment manager.

The first investment in the L&G Active Corporate Bond – All Stocks Fund was made on 17 December 2008.

Over the fourth quarter of 2010, the Fund return was -2.1% compared with the benchmark return of -2.4%.

The key driver of outperformance over the quarter was the portfolio's bias towards collateral debt; a defensive positioning also contributed positively.

Over the year, the Fund has performed well with a return of 8.8% compared with the benchmark return of 8.4%.

Section Four – Asset Allocation and Liabilities

Scheme asset allocation against asset benchmark split

	Start of Quarter			End of Quarter		
	Exposure %	Bmk %	Difference %	Exposure %	Bmk %	Difference %
UK Equities	30.5	30.1	0.4	9.1	29.4	-20.3
Overseas Equities	34.0	35.3	-1.3	28.4	35.9	-7.5
Fixed Interest	13.6	13.4	0.2	28.3	13.1	15.2
Bonds(held as part of Growth portfolios)	-	-	-	6.4	-	6.4
High Yield	-	-	-	7.3	-	7.3
Private Equity	-	-	-	1.2	-	1.2
Commodities	-	-	-	5.4	-	5.4
Absolute Return	-	-	-	0.9	-	0.9
Index-Linked*	5.0	4.8	0.2	-	4.7	-4.7
Property	5.2	6.2	-1.0	6.1	6.0	0.1
Cash/Other	11.7	10.2	1.5	6.9	10.9	-4.0

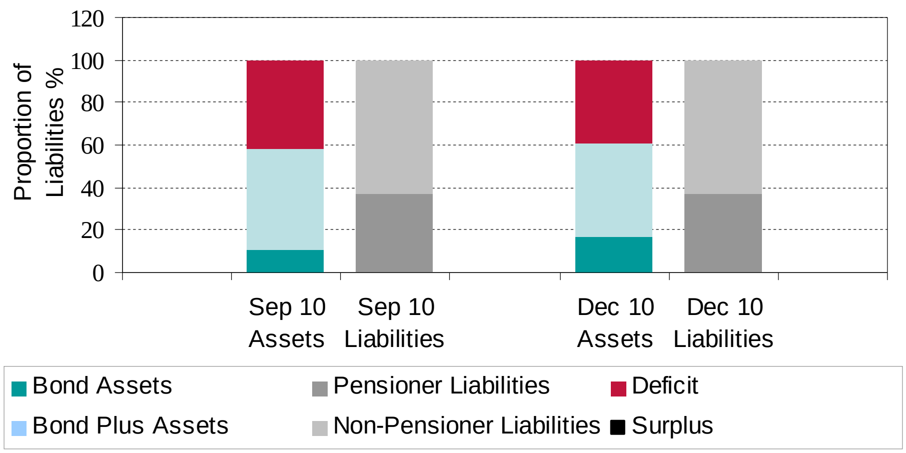
Source: Investment Managers. The end of quarter benchmark allocation is based on 49 funds within the WM universe. The benchmark allocation to Alternatives (shown as part of Cash) was 7% as at end September 2010 and 7.1% as at end December 2010.

*There is a small proportion (less than 1%) of Index-Linked gilts held as part of the Newton growth portfolio.

Over the quarter, the changes in asset allocation are primarily due to the Scheme's transition to the new investment strategy. Overall, the allocation to Equities, particularly UK Equities, has decreased whilst the allocation to Fixed Interest has increased. The Scheme now has a significant allocation to "Alternative" growth assets.

It is important to note here that the benchmark allocation at the end of the quarter is based on the WM universe which is no longer relevant to the Scheme, given the implementation of the new strategy, and is shown here for interest only.

Allocation to Bond and Bond Plus assets against estimated liability split



The chart above shows the allocation of the Scheme to Bond and Bond Plus assets (see appendix for definition) against the estimated liability split, which is based on changes in gilt yields underlying the Scheme Actuary's calculation of liabilities. The reference yield for the liabilities is the over 15-year gilt yield, as shown in the Market Statistics table in Section 2. These calculations do not take account of unexpected changes to Scheme membership and should not be construed as an actuarial valuation. However, by showing approximations to these liabilities, this chart should assist the Panel in making informed decisions on asset allocation.

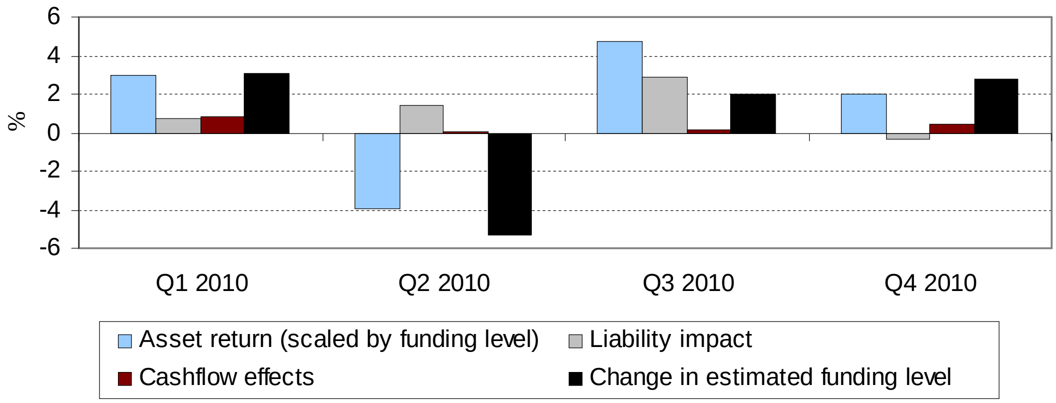
The split between non-pensioner and pensioner liabilities is estimated to have remained fairly stable over the quarter. The Scheme remains very underweight to Bond assets relative to its estimated pensioner liabilities; a mismatch that leaves the Scheme exposed to both market and interest rate risk.

Scheme performance relative to estimated liabilities

Long-dated government bond yields rose (i.e. government bond prices fell) over the quarter and this is expected to have reduced the value of the liabilities (all else being equal).

In addition, the value of the Scheme's assets rose over the quarter which has led to an improvement in the funding level.

Therefore, based on movements in the investment markets alone, this quarter has seen an improvement in the Scheme's estimated funding position with a reduction in the funding deficit.



The above chart shows, for each quarter, how changes in the value of the assets and the liabilities, combined with the cashflow of the Scheme, have affected the funding level. As detailed earlier, the value of the liabilities has been estimated with reference to changes in the gilt yields underlying the Scheme Actuary's calculation of liabilities, as shown in the Market Statistics table.

Section Five - Corporate governance

We have not included this section given the transition of the Scheme's assets held with Newton and Schroders, however, we do highlight that we have no concerns with each of the manager's approach to corporate governance and responsible investing.

We will resume this section in our Q1 2011 report following a full quarter of performance in the newly implemented strategy.

Section Six – Summary

Overall this has been a good quarter for the Scheme.

In absolute terms, the Scheme's assets produced a return of 3.5%, as growth markets produced positive returns, where a significant proportion of the Scheme is invested.

In relative terms, the Scheme outperformed the estimated benchmark return by 1.6%.

The transition to the new agreed portfolio strategy was completed in December. The structure was created to minimise the costs of transition and ensure that appropriate market exposures were maintained throughout.

Our next report will provide an analysis of the Scheme's performance relative to its liabilities subsequent to the completion of the new strategy.

Appendix

Liability benchmarking

An assessment of Scheme liabilities and how they change would require details of membership changes and actuarial valuation calculations to be carried out. However, by considering the changes in value of a suitable notional portfolio, based on your own liabilities, we can obtain an approximation to the changes in liabilities which will have occurred as a result of investment factors. In this report, when we refer to "liabilities" we mean the notional portfolio representing the actuarial liabilities disclosed in the actuarial valuation report dated 31 March 2007, adjusted approximately to reflect changes in investment factors as determined by an estimated projection of the 31 March 2007 actuarial valuation report as at 30 September 2008. This will, therefore, not reflect any unanticipated member movements since the actuarial valuation. However, as a broad approximation it will allow more informed decisions on investment strategy to be made on an ongoing basis.

Summary of current funds

Manager	Fund	Date of Appointment	Management Style	Monitoring Benchmark	Target
Newton Investment Management Limited (Newton)	Real Return	December 2010	Active, pooled	1 month LIBOR plus 4% p.a.	To achieve significant real rates of return in sterling terms predominantly from a portfolio of UK and international securities and to outperform the benchmark over rolling 5 years
Newton	Corporate Bond	December 2010	Active, pooled	Merrill Lynch Non Gilt Over 10 Years Investment Grade Index	To outperform the benchmark by 1% p.a. over rolling 5 years
Schroder Investment Management Limited (Schroder)	Diversified Growth	December 2010	Active, pooled	Retail Price Index plus 5% p.a.	To outperform the benchmark over a market cycle (typically 5 years)
Schroder	All Maturities Corporate Bond	December 2010	Active, pooled	Merrill Lynch Sterling Non-Gilts All Stocks Index	To outperform the benchmark by 0.75% p.a. (gross of fees) over rolling 3 years
Legal and General Investment Management (L&G)	World (ex UK) Equity Index Fund	September 2008	Passive, pooled	FTSE AW World (ex UK) Index	Track within +/- 0.5% p.a. the index for 2 years in every 3

Summary of current funds (continued)

Manager	Fund	Date of Appointment	Management Style	Monitoring Benchmark	Target
L&G	Active Corporate Bond – All Stocks	December 2008	Active, pooled	iBoxx Sterling Non-Gilts All Stocks Index	Outperform by 0.75% p.a. (before fees) over rolling 3 years
Internal	Property	N/a	Active, property unit trust portfolio	UK IPD Property Index	Outperform the index
Newton Investment Management Limited (Newton)	Balanced	April 2006	Active, segregated	WM Local Authority Weighted Average	Outperform by 1% p.a over rolling 3 years, and not to underperform by 3% in any rolling 12 month period
Schroder Investment Management Limited (Schroder)	Balanced	1994	Active, segregated	WM Local Authority Weighted Average ex property, Japan and other international equities	Outperform by 1% p.a over rolling 3 years, and not to underperform by 3% in any rolling 12 month period

Glossary of Terms

Term	Definition
Absolute return	The overall return on a fund.
Bond asset	Assets held in the expectation that they will exhibit a degree of sensitivity to yield changes. The value of a benefit payable to a pensioner is often calculated assuming the invested assets in respect of those liabilities achieve a return based on UK bonds.
Bond plus asset	Assets held in the expectation that they will achieve more than the return on UK bonds. The value of a benefit payable to a non-pensioner is often calculated assuming the invested assets in respect of those liabilities achieve a return based on UK bonds plus a premium (for example, if holding equities an equity risk premium may be applied). The liabilities will still remain sensitive to yields although the bond plus assets may not.
CAPS	A performance monitoring service provided by Russell Mellon. This shows manager by manager performance on a fund by fund basis, including median manager returns. CAPS use a form of time-weighted rate of return.
Duration	The average time to payment of cashflows (in years), calculated by reference to the time and amount of each payment. It is a measure of the sensitivity of price/value to movements in yields.
Equity risk premium	The additional return expected from equities over and above that expected from UK Gilts. An equity risk premium is given as an example and other risk premia also exist.
Funded liabilities	The value of benefits payable to members that can be paid from the existing assets of the scheme (i.e. those liabilities that have assets available to meet them).
IMAGE Median	The return from the median manager in the IMAGE survey.
IMAGE Universe	All the managers who are included in the IMAGE survey of pooled balanced funds.
Market stats indices	The following indices are used for asset returns: UK Equities: FTSE All-Share Index Overseas Equities: FTSE World Index Series (and regional sub-indices) UK Gilts: FTSE-A Gilt >15 Yrs Index Index Linked Gilts: FTSE-A ILG >5 Yrs Index Corporate Bonds: iBoxx Corporate Bonds (AA) Over 15 Yrs Index Non-Gilts: iBoxx Non-Gilts Over 15 Yrs Index Property: IPD Property Index High Yield: ML Global High Yield Index Commodities: S&P GSCI GBP Index Hedge Funds: CSFB/Tremont Hedge Fund Index Cash: 7 day London Interbank Middle Rate Price Inflation: Retail Price Index (excluding mortgages), RPIX Earnings Inflation: Average Earnings Index

Market forecast committee	An internal committee at HSBC Actuaries that meets each quarter to set long term return expectations on different asset classes using fund manager surveys and wider economic data from the investment market.
Market volatility	The impact of the assets producing returns different to those assumed within the actuarial valuation basis, excluding the yield change impact.
Money-Weighted rate of return	The rate of return on an investment including the amount and timing of cashflows.
Non-Pensioner liability	The value of benefits payable to those who are yet to retire, including active and deferred members.
Pensioner liability	The value of benefits payable to those who have already retired, irrespective of their age.
Relative return	The return on a fund compared to the return on another fund, index or benchmark. For IMAGE purposes this is defined as: Return on Fund *less* Return on Index or Benchmark.
Scheme investments	Refers only to the invested assets, including cash, held by your investment managers.
Standard deviation	A statistical measure of volatility. We expect returns to be within one standard deviation of the benchmark 2 years in every 3. Hence as the standard deviation increases so does the risk.
Surplus/Deficit	The estimated funding position of the Scheme. This is not an actuarial valuation and is based on estimated changes in liabilities as a result of bond yield changes, asset movements and, if carried out, output from an asset liability investigation (ALI). If no ALI has been undertaken the estimate is less robust.
Time-Weighted rate of return	The rate of return on an investment removing the effect of the amount and timing of cashflows.
Unfunded liabilities	The value of benefits payable to members that cannot be paid from the existing assets of the Scheme (i.e. those liabilities that have no physical assets available to meet them). These liabilities are effectively the deficit of the Scheme.
Yield (gross redemption yield)	The return expected from a bond if held to maturity. It is calculated by finding the rate of return that equates the current market price to the discounted value of future cashflows.
3 Year return	The total return on the fund over a 3 year period expressed in percent per annum.

Manager Research Tier Rating System

Tier	Definition
Tier One	Significant probability that the manager will meet the client's objectives.
Tier Two	Reasonable probability that the manager will meet the client's objectives.
Tier Three	The manager may reach the client's objectives but a number of concerns exist.
Tier Four	There is a reasonable probability that the manager will fail to meet the client's objective due to a number of key concerns.
Tier Five	Significant concerns exist and it is highly probable that the manager will not meet client's objectives.

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AGENDA ITEM: 10 Page nos. 70 - 75

Meeting	Pension Fund Committee
Date	21 March 2011
Subject	**Update on Admitted Body Organisations issues and revised monitoring arrangements**
Report of	Deputy Chief Executive
Summary	This report updates the Committee on admitted body organisation issues previously reported at the December meeting, sets out revised monitoring arrangements and seeks retrospective approval for the admission of Y-Gen to the Pension Fund.

Officer Contributors	John Hooton, Assistant Director of Strategic Finance Hansha Patel, Pension Services Manager Mark Rudd, Head of HR Service Delivery
Status (public or exempt)	Public
Wards affected	All
Enclosures	None
For decision by	Pension Fund Committee
Function of	Council
Reason for urgency / exemption from call-in (if appropriate)	Not applicable

Contact for further information: John Hooton, Asst Director Strategic Finance, 020 8358 2460

1. RECOMMENDATIONS

1.1 That the Committee notes:

1.1.1 The update to issues in respect of admitted body organisations within the Pension Fund;

1.1.2 The revised monitoring arrangements in place to avoid such issues reoccurring in the future

1.2 That the Committee grants, retrospectively, approval to the admission of Y-Gen as a 'Admission Body' to the Local Government Pension Fund, administered by the council.

2. RELEVANT PREVIOUS DECISIONS

2.1 None.

3. CORPORATE PRIORITIES AND POLICY CONSIDERATIONS

3.1 Maintain the integrity of the Pension Fund by ensuring robust monitoring of admitted body organisations and ensuring all third-parties comply fully with admission agreements and bond requirements. The principle supports the corporate priority of getting the best value from our resources.

4. RISK MANAGEMENT ISSUES

4.1 The ongoing viability of the Pension Fund is dependent on maximising contributions to the Fund. All admitted bodies are subject to reviews and actuarial assessments to ensure compliance with admissions agreements and maintenance of appropriate employer contribution levels in order to mitigate against any risk to the financial viability of the pension fund.

4.2 There is a possibility of financial losses on the Pension Fund where arrangements around admitted bodies and bond agreements are not sufficiently robust. The new monitoring arrangements are being put in place to ensure that Admissions Agreements and, where relevant, bonds, are in place and that bonds are renewed, as appropriate, during the lifetime of the, relevant, Admission Agreement.

5. EQUALITIES AND DIVERSITY ISSUES

5.1 Ensuring the long term financial health of the pension fund will benefit everyone who contributes to it.

6. USE OF RESOURCES IMPLICATIONS (Finance, Procurement, Performance & Value for Money, Staffing, IT, Property, Sustainability)

6.1 Paragraph 4, above, deals with the financial implications of this report.

6.2 There are no procurement, performance & value for money, staffing, IT, Property or Sustainability implications.

7. LEGAL ISSUES

7.1 The Local Government Pension Scheme (Administration) Regulations 2008 (as amended) provide that a Local Authority may admit a contractor into the Local Government Pension Scheme, provided that criteria, specified within the Regulations, are met.

7.2 The Regulations, further, provide for an assessment of the level of risk arising on premature termination of the provision of the service or assets by reason of insolvency, winding up or liquidation of the admission body. The assessment must be with the benefit of actuarial advice and, where the level of risk is such as to require it, the admission body shall enter into an indemnity or bond to meet the level of risk identified.

7.3 The Council's standard Admissions Agreement makes provision for the admission body to maintain a bond in an approved form and to vary the level of risk exposure under the bond as may be required from time to time.

8. CONSTITUTIONAL POWERS

8.1 The Council's constitution, Part 3 – Responsibility for Functions, Pension Fund Governance Compliance Statement, paragraph 2.2.13 empowers the Pension Fund Committee to "approve applications from organisations wishing to become admitted bodies into the Fund where legislation provides for discretion, including the requirements for bonds."

9. BACKGROUND INFORMATION

9.1 Officers have undertaken a review of all admitted body arrangements, following the administration of Connaught Partnership Limited (Connaught). This report provides a further update on issues previously reported at the Committee meeting held in December.

9.2 This report also sets out revised monitoring arrangements to ensure that sufficient control and management oversight is in place over the risks associated with bodies admitted to the Pension Fund.

10. UPDATE OF CURRENT ISSUES:

Admitted Body – Connaught Partnership:

10.1 Connaught went into administration with effect from 31/08/2010. The pension fund deficit has been calculated by the actuaries and the pension contributions that remain unpaid for August 2010 have been confirmed by the Pension section.

10.2 The Council's legal team are currently liaising with Connaught's Administrators, KPMG with a view to recovery of these monies. With respect to the Pension Fund deficit, KPMG notified the Council, on 16th February

2011, that, in their view, the deficit is an unsecured, non-preferential debt and the Council has been added to the list of creditors. With respect to the contributions, a Form RP15 – detailing the outstanding contributions for August 2010 - has been completed and submitted to KPMG. They have indicated that the outstanding contributions will be paid.

Admitted Body – Housing 21:

10.3 In August 2002, the Council entered in to a contract with Housing 21 ("H21") for the provision of Homecare Services and staff transferred from the Council to H21. In order that the transferred staff could continue to participate in the Local Government Pension Scheme Fund, administered by the Council, admission body status was granted to H21. This contract ended in September 2010 but H21 was successful, along with 3 other new contractors, in securing a, further, contract with the Council. Officers are liaising with representatives for H21 and the 3 new contractors to finalise matters relating to pensions and a further report will be presented to the next committee once these discussions have been concluded.

10.4 The Fund Actuary has provided financial data based on a number of scenarios to support future business decisions. The Pension Fund Committee will be notified of the full implications of any changes when these become clear. Given the continuing nature of the service provision, the risk to the pension fund for this particular arrangement is considered to be low.

Admitted Body – Fremantle Trust:

10.5 Fremantle Trust was awarded admitted body status in April 2001. The existing bond expired in September 2010.

10.6 The Pension Section has now received confirmation from the Director of Finance at Fremantle that a, further bond, for a three year term, to August 2013, has been arranged. It is expected that executed bond papers will be received by 31 March 2011.

Admitted Body – Birkins Cleaning Services Limited:

10.7 Birkins have been providing cleaning services for Queenswell Infant and Nursery Schools since September 2009. The bond expired on 31 August 2010. Birkins have now confirmed that a, further, bond has been provided and that executed bond papers have now been received.

Admitted Body – Go Plant:

10.8 An Admitted Body Agreement has been in place since April 2008. A deed of Variation for inclusion of additional staff was finalised and signed on 24 February 2011. A bond is in place and expires on 2 October 2011.

Admitted Body – Open Learning Partnership (OLP):

10.9 Admitted body will cease on 31/03/2011. The pension fund deficit, which has been confirmed by the scheme actuaries, will be paid by OLP by 31 March 2011.

Admitted Body – Greenwich Leisure Ltd:

10.10 Admitted body since December 2002. The last bond expired on 8 February 2011. The Pension Section is pursuing the provision of a further bond and is in contact with Greenwich Leisure to this end.

Admitted Body – Servite Homes (now Viridian Homes):

10.11 Admitted Body since April 2006. The bond is due to expire on 20 April 2011. The Pension Section is liaising with the actuaries for the re-assessment of the bond level.

Admitted Body – Woodhouse College/Duchy Catering/Graysons Restaurants:

10.12 Graysons contract ended 31 December 2010. The Pension Section has now obtained confirmation from the actuaries of the pension fund deficit and the monies have now been recovered.

10.13 **Caterlink**: staff from Graysons transferred to Caterlink on 1st January 2011, when Caterlink succeeded Graysons. Officers are liaising with Caterlink regarding the Pension Fund requirements in respect of the two members of staff who transferred.

Admitted Body – Y-Gen:

10.14 On 18 June 2007 (Agenda item 9 - "Future Provision of Connexions Service") Cabinet approved a preferred model for the provision of the Connexions Service in Barnet following the planned transfer of the service in April 2008. The decision was to approve an in-house model that was locally managed from within the schools, colleges and community services supported by an external provider for work with young people with learning difficulties (LDD) that was within the level of grant allocated.

Y-Gen was commissioned to deliver the LDD service in April 2008 and they requested admitted body status to the Barnet Local Government Pensions Scheme in respect of the two members of staff who transferred.

10.15 The service contract commenced in April 2008. Y-Gen provided a bond (which is due to expire on 31 March 2011) but, although Y-Gen have signed the Admissions Agreement it has not, yet, been signed on behalf of the Council. Authority is required, from this Committee, for the Agreement to be signed on behalf of the Council.

10.16 The service contract has been extended to 31/03/2012 and the Pension Section is pursuing Y-Gen for an extension of the current bond.

11. REVISED MONITORING ARRANGEMENTS

11.1 Revised monitoring arrangements are being put in place to make the monitoring of admitted body agreements more robust. A Pensions Operations Group consisting of Officers from Strategic Finance, Pensions, Treasury Management, Human Resources and Legal has been set up to meet on a quarterly basis to review the current position with each admitted body organisation.

11.2 The Pensions Administration Team will be responsible for the on-going day-to-day monitoring of admitted bodies; specifically that agreements and bonds are in place.

11.3 The Council's legal team will prioritise actions in respect of Admitted Body legal documentation.

11.4 The Pensions Administration Team and Legal will ensure that all admitted body documentation including agreements and bonds are held in a single central repository.

11.5 Where issues are identified that cannot be resolved by the Pensions Administration Team, these will be escalated in a timely manner as per the flowchart below.

11.6 Escalation Process: