Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND COMMITTEE**	
MEETING DATE:	**13 December 2013**	**AGENDA ITEM NUMBER**
TITLE:	**INFRASTRUCTURE INVESTMENTS**	
WARD:	ALL	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Appendix 1 – JLT Infrastructure Report		

1 THE ISSUE

1.1 The revised investment strategy allocates 5% of assets to infrastructure within the “growth” or return seeking portion of the Fund. The allocation is funded by a reduction in the allocation to hedge funds.

1.2 The Investment Panel have received training and considered advice from the investment advisor and a practitioner and are recommending the proposed infrastructure policy framework to the Committee for approval. There will be a pre-Committee meeting session for Committee members that wish to understand JLT’s report in greater detail.

2 RECOMMENDATION

That the Committee

2.1 **Agrees the proposed policy framework (in section 6).**

3 FINANCIAL IMPLICATIONS

3.1 There is provision in the 2013/14 budget for investment advice relating to investing in infrastructure.

4 BACKGROUND

4.1 The Fund's revised investment strategy agreed in March 2013 included a new allocation to Infrastructure of 5% of Fund assets.

4.2 An allocation to infrastructure meets the Fund's investment objectives as follows:

(1) Provides a source of returns as part of growth portfolio

(2) Reduces risk and increases diversification of returns within the investment portfolio

(3) Provides predictable income with a link to inflation

(4) Can generate income to meet the Fund's cashflow requirements

4.3 The proposed framework identifies how the investment in infrastructure should be structured to best achieve these objectives, and represents the start of the process to implement the allocation to infrastructure.

5 INVESTING IN INFRASTRUCTURE

5.1 JLT's report at Appendix 1 restates the role of infrastructure in the Fund, the characteristics of infrastructure investments, how investors can access infrastructure investments and the issues to consider.

5.2 The report recommends the framework as set out in Section 6 below.

5.3 It should be noted that an investment in Infrastructure attracts higher levels of manager fees than other more traditional asset classes, as the process of making investments in unlisted infrastructure is more resource intensive than equity or bond mandates. Expectations for fee levels are discussed in JLT's report.

5.4 The proposed framework delegates all decisions to invest in individual infrastructure assets or projects to the appointed investment manager. The investment manager will decide whether the Fund invests in local infrastructure projects, determined by any such project meeting the investment criteria set by the manager. The manager's evaluation of all projects will be based on the risk return characteristics of each project and the role each project plays in the portfolio to diversify and manage overall risk. For this reason, there is no specific allocation for investment in local infrastructure.

5.5 Infrastructure is potentially an asset class for which environmental, social and governance ('ESG') factors form an intrinsic part of the investment analysis of each particular project. For example, construction is expected to utilise the best technology to ensure efficient buildings complying with latest environmental regulations – not doing so represents certain risks to the portfolio. Indeed, many infrastructure projects address ESG issues such as climate change by investing in the upgraded technology. The tender evaluation process will assess the extent to which a manager incorporates ESG factors into their analysis. Therefore a specialist ESG fund is not required to ensure these factors are considered.

5.6 Leverage is an inherent part of the financial structure of many infrastructure projects and is expected to be used at the asset level. The extent to which managers assess the risks associated with the amount of leverage employed in the underlying infrastructure projects will be evaluated in the tender process. In contrast some fund managers may use leverage at the fund level for operational reasons or to increase returns. The Fund would not invest in a fund where the manager seeks to generate returns by using leverage at the fund level.

6 PROPOSED POLICY FRAMEWORK

6.1 To meet the strategic objectives of the Fund, the proposed investment in infrastructure should incorporate the following characteristics:

(1) Target a return of gilts +2.5% p.a., as set out in the SIP; (this is currently equivalent to a 7% return p.a. over the long term)

(2) Invest in an unlisted fund investing in unlisted infrastructure assets, based on the low correlation with equity markets and to take advantage of the illiquidity premium;

(3) Implement a global mandate giving the infrastructure manager the discretion to select where investments are made (geographically) to take advantage of all opportunities based on the risk/return characteristics of each deal. It is expected that the majority of exposure will be in developed markets and in core investments.

(4) Enable investment across core, value-add and opportunistic assets to ensure a steady and predictable yield whilst still meeting the return target of gilts +2.5%;

(5) Diversification across sectors to reduce sector concentration risk within the portfolio;

(6) Allow greenfield investments in addition to brownfield in order to meet return target of gilts +2.5% p.a.

(7) Allow debt to be considered under manager discretion for effective risk management of the portfolio

(8) No leverage at the fund level to enhance returns (accepting that a small amount of leverage maybe required over short term periods for operational reasons). Evaluate whether an appropriate limit on use of leverage in underlying investments is necessary or indeed feasible (especially if investing via pooled funds).

(9) Preference for one manager to manage the whole allocation but retain flexibility to appoint two managers if this is necessary to achieve the spread of investments needed to meet strategic aims. Invest in either in a direct fund structure or a fund of funds structure

(10) The tender process will evaluate how each manager manages the various risks associated with infrastructure investing including financial (for example leverage), ESG, regulatory, and reputational risks, as well as how they select investments and allocate geographically.

7 IMPLEMENTATION ISSUES

7.1 **Tender Process:** As infrastructure investing is often implemented via a private investing model, the investment may be made via pooled funds, which would mean OJEU requirements are not applicable. The flexibility of a non-OJEU process could be beneficial in this instance where it will be necessary to evaluate a broad range of potential approaches to investing. In addition, the Fund will want to consider all fund raising opportunities, not just those funds raising funds at the time of the tender. However, regardless of whether it is an OJEU process or not, the Fund will apply the same level of rigour to the tender analysis and evaluation.

7.2 **Potential collaboration:** In addition, Officers will consider the potential to collaborate with other LGPS funds that are looking to invest in infrastructure with a view to sharing some of the costs of the selection process. Any collaboration will not impact the mandate specification or evaluation criteria chosen by the Fund.

7.3 **Implementation:** Implementation of the tender process will be delegated to Officers and the Investment Advisor, and the Investment Panel which will be involved in the tender and selection process as required, given the specific characteristics of the asset class.

8 RISK MANAGEMENT

8.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. It discharges this responsibility by ensuring the Fund has an appropriate investment strategy and investment management structure in place that is regularly monitored. The creation of an Investment Panel further strengthens the governance of investment matters and contributes to reduced risk in these areas.

9 EQUALITIES

9.1 An equalities impact assessment is not necessary as the report contains only recommendations to note.

10 CONSULTATION

10.1 N/a

11 ISSUES TO CONSIDER IN REACHING THE DECISION

11.1 This report is for information only.

12 ADVICE SOUGHT

12.1 The Council's Monitoring Officer (Divisional Director – Legal and Democratic Services) and Section 151 Officer (Divisional Director – Business Support) have had the opportunity to input to this report and have cleared it for publication.

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Background papers	
Please contact the report author if you need to access this report in an alternative format	