Bath & North East Somerset Council	
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**
MEETING DATE:	**5 September 2024**
TITLE:	**Long Lease Property Review**
WARD:	ALL
AN OPEN PUBLIC ITEM	
List of attachments to this report: **Exempt Appendix 1 – Brunel Presentation**	

1. THE ISSUE

1.1. The Fund currently has a 9% strategic allocation to the Brunel Secured Income portfolio, which is split c.40% operational infrastructure and c.60% long-lease property (LLP). LLP strategies benefit from rents linked to inflation metrics and for this reason are considered a good fit for defined benefit schemes with long-term inflation linked liabilities.

1.2. At its December-23 meeting the Panel received a presentation from Mercer highlighting a number of issues relating to LLP including a general deterioration in the value of funds as a result of rising interest rates and large investor redemptions triggered by the 2022 gilts crisis.

1.3. Brunel have been invited to present (Exempt Appendix 1) at the meeting to help the Panel assess the outlook for LLP, whether the risks (and opportunities) highlighted last year are likely to persist and whether the current allocation to Secured Income remains consistent with the Funds overall strategic objectives.

2. RECOMMENDATION

The Avon Pension Fund Investment Panel:

2.1. **Notes the information contained in the Brunel Presentation in Exempt Appendix 1.**

3. FINANCIAL IMPLICATIONS

2.2. None

4. LONG LEASE PROPERTY ALLOCATION AND OUTLOOK

4.1. The overall strategic allocation to Secured Income is 9% and the portfolio is currently valued at £627m. LLP represents approximately 60%, or £376m, of this value, which itself is 6% of total fund assets. The remaining 40% is allocated to operational infrastructure.

4.2. The LLP component of the portfolio is split equally between two managers; ASI and M&G. The operational infrastructure component is managed by Schroders Greencoat (GRI).

4.3. In addition to the Secured Income allocation the Fund has a 7% allocation to core property. Compared to traditional commercial real estate, LLP strategies benefit from rents linked to inflation metrics or rents with fixed uplifts over long-term contracts, usually in excess of 15 years. As a result, where tenants remain solvent, cashflows derived from LLP assets are resilient to short-term economic disruption. Given the investment grade nature of tenants, LLP funds typically have a lower vacancy risk than core property portfolios and longer lease durations serve to increase the defensive characteristics of LLP funds. As long-lease assets exhibit fixed income-like characteristics, valuations can be sensitive to changes in interest rates.

4.4. The since inception internal rate of return across Cycles 1 and 2 for the LLP component of the Secured Income portfolio to March-24 was approximately -5.0% and -8.5%, respectively. This negative performance was largely offset by the positive performance from the operational infrastructure component, which has benefitted from ongoing demand for renewable assets and elevated power prices.

4.5. At its December-23 meeting the Panel discussed the challenges facing the LLP market. Notably, the investor base of a number of LLP funds had become concentrated due to redemptions from investors looking to shore up liquidity positions post the 2022 gilts crisis. Depressed LLP valuations present an opportunity to buy in at attractive levels but also call into question the ongoing viability of certain LLP funds should investor redemptions persist.

4.6. At its meeting in December the Panel was minded to retain its allocation to the Secured Income portfolio in its existing make-up of 60% LLP / 40% Operational Infrastructure and requested Brunel present their views on the return outlook for LLP, taking account of current demand from new investors and how redemptions and asset disposals have been serviced to date.

5. RISK MANAGEMENT

5.1. An effective governance structure, defining clear responsibilities, and ensuring that the decision-making body has an adequate level of knowledge and access to expert advice, is a key aspect of the risk management process.

6. EQUALITIES

6.1. A proportionate equalities impact assessment has been carried out using corporate guidelines and no significant issues have been identified.

7. CLIMATE CHANGE

7.1. The Fund is implementing a digital strategy across all its operations and communications with stakeholders to reduce its internal carbon footprint in line with the Council's Climate Strategy. The Fund acknowledges the financial risk to its assets from climate change and addresses this through its strategic asset allocation to Paris Aligned Global Equities, Sustainable Equities and renewable energy opportunities. The strategy is monitored and reviewed by the Committee.

8. OTHER OPTIONS CONSIDERED

8.1. None

9. CONSULTATION

9.1. The Head of Pensions has had the opportunity to input to this report and has cleared it for publication.

Contact person	Nathan Rollinson, Investments Manager
Background papers	Mercer Papers
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