

Bath & North East Somerset Council	
MEETING:	AVON PENSION FUND – INVESTMENT PANEL
MEETING DATE:	26 NOVEMBER 2024
TITLE:	NATURAL CAPITAL – INVESTMENT PANEL TRAINING
WARD:	ALL
AN OPEN PUBLIC ITEM	
Exempt Appendix 1: Mercer Presentation: Investing in Nature	

1 THE ISSUE

- 1.1 Natural Capital was identified at the last climate policy review as an area the Fund should explore further given its ambitious Net Zero 2045 target. To date, significant progress has been made to decarbonise the portfolio, however decarbonisation alone has limited real world impact. To drive the transition and allow the Fund the best chance of meeting its net zero ambitions further investment in climate solutions, and natural capital specifically, will be required.
- 1.2 Given the nascency and illiquidity of many natural capital strategies and the non-traditional nature of underlying return drivers, Committee asked the Panel to undertake further research and training before making a recommendation to allocate to the asset class.
- 1.3 Exempt Appendix 1 provides an overview of the investment case and implementation options for a dedicated Natural Capital allocation. Analysis shared with the Panel at its June meeting indicated an initial 2% of assets (c. £120m) would be a reasonable allocation.

2 RECOMMENDATION

- 1.4 **The Panel notes the information contained in the training materials in Exempt Appendix 1.**
- 1.5 **The Panel recommends to Committee that the Fund allocates 2% to Natural Capital, subject to the finalisation of the Brunel portfolio specification.**

2 FINANCIAL IMPLICATIONS

- 2.1 It is envisaged that the Natural Capital allocation would form part of the existing 32.5% overall allocation to illiquid assets and will be implemented via a Brunel portfolio.
- 2.2 There is provision for investment advice as pertains to natural capital within the 2024/25 budget.

3 FURTHER CONSIDERATIONS

- 3.1 **Risk/Return:** Fundamental to the thesis of natural capital is that climate change ambitions cannot be achieved without protecting and enhancing nature. This allocation is expected to deliver attractive returns whilst simultaneously driving nature positive outcomes.
- 3.2 Natural capital returns vary by sub asset class. More established asset classes such as sustainable forestry and agriculture typically target returns between 8-12%. Less established strategies, which focus on restoration and enhancement of natural resources such as wetlands and peatlands, have a much broader spread of returns between 4-12% due to a more diversified, and complex, set of underlying return drivers.
- 3.3 The Panel have expressed an interest in investing in restorative type strategies given their high degree of positive impact. The nascency of many of these strategies means care will need to be taken to ensure the risk/return profile is consistent with the Fund's overall strategic objectives. Furthermore, a balance will need to be struck between investing in assets that are viable today e.g. sustainable forestry and agriculture and those that may become more attractive over time. As such, it is likely this portfolio needs to be structured with flexibility in mind
- 3.4 **Implementation.** It is expected that implementation of the Fund's Natural Capital allocation will be via a dedicated Brunel portfolio. There are a number of underlying Brunel partner funds interested in making an allocation and Brunel are actively consulting with prospective managers.
- 3.5 Partner funds are keen to see an investible portfolio developed in good time, with high confidence of speed of deployment.

4 NEXT STEPS

- 4.1 The views of the Panel will be fed directly into the Brunel scoping process to help shape the natural capital portfolio specification.
- 4.2 Once the Brunel specification has been refined the Panel will make a recommendation to the Committee to invest the proposed 2% allocation. This recommendation is expected to go to Committee in the first half of 2025.

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 STATEMENT

- 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 Panel.

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.

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Background papers	Mercer Papers
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