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SCOTTISH BORDERS COUNCIL
PENSION FUND INVESTMENT AND PERFORMANCE SUB-COMMITTEE
TUESDAY, 16 FEBRUARY 2021
APPENDIX
BUSINESS CONSIDERED IN PRIVATE

4. **PRIVATE MINUTE**
The private section of the Minute of 29 September 2020 had been circulated.

DECISION
NOTED for signature by the Chairman.

5. **ISIO MANAGER BRIEFING**

5.1 With reference to paragraph 5 of the Minute of 29 September 2020, there had been circulated copies of a briefing paper by Isio giving a summary of the Fund's performance to 30 September 2020. Mr O'Hara explained that overall there had been a continued strong performance as global markets continued to recover. At the end of Quarter 3 asset values had risen to £808m from £792m at the start of the quarter. The funding position surplus has increased from £133m to £157m. The Baillie Gifford Global Equity Fund remained the standout performer both on an absolute and relative basis over the period.

5.2 With regard to the Investment Managers presenting to the Sub-Committee today, UBS UK Equity Fund and UBS Property Fund had both underperformed. Mr O'Hara advised that discussions with UBS about reducing their fee levels had been disappointing and the Pension Fund might wish to consider moving to a lower cost provision. Blackrock Long Lease Property Fund had also delivered a negative absolute return of 0.2% over the quarter driven by the reduction in capital values of some assets. Leisure had been the hardest hit sector because of the pandemic. Despite this, Blackrock were confident in the underlying quality of their assets and tenants. M&G's Alpha Opportunities Fund and Index Linked Gilt Fund significantly outperformed their respective benchmarks, benefitting from their decision to increase portfolio risk.

5.3 Referring to the supplementary papers circulated prior to the meeting. Mr Singh advised that the Fund's performance in Quarter 4, to 31 December 2020, delivered a positive return of 5.5% outperforming the objective by 0.5%. The majority of the Fund's assets contributed to the strong absolute performance. UBS – UK Equity Fund had delivered a strong performance of 12.6% over Q4, with UK equities one of the strongest performers with the easing of political uncertainty. Despite this the threat of future disruption remained as UK firms dealt with the increase in non-tariff free barriers. Mr O'Hara advised that Isio recommended the Pension Fund Committee carried out a formal review of the Fund's investment strategy and consider if the Strategy should be more global. Isio also recommended that the UBS mandate be reviewed and that other options be explored to reallocate assets to a lower cost, globally passive mandate. Mrs Robb confirmed that the next Strategic review was scheduled for the June joint meeting. In response to a question Mr O'Hara advised that M&G had deployed money into markets providing positive opportunities and had benefited from the recovery. They were relatively stable and had navigated the difficult market environment successfully.

DECISION
NOTED the report.

6. **PRESENTATION – UBS**

6.1 Chairman welcomed Malcolm Gordon, Antony Sander and George Griffiths who were in attendance to provide a performance update on UBS Real Estate. Copies of an investment report had been circulated with the agenda. Mr Sander began by advising that in 2020 UK property delivered -2.3% driven by the weakened retail sector, where yields were rising and rental values falling. The office sector had also declined by 1.7%. In contrast, industrial capital values delivered a 9.2% positive return. Quarter 4 had seen a positive return overall largely due to the industrial sector but there had been a significant decline in the office sector and parts of the retail sector, particularly retail warehouse. Looking forward UBS anticipated a degree of uncertainty but expected returns to be positive with the industrial sector continuing to outperform over the next three years. The retail sector was expected to underperform in the short term but would recover largely due to rental values being repriced. Office sector rentals were also expected to decline but would recover next year. The pandemic had resulted in a number of corporations reducing their overall footprint in the short term and recovery would depend on homeworking and the increase in flexible working environments.

6.2 In response to questions, Mr Sander advised that the portfolio was underweight in the industrial sector due to the overweight position in property. Repositioning of the portfolio had not been possible because of restrictions to the number of funds in the portfolio. Regarding removal of government support measures, Mr Sander advised that this would negatively affect consumer spending which would impact the retail sector and parts of the residential market. It was considered that business rates needed to be rebalanced with online digital platforms. Regarding the Nuveen UK Retail Warehouse Fund, Mr Sander advised that this Fund had delivered -36.4% and was the primary reason for the portfolio's underperformance. This was because the retail and hospitality sector had been badly affected by the pandemic. Mr Sander went on to advise that a number of retail parks had been trading but a number of occupiers had been unable or unwilling to pay rent. This had resulted in rental collections being down in 2020 compared to previous years. With regard to student accommodation, Mr Sander advised that student accommodation was 20% of the portfolio and delivered -3.9% over the year, largely driven by loss of income as discounts were offered to students and the loss of summer income. Going forward it was anticipated the next academic year would be more positive with an increase in valuations as a consequence. Regarding the arrears policy, Mr Sander advised that it depended on individual circumstances and some tenant negotiations had resulted in rent waivers, deferrals and concessions with extension to Lease terms. Mr Sander concluded his presentation by advising that as requested income distribution would not be reinvested as previously but was payable to the Pension Fund. The Chairman thanked Mr Sander, Mr Gordon and Mr Griffiths for their attendance and informative presentation.

DECISION
NOTED the presentation.

7. **PRESENTATION M & G INVESTMENTS**

7.1 The Chairman welcomed Alastair Mitchell, Jonathan Lahraoui and Robert Burrows who were in attendance to provide a performance update on the M&G Alpha Opportunities Fund and Index Linked Government Bond Fund. Copies of an investment report had been circulated with the agenda. Mr Mitchell began by referring to M&G's commitment to responsible investing explaining that since 2013 M&G had been an active signatory of the United Nations Principles of Responsible Investment (UNPRI). Analysis of ESG issues was an essential part of their investment process and credit assessment, with all clients included on their UNPRI Scorecard.

7.2 Regarding the M&G Alpha Opportunities Fund, Mr Burrows advised that M&G key principles was a value based approach, not reliant on forecasting and allocating risks where they had competitive advantage. This approach had delivered consistent outperformance since 2009. Last year, performance had been affected by Brexit and RPI reform. Going forward M&G's forecast was that performance would improve. Breakeven opportunities had coincided with RPI reform and they had taken the opportunity to sell some index linked bonds and purchase long dated investment grade industrials bonds. Mr Burrow went on to discuss RPI reform and changes to the methodology, essentially CPI, explaining that current yield if adjusted for CPI was considerably lower for the same level of return. The Cambridge Bond over benchmark gilt was linked to CPI so there would be no impact. In response to questions Mr Burrows advised that with the global vaccine rollout and the reopening of the economy, the outlook was positive with strong GDP projections going forward. M&G did not anticipate that the Bank of England would raise interest rates soon. Regarding inflation he advised that as the economy reopened there could be an increase in demand which might cause a short term spike in inflation.

7.3 Mr Lahraoui referred to M&G Alpha Opportunities Fund which had delivered a 7.2% return, with 2020 being a strong year for the Fund, being defensively positioned with low levels of credit risk. LIBOR was being phased out but there would be no changes to the management of managing the portfolio, although M&G were incorporating US names into the portfolio. M&G had reacted to market volatility by moving quickly from defensive assets to riskier parts of the market. There had been a number of opportunities such as Iceland Supermarket – which had increased sales; Nationwide Building Society which had fallen in value by 25% and Ford burdened by capex and an unprofitable European operation. Fallen Angels debt had increased and would provide interesting opportunities in the months ahead, as they had a strong incentive to regain investment grade ratings quickly. The outlook for 2021 was that Covid-19 market disruption had largely been corrected with credit stock selection being key, with the strong return delivered in 2020 continuing for the foreseeable future. Mr Lahraoui concluded by advising that their top five contributors all had robust, measurable targets to achieve ESG goals. If companies did not align to M&G standards they would be excluded from the portfolio until they realigned their goals in line with M&G's 2015 policy. The Chairman thanked Mr Burrow, Mr Lahraoui and Mr Mitchell for their attendance and informative presentation.

8. **PRESENTATION - BLACKROCK**

8.1 The Chairman welcomed Tamryn Rowlands, Uchenna Okwu, Geoffrey Shaw, Claire Cierpka and Lydia Thompson who were in attendance to provide a performance update on Blackrock UK Long Lease Property Fund. Copies of an investment report had been circulated with the agenda. Mr Shaw began by advising that GDP forecasts projected a sharp recovery in 2021 but geopolitical risk remained a key determinant of future economic growth. The pandemic had created a risk for property sectors, navigating these would be the key in determining future relative performance. The McKinsey Global Institute Report on remote working showed areas were jobs could be carried out remotely and effectively played into longer term thematic for building the Fund going forward.

8.2 Ms Cierpka went on to discuss rent collection during the pandemic explaining that Blackrock, recognising some tenants were under financial pressure, had been fair and equitable. To ascertain if support was required, Blackrock considered the support tenants were already receiving as well as undertaking a financial snapshot to understand the stresses affecting the business. There were different types of tenants – those that were not eligible for rent relief; those that required support; and, those requesting deferment by phasing rental payments over 12-18 months. There was also tenants that had requested a rental freeze in exchange for a lease extension and therefore of valuation benefit to Blackrock. One such company was Travelodge, were some rental payments had been written off in exchange for an extension to the Lease. Ms Cierpka further advised that over the last quarter there had been a higher normalised rent collection rate.

8.3 Mr Shaw then referred to income return over the 12 month period advising that there had been a reduction from 4.66% to 3.99% due to the allocation to leisure tenants. Blackrock's forecasting estimated a rise of up to 4.6% by the end of 2021. However, this was dependent on when businesses might be operational. Mr Shaw then referred to portfolio construction highlighting that certain sectors, such as supermarkets had continued to perform well. Healthcare, leisure and garden centres had been affected with the hardest hit cinemas. Ms Cierpka then gave an example of a recent acquisition, in December 2020, of Sainsbury's Bedford, a distribution warehouse for clothing. Sainsbury's had tenant stability, strong location and invested in improvements to the building. The lease rental of 15 year was not ideal but Blackrock would engage with Sainsbury's in the near future to secure a lease extension.

8.4 To conclude the presentation Mr Shaw advised that ESG was now formalised within their quarterly review process. Blackrock's independent team reviewed ESG and documented as part of the Quarterly Portfolio Review process. They were engaging with tenants to bring carbon weighting down believing that sustainable investing was the strongest foundation for client portfolios going forward.

8.5 In response to questions Mr Shaw advised that cinemas and gyms should recover when lockdown eased and they did not expect a reduction in values. Regarding the impact of government ending support measures, he advised that once the economy improved there should be a considerable amount of savings to drive expenditure for a positive bounce back. The Chair thanked Mr Shaw and Ms Cierpka for their attendance and informative presentation.

DECISION
NOTED the presentation.

9. MORGAN STANLEY INVESTMENT TRANSITION

There had been circulated copies of a report by Executive Director Finance and Regulatory reviewing the current positon of the investments held with Morgan Stanley in the context of the Pension Fund's Responsible Investment Policy. The report explained that the Pension Fund Committee had a fiduciary duty to maximise investment returns for the benefit of Fund members and to ensure investment activities were undertaken in a socially responsible way. The Committee had approved the Statement of Responsible Investment Policy (SRIP) on 30 November 2018 which set out the Fund's approach to responsible investment. The Pension Fund currently held investments with Morgan Stanley in their Global Brands Fund and Global Sustain Fund. The Pension Fund had committed £50m to the Global Sustain Fund, which excluded investments in tobacco, alcohol and fossil fuels as well as being carbon light. The Fund had now produced the expected returns over the last two years, outperforming the Global Brands Fund. The report proposed the Pension Fund transitions its investments with Morgan Stanley from the Global Brands Fund to the Global Sustain Fund. Isio also supported this move which would enhance the Pension Fund's commitment to SRIP and allow a direct saving of £133k in investment management fees on an ongoing basis. In response to a question Mr Robertson advised that he was not aware of any cap and the transition could be undertaking quickly.

Councillor Mountford seconded by Councillor Scott moved that delegated authority included the Chair of the Pension Fund Committee and this was agreed.

DECISION
AGREED

(a) **To transition the Pension Fund's investment held with Morgan Stanley from the Global Brands Fund to the Global Sustain Fund; and**

(b) **To delegate authority to the Executive Director Finance & Regulatory in consultation with the Chair of the Pension Fund Committee and the Fund's Investment Advisors to undertake the transition in the most prudent way.**