



LOCAL GOVERNMENT AND REGENERATION COMMITTEE

AGENDA

13th Meeting, 2015 (Session 4)

Wednesday 29 April 2015

The Committee will meet at 10.00 am in the David Livingstone Room (CR6).

1. **Decision on taking business in private:** The Committee will decide whether to take item 3 in private.
2. **Budget Strategy Phase 2016-17:** The Committee will take evidence at the Budget Strategy Phase 2016-17 from—

Chad Dawtry, Director of Policy, Scottish Public Pensions Agency;

Barry White, Chief Executive, Scottish Futures Trust;

Dave Watson, Scottish Organiser, Unison Scotland;

Peter Morris, Head of Pension Policy, Tameside Metropolitan Borough Council, Greater Manchester Pension Fund;

and then from—

Richard McIndoe, Strathclyde Pension Fund and Head of Pensions, Glasgow City Council;

Steven Whyte, North East Scotland Pension Fund and Head of Finance, Aberdeen City Council;

Bryan Smail, Falkirk Pension Fund and Head of Finance, Falkirk Council.

3. **Budget Strategy Phase 2016-17:** The Committee will consider the evidence received.

David Cullum
Clerk to the Local Government and Regeneration Committee
Room T3.60
The Scottish Parliament
Edinburgh
Tel: 0131 348 5223
Email: david.cullum@scottish.parliament.uk

The papers for this meeting are as follows—

Agenda item 2

Note by the Clerk

LGR/S4/15/13/1

PRIVATE PAPER

LGR/S4/15/13/2
(P)

Local Government and Regeneration Committee

Budget Strategy Phase 2016-17

Local government pension funds and capital infrastructure investment

Written submissions

Introduction

1. As part of its work programme, the Committee agreed to take evidence from local government pension funds as part of the Budget Strategy Phase 2016-17.
2. In its report to the Finance Committee on the 2015/16 draft budget, the Committee noted the lack of investment to date by Scottish local government pension funds in supporting capital infrastructure investment in Scotland.
3. The Committee undertook to hold an oral evidence session to explore this issue in more detail. At this meeting the Committee will hear from two panels of witnesses on this topic (as set out in the agenda).
4. To support this session, the Committee has received the written submissions from these witnesses—
 - Greater Manchester Pension Fund (GMPF) (**page 2**)
 - UNISON (**page 12**)
 - Scottish Public Pensions Agency (**page 17**)
 - Falkirk Pension Fund (**Pages 24**)
 - North East Scotland Pension Fund (**page 25**)
 - Strathclyde Pension Fund (**page 27**)

**Ross Fairbairn
Committee Assistant**

Written submission from the Greater Manchester Pension Fund (GMPF)

Executive Summary

This submission to the Local Government and Regeneration Committee sets out how Greater Manchester Pension Fund (GMPF) has invested in its local economy. The Fund's local investment programme has delivered its twin aims of commercial returns net of management and governance costs and has generated a positive local impact through significant property development and job creation.

- Commercial returns are defined as the return required by the actuary to help deliver low stable employer contribution rates to employers whilst maintaining the solvency of the Fund;
- To generate positive local impact, the Fund invests in the North West with a focus on Greater Manchester. This can include direct investment by the Fund and working with public and private sector partners investing in property and local businesses.

There are significant fiduciary and reputational risks in making local investments and it is crucial that the appropriate governance structure and other controls are in place to mitigate these.

This paper covers the background to GMPF and its governance structure, sets out the legal position, gives descriptions of its local investment programmes and assesses the benefits and risks of local investment.

GMPF Background And Governance Structure

GMPF is the largest Local Government Pension Scheme Fund (LGPS) in England and Wales. The Fund grew significantly last year with it becoming the "one LGPS fund" for probation staff as part of the Government's Transforming Rehabilitation programme. This resulted in £3bn of additional assets and 42,000 new members joining the Fund. This was the equivalent of adding another Manchester City Council size Employer to the fund.

The key statistics for the Fund are:

Membership	
• Employees	113,000
• Deferred	117,000
• Pensioners	111,000
Total	341,000
Assets	£17bn
Employers	400+
20 year investment return to 31/3/14	8.5%p.a. (ranked 2 nd against LGPS funds in England and Wales)
Funding level at 2013 valuation	90.5% in 2013 (ranked 3 rd using like for like assumptions out of 89 Funds)

GMPF has a very successful long term track record achieved through good decision making and strong governance. Contributing factors to the Fund's long term success include:

a) Stability

- of the leadership of the Fund – many members of the Fund's Management Panel have long service and this experience together with training has helped build skills and knowledge;
- of advice from the Fund's external advisors and in-house staff;
- in the investment management arrangements, appointed managers and other service providers

b) Economies of Scale

- in terms of lower unit costs; and
- the capacity to buy in external and in-house expertise

c) Inclusive and Consistent Governance Arrangements

- All 10 Greater Manchester local authorities and 6 trade union representatives are involved in decision making. This helps decisions to be taken from a long term perspective and helps build constancy of purpose which is complimented by a Core Belief Statement that sets out the Panel's investment beliefs. It is also important that the arrangements support "fleet of foot" decisions.

These factors have also been beneficial in developing the local investment programme.

The Fund has a long history of investing locally within Greater Manchester and the wider North West. This investment has the twin aims of generating commercial returns and supporting the local area/economic regeneration. The generation of commercial returns is critical to:

- contribute to the Fund's key aim of delivering low stable employer contribution rates whilst maintaining the solvency of the Fund; and
- satisfying the fiduciary duty requirement.

Investing in the local economy also has other beneficial effects for the Fund and its stakeholders who are seen as employer organisations, employees and local tax payers. These include.

- Improvements to the local economy securing the revenue base for employer organisations which also helps them to meet contributions to the Fund.
- Creation of jobs.
- Improvement of business environment

Local investment is resource demanding and carries reputational risks. The GMPF Management Panel has working groups to lead, oversee and support its operations, all of which meet quarterly. The Fund's Policy and Development Working Group

(which is chaired by the Chair of the Management Panel) oversees local investment and its terms of reference include.

- to consider in detail opportunities for local investments that may satisfy the twin aims of commercial returns and supporting the area, and make recommendations on these categories of investment and where appropriate the range of allocations to the Management Panel.
- to consider the resource implications of investment programmes, determine priorities and make recommendations to the Panel
- To monitor and evaluate the progress of new investment programmes, (established programmes are monitored by the other working groups)
- To provide guidance to the Director of Pensions in exercising delegated powers.
- To consider proposals for joint working with other funds / institutions.

Investment Restrictions and Fiduciary Duty

The LGPS Regulations require funds to:

- consider the advisability of investing fund money in a wide variety of investments;
- consider the suitability of potential investments;
- take proper advice.

The statutory regulations referred to above are supplemented with a general principle of fiduciary duty. There has been a recent legal opinion on fiduciary duty, (commissioned by the LGPS Shadow Advisory Board) and a report issued by DWP/BIS. Both conclude the prime focus of trustees should be the financial return generated from investments, but that other factors can be taken into account where the outcome does not have a material adverse effect on returns. This supports GMPF's longstanding view regarding the suitability of local investments.

GMPF – History of Local Investments

Pension funds have long term liabilities and they therefore have the capacity to be long term providers of capital. This ability to take a long term view can be a valuable differentiator from other providers of capital and it is potentially more "valuable" in difficult economic environments.

GMPF's development of its local investment portfolio has tended to coincide with challenging economic environments. It is at these times that the greatest opportunities are available.

Risks associated with local investments have been managed by:

- putting arrangements in place to demonstrate commerciality of the investment opportunity, including other investors participating on the same terms, external management, external advice and the development of in house capacity and expertise;
- limiting all local investments to in aggregate to no more than 5% of Fund value (recently raised from 3%)

- adopting a branding for local investment funds to emphasise commerciality.

Private Equity/Venture Capital

GMPF's first local investment was in 1982/83 with a £10m allocation to invest in local small companies in the North West known as the Business Development Fund. This programme was extended in 1988 with the creation of Ventures North West with a £20m allocation with further £20m allocation in 1995 and 2001.

The Fund appointed an external manager for these funds and their role included sourcing transactions, recommending investments, monitoring investments and recommending disposals.

In aggregate, these funds generated positive returns but lower than targeted and thus the decision was taken in 2005 to stop making new investments in this area. There have historically been disappointing returns for venture capital in the UK and Europe. The Fund has developed its approach to investing in SME's to focus on lending as detailed in section 9.

Property Development

Greater Manchester Property Venture Fund (GMPVF) was established in 1990.

GMPVF undertakes direct development and redevelopment of commercial property. The target area for investment is in the North West of England with a focus on Greater Manchester. The Fund has an allocation of up to 3% of Fund value and the norm for the scale of investments would be in the range of 1% to 15% of the Fund's allocation i.e. a current upper limit per investment of around £60m.

An external manager is employed to source and evaluate potential developments, recommend investments, oversee the development process, manage the properties and recommend disposals.

GMPVF has concluded over 1.3m square feet of completed developments. The investment and development process is often time consuming and complex and this together with the unique brief of the Fund manager has meant that the rate of investment has generally been limited to 2 to 3 developments per year. The types of developments include:

- 17 Quay Street, Manchester, the former skin hospital site was redeveloped as an office with a major pre-let to an occupier consolidating its position in Manchester
- Supermarket, Hyde – large site assembled on a speculative basis
- Deva Centre, Salford – the former part listed Chester's Brewery was developed and refurbished to provide space for a broad range of occupiers bringing together government and local authority support as well as the Fund's investment
- Westwood Park, Wigan – 2 offices were built as the first phase of a new office park
- Quattro Park, Stockport – a new distribution facility
- Regional Science Centre, Oldham – speculative development

- 1 St Peter's Square, Manchester – 270,000 square feet prime office development in Manchester city centre.

The Fund currently owns sites for development in a number of Greater Manchester locations and elsewhere in the North West, including Liverpool, Warrington and Preston. A key challenge to progress opportunities is the scope to find occupiers willing to pay rents or acquire, that deliver the required financial return.

The property market had an excellent run from the early 1990's to 2008. This provided a helpful background for GMPVF investments. So far all completed investments have generated a profit.

The Fund's flagship development is 1 St Peter's Square, it has a prime location and sits alongside many of Manchester's civic and historical buildings. The City Council has refurbished the civic buildings alongside the Square; it is redeveloping the Square and the Fund's decision to invest in 1 St Peter's is acting as a catalyst for further development and regeneration.



This development was a joint venture with Argent and the decision to proceed with a 25% pre-let to KPMG was taken at a time when very little development was taking place following the banking crisis. With hindsight, the decision to proceed was excellent timing and the building is letting well. It was also the only significant development taking place in Manchester at commencement providing a boost to the local construction economy.

Diversification of Local Investments

In recent years, the Fund has looked to broaden the types of opportunity in which it will invest. The aim is to build a diversified portfolio of investments albeit with a property bias. It is also looking to establish partnerships/joint working with other LGPS funds and private sector partners to increase scale and therefore reduce investment costs/improve net returns.

The current approvals are:

Portfolio	% of Main Fund	Projected Commitments £m p.a.
GMPVF	0-3	50+
Housing	0-1	50
Impact/Collaboration	0-1	50
LPFA Infrastructure – JV	0-1.5	150
Other Projects	0-2	
Aggregate	0-5	

Housing



The Fund has participated in a joint venture with Manchester City Council (MCC), which is its first direct involvement in building homes. The aim is to work with other Greater Manchester authorities to increase investment in homes. The purpose of the investment is to help respond to increases in demand for housing, support regeneration, provide benefits to the councils including new homes bonus and enhancement of council tax base and crucially from the Fund's perspective to generate a commercial return. The first project has been successful on these terms Construction has gone well as have sales and there is a high degree of certainty for the overall financial return to both the Fund and the Council.

In this first phase 240 homes are being built on 5 sites in Manchester, 4 of which were owned by MCC and the other by HCA. Of these 240 homes half are built for sale and half for market rent. The sales programme is going well and handover has started on the homes for rent.

The Fund provides all the capital to finance the development. MCC and HCA provide the 5 sites. Financial viability was determined in aggregate across the 5 sites and this facilitated more homes to be built sooner. It will also deliver financial returns that meet the needs of both parties. It also benefits Manchester's regeneration plans with good sites balancing more challenging regeneration areas.

The key roles in the development are the project manager and technical support and the prime objective is to manage risk through contracts including

- the builder for construction risk
- the tenant who has taken a long lease on all the homes for market rent and who will undertake the property management role taking on void and repair risk
- the sales agent

A key risk that is not mitigated is the ability to sell the homes at the planned price and to programme. So far the sales programme is going very well, reflecting affordable prices for 2, 3 and 4 bed homes.

The project has been resource demanding for both partners with significant staff time and finance needed to develop and implement the following which can now be transferred to future projects:

- an investment model
- site identification and land preparations
- legal structures for partnership
- procurement of delivery agents
- project delivery and monitoring

Impact Portfolio

The fund participated in the "Invest for Growth" initiative with 5 other LGPS funds. The aim is to deliver commercial returns and for the investments to have a social impact. Due diligence was shared between the participating funds and GMPF invested in opportunities targeting property, loans to SMEs, and social impact bonds.

The next phase, learning from our experience, is to build a local "Impact" portfolio. Again the aim is to build a diversified portfolio investing in funds and co-investments and investing in different parts of the capital structure. The current plan is to target opportunities in property, loans to SMEs and local infrastructure. Other North West funds may co-invest in some or all of the investments made adding to and benefitting from the economy of scale benefits including in-house resources.

Infrastructure Joint Venture with London Pension Fund Authority

Agreement has been reached with LPFA to create a joint venture to invest in infrastructure. Both parties have committed £250m each. Oversight will be exercised by the GMPF Management Panel and LPFA Board.

GMPF and LPFA will both allocate significant in house resource to this project with investment decision making delegated to officers. The aim is to build a diversified

infrastructure portfolio through a wide range of approaches. The aim is to commit investment over a 3 year period. Both Funds have recognised the need to reduce investment costs and this direct approach should have considerably less fees than a comparable fund or fund of fund structure.

The definition of infrastructure is broad with both organisations having the capability of sourcing investments and these investments are expected to have a bias to the partners' location.

The legal arrangements are structured to facilitate other funds joining the JV in future.

Other Projects

The Fund has also looked to partner on major projects with organisations with access to high quality deal flow and who can bring development expertise and share financial risk. The main project that the Fund is currently involved in is Airport City Manchester.



This project is part of an Enterprise Zone. It is a long term project with the aim of undertaking approximately £800m of development over the next 15 years.

- In March 2011 Manchester Airport was confirmed as the location of one of the UK Government's vanguard Enterprise Zones. Centred on the new Airport City development area, businesses will be offered incentives in order to create new jobs and stimulate economic growth locally, regionally and nationally. The incentives include savings on business rates, the introduction of super-fast broadband and the local authority will be allowed to retain business rates.
- The 116 hectare Manchester Enterprise Zone sits around the new strategic scale development of Airport City involving the creation of a significant new business destination in the area adjacent to the airport's terminals and ground transport interchange. Complementing this will be health and biotech related

research and development and training facilities associated with MediPark which also benefits from the proximity of Manchester Airport.

- The plans envisage Airport City to be a very significant development as its name suggests. The intention is that “Airport City will become an international business destination providing world-class environments in which people work, play and stay. A vibrant economic hub with connectivity at its heart, it aims to be one of the world’s most accessible and leading commercial locations”.
- “Airport City will reposition Manchester Airport as a key international business destination.”

The partners in this project are Manchester Airport, BCEG (Beijing Construction and Engineering Group), Carillion and GMPF.

In addition to its equity participation in the Joint Venture, this may provide deal flow opportunities for the Fund to acquire long term assets and provide debt to some Joint Venture projects.

Evaluation of Benefits and Risks of Local Investment and Mitigation

Pension funds generally have the capacity to be long term providers of capital. Increasingly LGPS funds are seeking long term secure income streams as well as capital gains to help manage funding volatility. The capacity to provide long term capital particularly at times when markets are challenging makes LGPS funds a credible investor and partner for developers. This can also result in investments being undertaken that would not otherwise have occurred or earlier than would have been the case.

For successful investment, there is a need to

- identify an investment opportunity that meets return criteria
- be able to access such opportunities
- be able to make the investment decision

For local investment to work well there needs to be the capacity and capability to deliver on the tasks set out at 12.2. If for example, the local area is providing very few opportunities, then identifying opportunities will be very unlikely.

GMPF’s Management Panel has aimed to build diversified portfolios over time learning from its experiences. Its advantages are the economic strength of Greater Manchester, the scope to allocate significant sums without building material concentration risks and a willingness to resource such investment programmes.. The Fund uses a variety of arrangements to gain its exposure including external managers, Joint Ventures, in-house resources and support from independent advisors. The Panel’s view is where there is scope to invest locally and generate comparable returns to other investments; there is merit in investing locally to capture the benefits of supporting the area, subject to managing the relevant risks.

Local investment is sensitive and brings with it reputational risks should the investment not perform in line with the business plan/appraisal. Hence the

importance of a thorough due diligence and evaluation process to demonstrate a decision based on commercial criteria.

It can also be complex, e.g. the financial appraisal and it will often involve legal, project management, procurement, financial and other specialist skills. The type of investment and the capability and capacity of the in-house team will determine the process for evaluating and progressing investments.

In summary, local investment is demanding at Board level from a governance perspective and operationally. The costs of a local investment programme will be materially higher than the investment management costs associated with a standard securities portfolio. However, with appropriate capability and capacity either individually or through collaboration, local investment delivering on the twin aims of commercial returns (that deliver long term returns in line or better than the Actuary's return assumption) and support for the area is considered by GMPF to have great merit.

Written submission from UNISON

Funding and building the homes Scotland needs: a proposal by the union UNISON to develop a new stream of finance to provide much needed social and affordable housing in Scotland. March 2013.

Introduction

This paper outlines a proposal from UNISON Scotland, developed with assistance from the Scottish Federation of Housing Associations, to finance social housing in Scotland. It recognises Scotland's current housing crisis and the cost of finance to build new houses for rent. In particular it looks at the potential for utilising local authority pension funds as a source of finance.

Housing in Scotland

The latest statistics confirm that Scotland has a housing crisis. In Scotland there are approximately 1.5 million owner-occupied homes, 290,000 privately rented homes, 275,000 homes rented from housing associations and 320,000 homes rented from local authorities. There are also 87,000 empty homes across Scotland.

The key problem is that not enough homes are being built in Scotland. In 2011-12 there were 10,039 dwellings built by the private sector, 4,776 dwellings built by housing associations, 1,085 dwellings built by local authorities.

This rate of build is insufficient to address the housing needs of the 335,000 households on social housing waiting lists across Scotland. Of these, 157,700 people were on waiting lists and 30,200 were on transfer lists. 71,000 households are overcrowded and 65% of those are families with children. Many of the homes that we do have are in poor condition with 298,000 homes in Scotland affected by dampness or condensation.

A total of 62 per cent of Scotland's social housing currently falls beneath the new Scottish Housing Quality Standard.

At a time of falling real wages and welfare benefit cuts housing costs are beyond many families. The average house price in Scotland has increased from £73,570 in 2001 to £179,863 in 2011, an increase of 144 per cent. The average weekly Local Authority rent in Scotland has risen from £39.30 in 2001-2002 to £59.94 in 2011-12, an increase of 53 per cent.

UK Government cuts have seen a reduction in the capital budget Scotland receives from Westminster and there has been a consequential cut in the Scottish Government's housing budget.

Funding options

Cuts to the Scottish block grant and SG budget choices have had an impact on the funding available for housing, together with the banking sector's reluctance to lend. The Scottish Government is working with the RSL sector to identify further funding

opportunities such as a Scottish Housing Bond, through which a number of Scottish landlords would jointly access bond finance.

The Scottish Government has also announced a new Innovation and Investment Fund. It is open to any constituted body to provide new affordable housing for any type of tenure and will be designed to support entirely new approaches to funding and delivery of new affordable homes. For RSLs this signals a move away from subsidy calculated at individual project level and will require RSLs to contribute substantially increased resources from, e.g. borrowing capacity across existing stock, reserves or cross-subsidising activities.

The National Housing Trust (NHT) for Developers Scheme is aimed at getting stalled housing developments back on track, and bringing these properties into the mid market rental stream. These properties are rented for between 5 to 10 years, with the rental income covering the borrowing costs. A number of RSLs are also looking at a variant of this option the (newly launched NHT for RSLs Initiative) to deal with an increasing demand for mid market properties and the option of using this to cross-subsidise their social rented properties.

While these initiatives are welcome, they are not at the scale required to tackle Scotland's housing crisis. Shelter Scotland estimates we need 10,000 new homes every year and the Scottish Government's action plan for housing – Homes Fit for the 21st Century, falls considerably short of that.

Pension funds

The Scottish Local Government Pension Fund (LGPS) is a funded scheme administered by 11 funds with regulations devolved to the Scottish Government. The funds are currently valued at £24.1bn. The funds are currently invested in a range of areas including: 26% in UK equities, 45% in overseas equities and the balance mostly in gilts (7%), bonds (6%) and property (7%). They are a significant source of investment in the Scottish economy.

Both UNISON and the Scottish Government have suggested that the funds might be invested in infrastructure including housing. There are difficulties with this approach as the government is

not a party to investment decisions and scheme members (staff) may be wary of government interference in their pensions. This is particularly so at a time when members of the LGPS Scotland are facing further reforms. Therefore a proposal that has the support of the main local government trade union and others could help in alleviating those concerns. It would also demonstrate the economic potential of public service pensions.

Since we initiated discussions on this issue there have been similar developments elsewhere in the UK. In England the local government minister has announced plans to double the amount pension funds can invest in infrastructure projects. According to a survey by Greenwich Associates, many funds are reviewing their position and some have begun to change the balance of their portfolios to close mounting funding shortfalls while reducing volatility. The Greater Manchester Pension Fund is to use their fund to invest in local housing projects with an initial 240 homes being built.

Strathclyde Pension Fund is investing, albeit relatively small amounts, in new businesses.

Local authority pension funds are already invested in all manner of projects – from property to infrastructure. However, funds are less often focusing investment on local projects.

A report published by the Smith Institute, Centre for Local Economic Strategies, Pensions Investment Research Consultants and the Local Authority Pension Fund Forum has also highlighted the issue. The research showed that while fund managers said they wouldn't accept lower returns in exchange for delivering local benefits, it did detect a growing interest in finding new ways to invest generally and in maximising the social, environmental and economic impact of pension funds. Paul Hackett, Director of the Smith Institute said, "This group of people are very careful, they don't want to be in the spotlight but do "get it" and want to invest in projects with social and economic value."

The Future Homes Commission (2012) argued that Britain needs a revolution in the scale, quality and funding of home building. They recommend a kickstart from an independent Local Housing Development Fund, financed and owned by local authority pension funds. They said, "But there is a way to kick-start housing expansion. Concerted action by local authority pension funds.

This is the right decision for the fund managers, who need to achieve higher returns than they are getting in the equity or bond markets, while the councils themselves win because it provides more affordable housing."

Richard Murphy of Tax Research puts it rather more forcefully, "At a time when conventional pension fund investment policy is simply guaranteed to lose people money in the UK because of inept management, market corruption and excessive charges why aren't pension funds being invested in things that we really need, like housing, where the payback over a period of, say, 25 years is exactly the sort of return a pension fund needs?"

Proposal

Any investment in housing from pension funds would have to provide a rate of return equivalent to that achieved by current investments. Or as an alternative, could be subsidised by the Scottish Government using their housing finance, stretching the budget further than commercial finance.

The most straightforward investment would be in middle market housing. However, as can be seen above, the greatest need is for social housing. This might be accommodated in mixed developments or through cross subsidy. It might also be an opportunity to provide rented or shared equity accommodation for other workers, including many UNISON members, who are finding it difficult to access housing in the current property market.

Our proposal is to invest pension funds with one or more housing associations. The technical term for a registered housing association or co-operative is a "Registered Social Landlord" (RSL). An RSL is a not-for profit corporate entity who's objective is

in essence to provide good quality rented accommodation at rents which are generally affordable to those on the lowest incomes, without recourse to benefits. This is generally known as “social rent”. There are 167 housing associations operating in Scotland. RSLs are registered and regulated by the Scottish Housing Regulator which is an independent body funded by the Scottish Government to regulate RSLs in accordance with Government policy. Typically, an RSL will be an Industrial and Provident Society and will in most cases be charitable. They will normally own, manage, maintain (and in some cases develop) voluntary boards of management. Almost all boards have tenant representation; some are governed exclusively by their tenants.

Although RSLs are generally self-financing, many receive capital funding to build new homes. Since the 1970s, when new council house building declined, capital funds were diverted to RSLs to replace the provision of new homes. Initially funding 100% of the costs of new homes, funding has gradually decreased over time to around 30% of the capital cost with the RSL borrowing from banks and other financial institutions to provide the remaining 70%.

RSLs have always represented a very low risk to lenders and this was reflected, pre credit crunch, in extremely low margins, in some cases as low as 20 basis points. Loans were for 30 years with the ability to fix. This reflects a number of factors including:

- assets of around £7.125bn as against debt at £2.6bn;
- a huge demand for social rented housing with a waiting list of 335,000
- Projected new supply of around 6,000 PA
- Good performance in housing management, maintenance and refurbishment
- Indirect government regulation
- Government intervention in the event of individual RSL encountering difficulties, essentially making RSL lending ‘sovereign debt’.
- Historic above-inflation rent increases unlikely to change in the future

However, since the credit crunch, banks are experiencing a lack of capital with which to lend. Coupled with more stringent conditions under Basel II, and BASEL III on the horizon means banks are less likely to lend at all, let alone at the previous margins. At time of writing, the cost of borrowing is largely the same as pre-crunch, RSLs now experience much higher margins with much lower rates. Furthermore, lending is made available for 10 years at most with a 5 year review – effectively 5 years. RSLs financial models are geared towards repayment of loans over 30 years or more. Clearly this represents a risk. Despite these challenges the sector can offer investors:

- Strong balance sheet / cash and asset backed security
- Insatiable demand for product
- Quasi-state regulation
- Government backing – very low risk of failure
- Index-linked income streams
- Track record
- Low gearing
- Generally good asset cover

- Robust and credible business plans
- Match pension funds expectations / long term lending – hands off
- Good fit with “ethical” investment policies
- CML quote: Report by CML concluded “the key requirement for investors are that landlords are effectively regulated, operate to a credible business plan reflecting local market conditions and produce a reliable steady income stream and return for investors”

What does the sector need from an investor?

- Long term lending
- Rates that recognise low risk / track record / and security offered
- Reasonable covenants
- Agreed purposes
- Relatively small amounts
- Bullet repayment rather than amortised

What form might the investment take?

- Secured lending – new build & development
- Secured lending – existing stock
- Sale & leaseback
- Others?

Conclusion

This paper outlines a proposal to develop a new stream of finance to provide much needed housing in Scotland. The aim is to develop one or two initial projects to test the viability of the idea with one or more local authority pension funds. We have had some preliminary discussions with housing associations that would be interested in this approach. We believe that this is an idea whose time has finally come.

Written submission from Scottish Public Pensions Agency

Introduction

The Local Government Regeneration Committee invited the Scottish Public Pensions Agency (SPPA) to give evidence to the Committee on Wednesday 29 April 2015 on the Local Government Pension Scheme (LGPS) in Scotland and its approach to how the Scottish Local Government Pension Scheme can support the delivery of key capital infrastructural needs in Scotland, such as transport projects and housing. The Agency was also invited to provide a written submission in advance of that evidence session, setting out the background to any impediments to LGPS investment in capital infrastructure and what actions may be required to address these issues. This paper comprises that written submission.

Scheme governance

It may be helpful to begin by setting-out the legislative and governance context for the LGPS in Scotland. The scheme is governed by five main Scottish Statutory Instruments (**Annex A**) which provide the scheme's regulations. Of these, [The Local Government Pension Scheme \(Scotland\) \(Management and Investment of Funds\) Regulations 2010](#) (as amended) provide the legal framework which governs LGPS investments.

Scottish Ministers have the power to make such regulations within the confines of UK primary legislation. However, the day-to-day operation and management of the scheme is delegated to eleven legally separate scheme managers (**Annex B**) who act on behalf of the members of the scheme and their employers. Roughly 74% of the scheme's membership is local authority employees. The remaining 24% of members are employed by other public and third-sector bodies.

Each of the eleven scheme managers has its own separate pension fund into which scheme contributions and investment returns are paid and from which pension liabilities are met. Scheme managers are supported by their own Pension Committee which takes the formal decisions on where and how to invest fund monies. Since 1 April 2015 the [Public Service Pensions Act 2013](#) requires that each scheme manager is also supported by their own statutory Pension Board containing equal numbers of scheme member and scheme employer representatives. Section 5 of that Act explains that Pension Boards exist to assist the scheme manager with securing compliance:

- a) with the scheme regulations and other legislation relating to the governance and administration of the scheme; and
- b) with requirements imposed in relation to the scheme by the Pensions Regulator.

The Management and Investment of Funds regulations require scheme managers to invest any fund money not immediately needed to make benefit payments, and that investment policy must be formulated:

- b) as to the advisability of investing fund money in a wide variety of investments; and

- c) as to the suitability of particular investments and types of investments.

Scheme managers are also required to obtain and consider proper advice on their investments and publish their investment policy and statement of funding strategy. Each funds' annual report includes a statement on investments and an actuarial assessment of the level of funding (ratio of assets to liabilities).

Fiduciary duty

Pension Committees have a fiduciary duty to act with the interests of scheme members as paramount, because LGPS pension funds exist to meet pension liabilities when they fall due. This means that investments made on behalf of scheme members must obtain the best rate of return taking into account the alternatives and any restrictions. The Scottish Government does not influence LGPS funds' investment priorities and cannot require scheme managers to invest in infrastructure.

Restrictions

Regulation 14 of the 'Management and Investment of Funds' regulations imposes certain limits on the types of investment which may be held. The principle behind these limits is that, whilst fund authorities have a wide discretion in the way in which they choose to make their investments, Ministers have sought to protect scheme members and taxpayers by requiring that investments are well diversified and spread over a range of investment vehicles.

This regulation also allows an administering authority to increase contribution to investments beyond the normal limits up to increased "headroom" limits as set out in Schedule 1 (Annex C) to the regulations. To do this the authority must comply with certain requirements including disclosure of the use of the increased limits within its 'Statement of Investment Principles'.

As a result of concerns raised by the industry and fund authorities about the continuing relevance of certain limits, these limits have previously been revised when the case has been made that they would prevent funds from maximising investment returns. The current limits are quite different from those established at the outset. The table which specifies the amount an authority can use to invest in infrastructure, "Limits on Investments, Part 1, (2) & (3)" which refers to 'contributions to partnerships', was amended to introduce a second, more generous set of limits i.e. the current 15% limit which fund authorities could adopt under certain prescribed conditions.

Wider context

The Scottish Government published an Infrastructure Investment Plan (IIP) on 6 December 2011 setting out priorities for investment and long term strategy for development of public infrastructure. The IIP:

- sets out why we invest, how we invest and what we will invest in from now to 2030; and
- provides certainty and transparency to the construction industry by outlining a clear pipeline of major projects.

The existing IIP is underpinned by four prioritisation criteria agreed by the SG Infrastructure Investment Board. Each new investment proposal is considered against these criteria, which are:

- delivering sustainable economic growth;
- managing the transition to a low carbon economy;
- supporting delivery of efficient and high quality public services; and
- supporting employment and opportunity across Scotland.

In 2011 the UK Government established the [Pensions Infrastructure Platform \(PiP\)](#) to encourage and facilitate UK pension scheme investment in infrastructure. The PiP was developed as a result of discussions between the National Association of Pension Funds (NAPF), Pension Protection Fund (PPF) and HM Treasury. Subsequently developed for pension funds, by pension funds; the PiP is fully independent of government and offers future opportunities for investment in infrastructure and housing projects. A 'Memorandum of Understanding' signed in November 2011 noted that there is the potential for mutual benefit for the Government and pension funds from increased levels of investment in infrastructure. Strathclyde Pension Fund is one of the founding members of this venture.

Local authority pension funds already invest in a wide variety of projects including housing and wider infrastructure. Falkirk Council's Pension Fund Committee has agreed a £30 million commitment to Social and Affordable Housing in the Edinburgh area. They have also agreed a further £30 million commitment to investment in UK social and affordable housing, after reaching an agreement with Lothian Pension Fund to consider UK investment opportunities, identified as likely to afford further opportunities for collaboration.

Unison's paper "[Funding and building the homes Scotland needs](#)" 2013 outlined a proposal from UNISON Scotland, developed with assistance from the Scottish Federation of Housing Associations, to finance social housing in Scotland. It recognises Scotland's housing crisis and the cost of finance to build new houses for rent. In particular it looks at the potential for utilising local authority pension funds as a source of finance. The Committee will take evidence from Unison on 29 April.

The paper calls for concerted action by local authority pension funds, with Government backing, to invest in registered housing associations or co-operatives known as a "Registered Social Landlord" (RSL). An RSL is a not-for profit corporate entity whose objective is to provide good quality rented accommodation on affordable rents. The paper argues that these investments would have a very low risk of failure and could achieve high returns with less risk than in the equity or bond markets; so they would therefore be attractive to fund authorities and provide more affordable housing.

LGPS scheme managers will be interested in infrastructure investment that can provide reliable, inflation linked income streams in a low risk environment. However according to the Government Actuary's Department¹ (GAD) less than 1% is typically invested in this category of investment in the UK. GAD cites lack the expertise required to assess and quantify risks involved with Infrastructure investments as one

¹ Government Actuary's Department "Investment News", 2 May 2014.

potential barrier, concluding that, as a result, schemes prefer to invest in assets with an established income stream.

Continued relevance of restrictions in the regulations

The Scottish Government accepts that it is time to review the continued relevance of the restrictions in the regulations. The SPPA had intended to lead a tri-partite (scheme employers, representative trade unions and Scottish Government) review of these regulations during 2012, however, that activity was put on hold until the conclusion of the recent wide-ranging reform of the LGPS under the Public Service Pensions Act, negotiations for which concluded in 2014 with implementation from 1 April 2015.

Strathclyde Pension Fund officials have commented that the limits in the regulations are no longer fit for purpose. Their view is that the 15% limit is arbitrary and, whilst they have not yet reached this limit, they are fast approaching it. The Committee is due to take evidence from Strathclyde Pension Fund officials on 29 April 2015. Falkirk Pension Fund officials have not identified any impediment to their infrastructure investment activities originating from the current investment regulations. The Committee will also take evidence from their officials on 29 April.

The Committee may wish to note that in 2014 the UK Government's Department for Communities and Local Government (DCLG) consulted on and made subsequent amendments to that scheme's investment regulations to increase the limit on limited liability partnerships (the vehicle most funds use to invest in infrastructure) from 15% to 30%. The Committee may wish to note that that was the extent of the change made to those regulations following that consultation.

Conclusion

Since 1 April 2015 the Public Service Pensions Act requires that a statutory Scheme Advisory Board (SAB) exists to advise Scottish Ministers, at their request, on the desirability of changes to the LGPS. The first meeting of that new board will be on 30 April 2015, the day after the Committee has considered this issue. SAB membership is drawn from LGPS employers (predominantly local authorities) and trade unions. The SPPA will attend SAB meetings with observer status, to represent the Scottish Government.

In establishing these new governance arrangements, the SPPA has previously agreed with the SAB's predecessor, the Scottish Local Government Pensions Advisory Group (SLOGPAG), that the SAB's draft work plan (which requires Scottish Ministers' approval) should include a review of the terms of the Management and Investment of Funds regulations to address this and other key issues.

The Scottish Government believes that these arrangements give will facilitate an appropriate and effective review of the need for changes to the Management and Investment of Funds and related regulations.

Annexe B

[The Local Government Pension Scheme \(Management and Investment of Funds\) \(Scotland\) Regulations 2010](#)

[The Local Government Pension Scheme \(Scotland\) Regulations 2014](#)

[The Local Government Pension Scheme \(Transitional Provisions and Savings\) \(Scotland\) Regulations 2014](#)

[The Local Government Pension Scheme \(Governance\) \(Scotland\) Regulations 2015](#)

[The Local Government \(Discretionary Payments and Injury Benefits\) \(Scotland\) Regulations 1998](#)

Annexe C

Local Government Pension Fund - Scheme Manager

Scottish Borders Pension Fund
Scottish Borders Council Newtown
St Boswells
Melrose
TD6 0SA

Dumfries & Galloway Pension Fund
Dumfries & Galloway Council
The Crichton
Glencaple Road
Dumfries
DG1 4ZZ

Highland Pension Fund
Highland Council
Glenurquhart Road
Inverness
IV3 5NX

North East Scotland Pension Fund
Corporate Governance
3rd Floor West
Marischal College
Broad Street
Aberdeen
AB10 1AB

Shetland Islands Pension Fund
Shetland Islands Council
8 North Ness
Lerwick
Shetland
ZE1 0LZ

Falkirk Pension Fund
Falkirk Council
Finance Services
Municipal Buildings
Falkirk
FK1 5RS

Strathclyde Pension Fund
P.O.Box 27001
Glasgow
G2 9EW

Tayside Pension Fund
Dundee City Council
Finance Dept, Pensions Section
Tayside House
28 Crichton Street
Dundee DD1 3RF

Orkney Pension Fund
 Orkney Islands Council
 School Place
 Kirkwall
 Orkney KW15 1NY

Lothian Pension Fund
 Atria One
 144 Morrison Street
 Edinburgh
 EH3 8EX

Fife Pension Fund
 Fife Council
 North Street
 Glenrothes
 Fife KY7 5LT

Annexe D
Schedule 1: Limits on Investments - Part 1

	Column (1)	Column (2)
	<i>Limits under <u>regulation 14(2)</u></i>	<i>Increased limits under <u>regulation 14(3)</u></i>
1. Any single sub-underwriting contract	1%	5%
2. All contributions to any single partnership	2%	5%
3. All contributions to partnerships	5%	15%
4. The sum of — (a) all loans (but see paragraph 14 of Part 2); and (b) any deposits with — (i) any local authority; or (ii) any body with power to issue a precept or requisition to a local authority, or to the expenses of which a local authority can be required to contribute, which is an exempt person (within the meaning of the 2000 Act) in respect of accepting deposits as a result of an order made under section 38(1) of that Act. (exemption orders).	10%	—
5. All investments in unlisted securities of companies	10%	15%
6. Any single holding (but see paragraphs 15 and 16 of Part 2)	10%	—
7. All deposits with any single bank, institution or person (other than the National Savings bank).	10%	—
8. All sub-underwriting contracts	15%	—

9. All investments in units or shares of the investments subject to the trusts of unit trust schemes managed by any one body (but see paragraph 16 of Part 2).	25%	35%
10. All investments in open-ended investment companies where the collective investment schemes constituted by the companies are managed by one body.	25%	35%
11. All investments in units or other shares of the investments subject to the trusts of unit trust schemes and all investments in open-ended investment companies where the unit trust schemes and the collective investment schemes constituted by those companies are managed by any one body (but see paragraph 16 of Part 2 below).	25%	35%
12. Any single insurance contract.	25%	35%
13. All securities transferred (or agreed to be transferred) by the authority under stock lending arrangements.	25%	35%

Written submission from Falkirk Council

Overview

Core Data

Active	-	14,700
Deferred	-	5,430
Pensioner	-	8,500
Fund Value	-	£1.7bn
Employers	-	36

Fund Asset Classes

Asset Class		Actual	Strategic
	£'m	%	%
Equities			
- UK	230	14	14
- Global	475	28	28
- Passive	360	21	15
Bonds	150	9	10
Property	125	7	10
Diversified Growth	200	12	10
Private Equity	80	5	5
Global Infrastructure	40	2	3
UK Infrastructure		0	2
Social/Affordable Housing	15	1	2
Credit Markets	15	1	1
Grand Total	1,690	100%	100%

Fund Aspects which may be of particular interest to the Committee

- The Fund has a strategic infrastructure global mandate of £50 (gross) with Grosvenor (formerly Credit Suisse). This entitles the Manager to search for opportunities across the globe including the UK.
- The Fund has also set aside £30m (gross) for infrastructure investment in UK with a particular focus in Scotland. This is being done in association with the Lothian Pension Fund with whom we have a broader partnership framework.
- The Falkirk Fund has agreed to invest £30m in Social/Affordable Housing. This is via Hearthstone Asset Management Ltd and will form the initial investment in a Housing Fund for Scotland which, with other investors, has a target size of £150m.

Written submission from North East Scotland Pension Fund

Aberdeen City Council Pension Fund (North East Scotland Pension Fund) is aware of the capital infrastructural requirements with in Scotland and the local area.

Over the last few decades the Fund has supported local business and participated in potential local investment discussions within the Local Authority.

Currently the Fund participates within the Scottish loan Funds managed by Maven Capital Partners which provide capital investment to small business across Scotland.

However the Fund recognises the need for investment across infrastructural Scotland.

As stated in your letter dated the 25th March 2015 you mention the Fiduciary duty that applies to the trustees of local government pension funds and this is absolutely at the fore front of our investment process, however there is a need to address the capital requirements underpinning the future and delivery of transport, housing and other national and local development.

Impediments past and present that need to be addressed would be that any potential investment meets the required individual Fund's Risk and Return profile within their investment Strategy, while complying with its Fiduciary duty and with Local Government Investment Regulations.

The Aberdeen City Council Pension Fund (North East Scotland Pension Fund) experience in recent years is that we have not come across potential investments that fit with in the Fund's strategy and Fiduciary duty.

Looking forward there is significant potential for The Aberdeen City Council Pension Fund (North East Scotland Pension Fund) to participate in delivering capital requirements with in the North East of Scotland.

There are a number of projects with in Aberdeen City and the North East currently in their early stage of development which the Fund has had the opportunity to participate with in those early discussions. These projects cover housing and developments across the local area.

Further to these there are far longer term initiatives with in Aberdeen we have the City Centre Master plan a 20 year plan to develop the City working with the community, agencies, Local Businesses and Council Staff.

With a wider remit the recent publication of the City Region Deal, a proposed development programme costed at approximately £2.9bn which will see funding for infrastructure in the area over the next 20 years.

The Fund is also currently reviewing its investment strategy following its recent triennial actuarial valuation outcome. Following a review and recommendations during 2012 the Fund will continue over the medium and long term look to seek additional income generating assets to address the Funds long term cash flow requirements.

These assets and projects that we have been discussing could play a significant role in achieving the Fund's long term funding objectives providing income and liability matching assets with in an existing diversified asset portfolio.

As part of this investment Strategy, recommendations will also be made to committee that a percentage of the Fund will be allocated to facilitate these potential local opportunities.

Assuming Risk and Return profiles are in line with the Fund expectations, comply with Local Government Investment Regulations and the Funds Fiduciary duty one would expect a favourable outcome with stable covenants and the potential lack of additional third party fees.

The Fund will continue to monitor these potential investment opportunities while continuing to develop relationships across the North East, including Aberdeen City Council, Aberdeenshire Council, Moray Council and other stakeholders and interested parties.

Written submission from the Strathclyde Pension Fund

Executive Summary

- Strathclyde Pension Fund (SPF) has total investment assets of approximately £15.5 billion.
- The Fund's investment strategy is global and primarily equity based.
- SPF established a New Opportunities Portfolio (NOP) in 2009 with a very broad remit to invest on an opportunistic basis in assets for which there was an attractive investment case but to which the current structure did not provide access.
- The NOP had an initial capacity of £300m. It was not created as an exclusively local investment vehicle but was designed to be well-placed to take advantage of local implementation and management benefits.
- The portfolio agreed its first investments in 2010 in debt and equity financing of SMEs through 3 Scottish based funds – Panoramic, Scottish Loan Fund (SPF was a founder investor), and Scottish Equity Partners fund IV.
- NOP made its first infrastructure investments in 2012 and agreed in 2013 that infrastructure, housing and economic development would be its main investment focus.
- To date the New Opportunities Portfolio has agreed infrastructure investments of £275m many of them based in Scotland.
- Investment highlights include:
 - Providing £35m for cash flow, to enable the completion of the Glasgow 2014 Commonwealth Games Village – now retro-fitted as 700 private, socially rented, and mid-market homes.
 - £82m committed to UK core infrastructure funds whose investments to date include the maintenance contract for the M8 and to fund the Scottish Futures Trust for the replacement hospital for the Royal Infirmary in Dumfries and Galloway.
 - In 2014, SPF established a £50m local property fund known as the Clydebuilt Fund. Managed by Ediston Real Estate, the most significant investment to date has been purchase and proposed redevelopment of a retail park in Port Glasgow, completing the regeneration of the old shipyard sites in that town.
 - A growing portfolio of renewables investments heavily biased to Scottish projects.
 - Funding commitments for supported living residential development and a residential project in East Lothian.
- Portfolio capacity was recently increased from 3% to 5% of total assets - £775m at current market values. Infrastructure will continue to be a focus for new investments from the portfolio.
- Potential impediments include risk, return, and governance considerations, and various practicalities. None of these is insurmountable.
- The limits on partnership investments contained in the Local Government Pension Scheme (Scotland) (Management and Investment of Funds) regulations provide a particular impediment to further investment.

Strathclyde Pension Fund (SPF)

Background

Strathclyde Pension Fund (SPF) is managed by Glasgow City Council on behalf of the 12 local authorities in the west of Scotland and some 200 other employers. The Fund has around 200,000 members (90,000 contributing, 40,000 deferred, 70,000 pensioners). Total investment assets are approximately £15.5 billion.

Investment Objectives

Until recently the Fund's investment objective has been to reduce the cost to employers of providing pension benefits by maximising investment returns within acceptable risk parameters. More recently availability of funds, stability of employer contributions and a strong and stable funding level have become increasing priorities. This year, the investment objective has been re-stated as: to support the funding strategy by adopting an investment strategy and structure which incorporate an appropriate balance between risk and return.

Investment Strategy

The Fund's current strategy is summarised in its high level strategic asset allocation of:

Asset	%
Global Equities	72.5
Property	12.5
Bonds	15.0
	<hr/>
	100

The strategy is being reviewed and will change to reflect the changing investment objective.

New Opportunities Portfolio (NOP)

Background

In December 2009, the Strathclyde Pension Fund Committee agreed an initial governance structure for a New Opportunities Portfolio (NOP) with a very broad remit to invest on an opportunistic basis in assets for which there was an attractive investment case but to which the current structure did not provide access. The NOP had an initial capacity of £300m. It was not created as an exclusively local investment vehicle but was designed to be well-placed to take advantage of local implementation and management benefits.

First Investments

The portfolio agreed its first investments in 2010 in debt and equity financing of SMEs through 3 Scottish based funds – Panoramic, Scottish Loan Fund and SEP IV (Scottish Equity Partners). The portfolio agreed its first infrastructure investments in 2012.

Review

During 2012 the NOP arrangement was reviewed. This led to a revised implementation framework being agreed in March 2013 with a focus on three principal areas: infrastructure, economic development and (social) housing. As part of a further review in 2015 the capacity of the NOP was increased to 5% of total Fund - £775m at current market valuation.

NOP Infrastructure Investments

Background

From an early stage, infrastructure was acknowledged as an attractive area for NOP investment. In 2012, the portfolio agreed in principle to invest £100m into the Pensions Infrastructure Platform (PIP). The portfolio also committed £35m as part of the funding package to enable the completion of the construction of the Athlete's Village for the Glasgow 2014 Commonwealth Games.

Review

After a review of implementation it was agreed in 2013 that, together with housing and economic development the portfolio would focus on infrastructure including economic, social and renewable infrastructure, either project, asset or company-based investments.

Summary of Investments to Date

As at 31st March 2015 NOP had agreed 12 separate infrastructure and related investments with a total commitment value of c £275m (total value including other investors of over £1 billion. These range across a wide spectrum of projects throughout the UK and beyond but with a significant allocation to Scotland. Some of the principal investments agreed to date are summarised in Annexe A.

Investment Pipeline

Since its inception SPF has received a steady and growing stream of potential investment opportunities. These are subject to a multi-stage analysis to review their suitability in terms of risk, return, geography, sector, size, cash-flow requirements, exit options, governance, legal format, and impact in terms of environmental, social, and governance criteria. Many investment proposals do not progress to completion because they cannot satisfy the Fund's requirements in terms of these criteria. Pricing, timing and comparison with other opportunities are also factors.

Current Opportunities

A large proportion of current proposals focus on core infrastructure, renewable energy and housing. These are mainly in the form of funds, which generally have some form of Scottish content. Increasingly, a number of local stand-alone investment opportunities are starting to be presented, often at early stage and with longer term timelines.

Impediments to investment

Overview

Infrastructure is, in theory, an attractive investment for a pension fund because investments are generally made for the long term, returns are inflation linked and performance tends to be uncorrelated with GDP or equity markets.

In practice however, pension funds have often not found infrastructure investment easy to achieve. Reasons cited are a lack of in-house expertise, high external manager fees, risk inherent in greenfield infrastructure investment, and limited supply of brownfield assets.

Given the investments made to date by the Strathclyde Pension Fund, there are clearly no absolute impediments to investment. There are however various challenges and obstacles to overcome. Some of these are summarised below.

Return

Infrastructure returns are typically lower than the equity returns which have been the mainstay of investment strategies for most local government pension scheme funds. This may be offset by reduced volatility, more reliable yield and inflation linkage from infrastructure, but historically pension funds have often still preferred the relative simplicity of equity investment.

Risk

Development stage or greenfield investment is inherently risky. The risks can be managed through extensive due diligence, robust contractual arrangements, and thorough counterparty and covenant analysis but these require significant time and resource. Later stage investment is typically less risky, involving a predictable income stream over an extended period. But it often still carries some obsolescence, regulatory, political or inflation risk together with idiosyncratic project risk. Exit options may be limited or non-existent.

Governance

The most common investment model adopted by local government pension scheme funds has been to appoint a number of external managers to oversee large portfolios of listed investments. In comparison to this model, infrastructure investment requires a higher level of governance. Direct investment, in particular requires greater oversight. Local investment brings potential conflicts of interest which require to be managed. Investment perspectives and benchmarks are global, and the core

responsibility of funds is to pay their members' pensions. Each investment has to stand up to scrutiny in that context.

Practicalities

The practicalities of identifying suitable strategies and projects, appointing managers, structuring an investment proposal, bringing together investors, agreeing terms, concluding legal documentation and approving funding should not be underestimated. Each can represent a significant impediment. For a project to succeed it needs strong and committed leadership to manage each of these stages.

Regulations

Strathclyde Pension Fund has long held the view that the Local Government Pension Scheme (Management and Investment of Funds) regulations would benefit from significant review and that the existing limits on investments should be replaced by a prudential code. In particular, the limits on investment in partnerships are a potential impediment to large scale infrastructure investment which is typically structured as a limited partnership. The existing limits are 2% (of total assets) in a single partnership and 5% in all partnerships. There is scope for a Fund to increase these to 5% and 15% respectively and the Strathclyde Fund has used this additional headroom. The Fund's current investments in limited partnerships are around 10% of total assets.

Conclusion

The Strathclyde Pension Fund New Opportunities Portfolio is still fairly immature and it is still too early for performance figures to be meaningful, but on a qualitative analysis the progress which this initiative has made to date has been an unqualified success in terms of:

- establishment of robust governance, implementation and monitoring procedures;
- selection of a well diversified portfolio of investments with strong return expectations; and
- no failures or significant concerns within the portfolio at this stage.

The portfolio has achieved its initial objective of providing a means for the Fund to participate in emerging opportunities for which there is an attractive investment case but to which the existing structure does not provide access. The portfolio also demonstrates strong environmental, social and governance characteristics with many investments likely to have a positive impact in these areas. Portfolio capacity has very recently been increased from 3% to 5% of total Fund. Infrastructure will continue to be a focus for new investments from the portfolio.

Annexe A

Principal infrastructure investments to date

City Legacy	Through the NOP, SPF provided a facility of £35m as part of the funding package for construction of the Athlete's Village for the Glasgow 2014 Commonwealth Games. The project was completed well within timescale and once utilised for its original purpose was retrofitted to provide a mixture of social and private housing, assisting in the regeneration of the East End of Glasgow as part of the Commonwealth Games Legacy.
PIP	<p>During 2012, NOP approved a loan investment of £100,000 to fund start-up costs for the proposed Pensions Infrastructure Platform (PIP), an initiative to create an infrastructure fund tailored to the specific investment requirements of UK Institutional pension funds. An investment of £100m in PIP was approved in principle subject to satisfactory resolution of all relevant set up issues and further committee approval.</p> <p>In December 2013, the first tranche of actual investment in PIP was approved – a NOP commitment of £50m to a PPP Equity Fund run by infrastructure managers Dalmore Capital. Assets acquired to date by the fund include schools, government accommodation and projects overseen by the UK Ministry of Defence.</p> <p>In March 2015, NOP approved a second tranche of PIP investment - £20m into the PIP Solar PV fund together with £770k of development finance for the PIP project.</p>
Aberdeen UK Infrastructure Fund	NOP agreed £32m into this primary infrastructure fund which has made equity investments into core infrastructure projects across the UK including the maintenance contract for the M8 and the construction of the replacement hospital for the Royal Infirmary in Dumfries and Galloway.
Clydebuilt Fund	In 2014, SPF established a £50m local property fund known as the Clydebuilt Fund. Managed by Ediston Real Estate it focuses on property opportunities within the Strathclyde area with lot sizes of below £10m, where there are opportunities to work the underlying assets, perhaps with the benefit of limited capital expenditure or lease re-gearing. Most significant investment to date has been purchase and proposed redevelopment of a retail park in Port Glasgow, completing the regeneration of the old shipyard sites in that town.
SEP Environmental Capital Fund	This has a dual strategy, investing in an existing gas transmission network (together with the establishment of a significant number of new connections) as well as pursuing investments in a variety of renewables strategies. NOP committed £7.5m to a total fund of £79m.
Renewables	During 2014 NOP committed £10m each to Albion Community Power, Iona Environmental Infrastructure LP, and Resonance British Wind Energy Limited.
Supported Living Developments	Catering for adults with a mixture of physical and mental challenges, the objectives of this fund are to provide an improved level of social care allowing the individuals to live in their own flats in the community with appropriate support, rather than in a residential home. NOP committed £15m to a targeted £50m fund.