DRAFT
AGENDA ITEM 3(a)

FALKIRK COUNCIL

MINUTE of MEETING of the PENSIONS COMMITTEE held in the MUNICIPAL BUILDINGS, FALKIRK on THURSDAY 6 MARCH 2014 at 9.30 A.M.

PRESENT:	Councillors: Jim Blackwood Steven Carleschi Tom Coleman Depute Provost Patrick (Convener) Dr Craig R Martin Mary Keggan Alistair Redpath
ATTENDING:	Jason Koumides, Pensions Accountant Alastair McGirr; Pensions Manager Bruce Miller, Investment Manager, Lothian Pension Fund Bryan Smail, Chief Finance Officer Antonia Sobieraj, Committee Services Officer
ALSO IN ATTENDANCE:	Bruce Miller, Investment Manager, Lothian Pension Fund Jim Rundell and Neil Cartlidge, Audit Scotland James Sparshott, Legal and General Clare Watson, Anthony Doherty and Gordon Rutter, Schroders Investment Management

PE79. APOLOGIES

Apologies were received from Councillor Campbell, Stirling Council and Councillor C Martin, Falkirk Council.

PE80. DECLARATIONS OF INTEREST

No declarations were made.

PE81. MINUTES

Decision

(a) The minute of the Meeting of the Pensions Panel held on 28 November 2013 was noted; and

(b) **The minute of the Meeting of the Pensions Committee held on 12 December 2013 was approved..**

PE82. ANNUAL AUDIT PLAN - 2013/14

The Committee considered a report by the Chief Finance Officer presenting the Annual Audit Plan for 2013/14 as proposed by Audit Scotland in its capacity as Auditor of the Falkirk Council Pension Fund.

The Audit Plan included a summary of proposed audit activity and associated key milestones for unaudited final statements by 30 June 2014 and the audited annual report and accounts by 30 September 2014.

Decision

The Committee noted Annual Audit Plan for 2013/14, consistent with the audit of the Pension Fund Annual Report and Accounts for 2013/14.

PE83. LGPS (SCOTLAND) 2015

The Committee considered a report by the Chief Finance Officer summarising the major changes to the Local Government Pension Scheme, the common framework and implications of the Public Service Pensions Act 2013 with effect from 1 April 2015, and detailing the latest developments since the Panel's meeting in November 2013 in the implementation of the new scheme.

These changes included:-

- The scheme benefits based on the Career Average (CARE) rather than the Final Salary;
- The alignment of the Scheme Retirement Age with the State Pension Age as this increased from age 65 to 68; and
- The introduction of new governance arrangements.

The Public Service Pensions Act 2013 aimed to establish a common framework for public sector pensions in the UK and to ensure that the schemes were sustainable in the long term.

The report confirmed that negotiations in relation to the Local Government Pensions Scheme (LGPS) were the responsibility of the Scottish Local Government Pension Advisory Group (SLOGPAG), consisting of COSLA, Scottish Government and Trades Union representatives.

The finalised Heads of Agreement was published by the Scottish Public Pensions Agency (SPPA) in early January 2014 and was circulated to all Falkirk Fund employers for publicising to scheme members.

Consultation thereafter took place on the implementation of the new scheme as undernoted:-

- Draft Scheme Regulations - This 6 week consultation exercise, from 6 January to 16 February 2014, was designed to establish whether the regulations were generally fit for purpose and conformed to the terms of the Act and the Heads of Agreement. A joint response was submitted by Pensions Managers of the Scottish Funds;

- Governance Arrangements **-** This 6 week consultation exercise, from 23 December 2013 to 3 February 2014, aimed to stimulate debate relating to the various governance issues associated with the 2013 Act. The response, agreed by the Conveners of the Pensions Panel and Committee, was consistent with those submitted by the LGPS Fund Conveners' and the National Pension Fund Officers Groups. The key governance roles for the public service schemes included the Responsible Authority, the Scheme Manager, the Pension Board and the Scheme Advisory Board; and

- Pension Regulator's Draft Code of Practice - The Act extended the Pension Regulator's (TPR) role to provide regulatory oversight of public service pension schemes. To this end, a draft Code of Practice was issued for consultation on 10 December 2013. This reference document, for Scheme Managers and Pensions Boards, provided guidance on the Schemes appropriate management in key areas:- knowledge and understanding, conflicts of interest, management of risk, scheme administration and resolving member disputes.

The other pertinent responsibilities included communicating with scheme members, staff and employer training on the scheme's provisions and meeting ensuring the Regulator's Standards were met.

Decision

The Committee noted the latest developments in relation to the establishing of LGPS (Scotland) 2015.

PE84. ADDITIONAL VOLUNTARY CONTRIBUTIONS (AVC's)

The Committee considered a report by the Chief Finance Officer on the Additional Voluntary Contributions (AVC's) and consideration of the appointment of Prudential as an additional AVC Provider to the Pension Fund.

Additional Voluntary Contributions (AVC's) were introduced as part of the Local Government Pension Scheme since 1987 and provided the opportunity for Pension Fund members to build up benefits on a money purchase basis receiving tax relief on their contributions, which were in turn invested with an external manager (AVC Provider). The Provider generally offered a spread of investment funds ranging from a low risk cash fund to more volatile equity linked funds. On retirement, the accumulated AVC pot converted into an annuity or could be realised as a tax free lump sum.

The current AVC arrangement enabled member investment in three Standard Life Funds. These were Cash, Profits and Managed Funds. Members had the opportunity to spread investment across the Funds and switch between them. The local authority AVC market was specialised and Standard Life and Prudential were considered to be the only two credible providers.

The report highlighted that whilst Standard Life was a well-known institution with a strong financial rating and its approach to marketing AVC arrangements had been low key. Despite this it was considered that Standard Life could be retained as one of the Fund's AVC Providers.

Prudential was recognised as a leading provider in the AVC field. Hymans Robertson, the Fund's Investment Adviser, was therefore requested to comment on the proposed appointment of Prudential as joint AVC Provider to the Falkirk Fund. Feedback was positive and indicated their leading status player in the LGPS AVC market and their long term stability.

The appointment of Prudential was considered to offer Fund members greater AVC investment choice. This was supported by Hymans Robertson. In addition, the appointment would assist in refreshing the AVC facility and provide members a greater retirement saving opportunity.

Decision

The Committee noted the proposal to appoint Prudential as an additional AVC Provider.

PE85. ATTENDANCE AND TRAINING MATTERS

The Committee considered a report by the Chief Finance Officer on the Pension panel and Committee member attendance at Pension Fund related meetings/training events and to share the findings of the recent survey on training needs.

The Pension Fund's Training Policy recognised that those persons involved in the governance of the Fund should have the necessary level of skills and knowledge to carry out the necessary duties. This included detailing the expected number of Fund related meetings and training events to attend and reporting attendance information periodically to the Panel and the Committee as well as assessing training needs.

The report highlighted attendance at meetings between August 2012 and December 2013 together with training events during the same period. In addition, an online Panel and Committee member anonymized questionnaire prior to Christmas 2013 sought feedback on areas for further training. 66% of members completed the questionnaire providing valuable information.

Decision

The Committee noted the report and that further training would be provided as appropriate.

PE86. GENERAL GOVERANCE MATTERS

The Committee considered a report by the Chief Finance Officer presenting an update on various matters associated with the governance of the Falkirk Council Pension Fund.

The areas covered within the report included the following:-

- The Autumn Statement State Pension Review;
- The Pension Fund's Risk Register;
- The UK Infrastructure Investment;
- The Local Authority Pension Fund Forum (LAPFF) of 58 local authority Pension Funds and the workplan for 2014;
- The Fiduciary Duty of Trustees; and
- The Annual Pension and Investment Fund conference In Falkirk on 17 April 2014.

Decision

The Committee noted the report.

PE87. FUND MANAGER PERFORMANCE REVIEW

The Committee considered a report by the Chief Finance Officer reviewing the overall performance of the Fund and of the undernoted Fund Managers:-

- Aberdeen Asset Management;
- Baillie Gifford Bonds;
- Baillie Gifford Diversified Growth;
- Legal and General;
- Newton Investment Management;
- Schroder Investment Management UK Equities; and
- Schroder Investment Management Property.

Decision

The Committee noted the Fund Managers' performance and the action taken by them during the quarter to 31 December 2013, in accordance with their investment policies.

PE88. PRIVATE EQUITY AND ALTERNATIVES UPDATE

The Committee considered a report by the Chief Finance Officer on the progress of the Pension Fund's private equity and alternatives programme arising from the Investments Programme of SL Capital (Standard Life), Wilshire Associates, Grosvenor Capital and M&G for the quarter ending 31 December 2013.

Decision

The Committee noted the progress of the Pension Fund's private equity, infrastructure and credit markets programme for the quarter ending 31 December 2013.

PE89. ORDER OF BUSINESS

In terms of Standing Order 14.2(i), Depute Provost Patrick advised of a variation to the order of business from that detailed on the agenda for the meeting. The following items have been recorded in the order that they were taken.

PE90. INVESTMENT IN SOCIAL/AFFORDABLE HOUSING

The Committee considered a report by the Chief Finance Officer presenting an update on the latest developments regarding the possibility of the Fund making an investment in social and affordable housing.

At the Special Joint Meeting of the Committee and Panel on 10 September 2013 it was agreed as undernoted:-

(1) That an investment in social housing should be progressed;

(2) That a manager search be undertaken, consistent with procurement rules;

(3) That the final decision to invest remain dependent on identifying a suitable manager and fund;

(4) That whilst examining the market within the UK as a whole, any mandate to a suitably appointed manager should require that consideration is given to both the Scottish and local (pension fund area) dimensions;

(5) That any investment should be made gradually and limited to not more than £30m; and

(6) That the Chief Finance Officer would report on progress to the next round of Panel/Committee meetings.

The updated report provided an update on the Manager search initiated in November 2013 with proposals being invited through the Official Journal of the European Union (OJEU). Tender responses were received from the following Fund Managers:

- Aviva;
- Catalyst for Homes;
- Hearthstone;
- Horizon;
- Legal and General;

- Threadneedle Investments; and
- Invesco.

The tender submissions were now being evaluated by Hymans Robertson, the Pension Fund's investment advisers and further details formed an appendix to the report. The shortleet would include only those submissions meeting the minimum criteria. A maximum of four Fund Managers would be invited for interview. The interviews would be undertaken by Committee members at a special meeting of the Pensions Committee on 17 March 2014. The Committee agreed that the tender information and the suggested shortleet contained exempt information as defined in Paragraph 9 of Part 1 of Schedule 7 of the Local Government (Scotland) Act 1973 and resolved that, to the extent that there required to be discussion on the detail contained therein, it would be taken in private, and the document would not be available to the press or public.

Decision

The Committee noted the actions taken in relation to investment in social and affordable housing.

PE91. EXCLUSION OF PUBLIC

RESOLVED in terms of Section 50A(4) of the Local Government (Scotland) Act 1973, to exclude from the meeting the press and public for the following item of business on the ground that it would involve the likely disclosure of exempt information as defined in Paragraph 9 of Part 1 of Schedule 7A to the said Act.

PE92. INVESTMENT MANAGEMENT FEES

The Committee considered a report by the Chief Finance Officer on the remuneration terms of the Fund's investment managers and the fees paid during the calendar years 2012 and 2013.

Decision

The Committee:-

(1) noted the report; and

(2) agreed that the Strategic Asset Allocation should, as far as possible, run in conjunction with the Fund Valuation process.

The Convener agreed an adjournment at 10.55 a.m. prior to consideration of the following item of business. The meeting reconvened at 11.05 a.m. with all Members present as per the sederunt.

The following subsequent items were then taken in public as detailed on the agenda.

PE93. FUND MANAGER REVIEW

The Committee received a presentation by James Sparshott of Legal and General.

The areas covered by the presentation included:-

- Fund Valuation and Distribution;
- Investment Views, Corporate Bonds, Rates and Currency Positions;
- Diversified Growth; and
- Portfolio Review.

The Convener thanked Mr Sparshott for his comprehensive presentation.

Decision

The Committee noted the presentation.

PE94. FUND MANAGER REVIEW

The Committee received a presentation by Clare Watson, Anthony Doherty and Gordon Rutter of Schroders.

The areas covered within the presentation included:-

- Global Equities;
- Stock Attribution; and
- Portfolio Review.

The Convener thanked Ms Watson, Mr Doherty and Mr Rutter for their comprehensive presentation.

Decision

The Committee noted the presentation.

DRAFT
AGENDA ITEM 3(b)

FALKIRK COUNCIL

MINUTE of A SPECIAL MEETING of the PENSIONS COMMITTEE held in the MUNICIPAL BUILDINGS, FALKIRK on MONDAY 17 MARCH 2014 at 9.30 A.M.

PRESENT:	Councillors: Jim Blackwood Steven Carleschi Tom Coleman Dr Craig R Martin Depute Provost Patrick (Convener) Mary Keggan Councillor Callum Campbell, Stirling Council
ATTENDING:	Jason Koumides, Pensions Accountant Alastair McGirr, Pensions Manager Bryan Smail, Chief Finance Officer Antonia Sobieraj, Committee Services Officer
ALSO IN ATTENDANCE:	Linda Selman and Simon Jones, Hymans Robertson

PE95. APOLOGIES

Apologies were received from Alistair Redpath

PE96. DECLARATIONS OF INTEREST

No declarations were made.

PE97. MINUTE

Decision

The minute of Meeting of the Pensions Panel held on 20 February 2014 was noted.

PE98. EXCLUSION OF PUBLIC

RESOLVED in terms of Section 50A(4) of the Local Government (Scotland) Act 1973, to exclude from the meeting the press and public for the following item of business on the ground that it would involve the likely disclosure of exempt information as defined in Paragraph 9 of Part 1 of Schedule 7A to the said Act.

PE99. INVESTMENT IN SOCIAL/AFFORDABLE HOUSING

With reference to Minute of Meeting of the Pensions Committee held on 6 March 2014 (Paragraph PE90 refers), Committee considered a report by the Chief Finance Officer on the tendering process undertaken regarding the possibility of the Fund making an investment in social and affordable housing and their evaluation by Hymans Robertson, the Pension Fund's investment advisers.

The report detailed that four Fund Managers were invited to present their cases to the Committee.

The Committee thereafter heard presentations from the shortleet of four Managers.

Councillor Carleschi entered the meeting during the submission by the second Fund Manager.

Having heard submissions from two of the four Fund Managers, the Convener agreed an adjournment at 12.10 p.m. prior to consideration of the other two presentations. The meeting reconvened at 12.50 p.m. with all Members present as per the sederunt.

Councillor Campbell thereafter left the meeting prior to the conclusion of the third Fund Manager submission.

Depute Provost Patrick, seconded by Councillor Coleman, moved that Committee make an investment in social and affordable housing with the Fund operated by the fourth Manager of social housing and affordable housing on a ratios 2:1 basis.

By way of an amendment, Councillor Dr C R Martin, seconded by Ms Keggan, moved that that the Committee make a Pension Fund investment in social and affordable housing with the Fund operated by the fourth Manager of social housing and affordable housing on a ratio 1:2 basis.

Councillor Blackwood gave notice of a further amendment.

In accordance with Standing Order 21.9 Depute Provost Patrick and his seconder Councillor Coleman withdrew their motion.

By way of a further amendment, Councillor Blackwood, seconded by Councillor Coleman, moved that the Committee make a Pension Fund investment in social and affordable housing within the Fund operated by the fourth Manager (Hearthstone plc) on an equal basis (i.e. £15m to be invested towards Social housing and £15m towards affordable housing).

In terms of Standing Order 20.7, the amendment became the substantive motion upon which the further amendment could be moved.

On a division, 2 Members voted for the motion and 4 voted for the amendment.

Decision

The Committee agreed a Pension Fund investment of the sum detailed within the report in social and affordable housing with Hearthstone plc to be invested in an equal basis between social and affordable housing and subject to the appropriate conditions.

DRAFT

FALKIRK COUNCIL

MINUTE OF MEETING OF THE PENSIONS PANEL
THURSDAY 29 MAY 2014 AT 2.00 P.M.
MUNICIPAL BUILDINGS, FALKIRK

PRESENT:- **Officers – Falkirk Council**

Jason Koumides, Pensions Accountant
Alastair McGirr, Pensions Manager
Antonia Sobieraj, Committee Services Officer

Organisations

Andrew Douglas, Unison
Mary Keggan, Unison
Sandy Harrower, UCATT
Gordon Laidlaw, Scottish Autism
Ed Morrison, Scottish Children's Reporter Administration's (SCRA)
Susan MacKay, Clackmannanshire Council
Ian McLean, Pensioner Representative
Alistair Redpath, Pensioner Representative
William Watson, Stirling Council (Convener)
Jennifer Welsh, SEPA

Attending

Cameron Graham and Mark Nicolson, SL Capital (for agenda item 10) (minute item 11)
David Moylett and Rob Hay, Newton Investment Management (for agenda item 9) (minute item 10)
Bruce Miller, Investment Manager, Lothian Pension Fund,

1. CONVENERSHIP OF MEETING

In terms of Standing Order 12.1, the Clerk presided at the start of the meeting in the absence of the Convener and invited a member of the Panel to take the Chair for the duration of the meeting. William Watson, Stirling Council thereafter took the Chair with the consent of members present.

2. APOLOGIES

Apologies were intimated on behalf of Councillor Callum Campbell, Stirling Council; Councillor Archie Drummond, Clackmannanshire Council; Bryan Smail, Chief Finance Officer, Falkirk Council; and Alison Stewart, Head of Finance, Forth Valley College.

3. **DECLARATIONS OF INTEREST**

No declarations were made.

4. **MINUTES**

Decision

(a) The minute of the meeting of the Pensions Panel held on 20 February 2014 was approved;

(b) The minute of the meeting of the Pensions Committee held on 6 March was noted; and

(c) The minute of the special meeting of the Pensions Committee held on 17 March was noted.

5. **LOCAL GOVERNMENT PENSION SCHEME - 2015 UPDATE**

The Panel considered a report by the Chief Finance Officer providing an update on the recent developments in relation to the ongoing reform of the Local Government Pension Scheme through the Public Service Pensions Act 2013 with effect from 1 April 2015

The report detailed that a Heads of Agreement on scheme design was reached in December 2013 between COSLA, Trades Unions and the Scottish Government. A Heads of Agreement on governance requirements was subject of ongoing discussions.

Prior to full implementation of the scheme, the Scottish Parliament would produce appropriate legislation to expand on the high level principles within the Heads of Agreement. There was a delay however by the Scottish Public Pensions Agency in drafting the provisions. Although this was not considered material, further slippage may have consequences on software houses in the development of systems with resulting cost implications for local authorities. This issue was currently being pursued by COSLA through appropriate channels.

Confirmation in relation to the scheme's governance arrangements included as undernoted:-

- At a national level a Scheme Advisory Board would provide advice and guidance on the effective administration and management of the scheme. At local level a Scheme Manager (such as the Pensions Committee) would take scheme decisions with support form a Pensions Board to support the Scheme Manager and comprise an equal number of Trades Union and member representatives;
- The existing Scottish Local Government Pensions Advisory Group (SLOGPAG) becoming the Scheme Advisory Board for Scotland with the Scottish Government acting as observers rather than being voting members; and

- At the local level differing views being raised by Trades Unions and other stakeholders on whether to combine Committees and Boards or for them to operate as separate entities, one pertinent issue being the implications in terms of voting rights on setting the Investment Strategy.

The report additionally highlighted developments within England and Wales and possible implications on the Pension Fund within Scotland including the issues associated with passive investment.

Discussion included the issues associated with the delay in the implementation of the provisions, progress in procuring a new pensions administration system, further timescales, risk parameters and the potential adoption of collective investment vehicles and or more passive investments.

Decision

The Panel noted the latest developments in relation to the implementation of the LGPS (Scotland) 2015.

6. PENSION FUND - GENERAL GOVERNANCE MATTERS

The Panel considered a report by the Chief Finance Officer presenting an update on various matters associated with the governance of the Falkirk Council Pension Fund.

The areas covered within the report included the following:-

- The Pensions and the Budget;
- The Pension Fund's Risk Register;
- The Councillors Pensions; and
- The Local Authority Pension Fund Forum (LAPFF) of 58 local authority Pension Funds.

The Panel noted that whilst there was a risk of falling asset values from increased interest rates, this would be countered to some extent by a reduction in liabilities as bond yields rose.

Decision

The Panel noted the report.

7. INVESTMENT IN SOCIAL/AFFORDABLE HOUSING

The Panel considered a report by the Chief Finance Officer presenting an update on the recent Committee decision to invest in social and affordable housing.

At the special meeting of the Committee on 17 March 2014 it was agreed that Hearthstone plc be appointed to manage a £30m investment in social and affordable housing in an equal basis (i.e. £15m to be invested towards social housing and £15m towards affordable housing) and subject to the appropriate conditions.

The updated report detailed as undernoted:-

- That in broad terms the £30m investment was estimated to deliver around 300 property units on the basis that each housing unit costing around £100,000;
- The target return from the investment was RPI plus 2% net of fees and costs;
- The manager fee was 0.5% of the Fund per annum;
- The investment process involved the £30m being invested in Hearthstone's soon to be launched "Housing Fund for Scotland" and made available to Hearthstone's strategic partner Castle Rock Edinvar (CRE) Edinburgh;
- The legal structure of the Hearthstone Fund being an EPUT (an Exempt Property Unit Trust), an onshore tax efficient vehicle;
- The investment in social housing being delivered through Hearthstone making a 10 year loan to CRE at a fixed interest rate of 4.5% per annum;
- The investment in affordable housing being delivered through Hearthstone/CRE purchasing newly built properties and consequent rental out under mid-market projects, possibly within in Edinburgh and Aberdeen where rents were highest and thus avoiding an over concentration of risk in one location and envisaging the affordable investment spread across 4 to 5 different sites;
- The opportunities enabling, depending on the growth in property capital value, of eventual sale of some units to maintain an appropriate level of return for the Fund and investors;
- The drafting of the legal documentation for the establishment of the Hearthstone Fund;
- The ongoing discussions with various parties to finalise the investment agreement and to consider the options for the social housing development; and
- That subject to the completion of legal formalities, the expected launch of the Fund towards the start of July 2014.

Decision

The Panel noted:-

(1) the actions taken in relation to investment in social and affordable housing; and

(2) that representatives from Hearthstone and CRE would attend the meeting of the Pensions Committee in September 2014 to provide an update in relation to developments.

8. FUND MANAGER PERFORMANCE REVIEW

The Panel considered a report by the Chief Finance Officer reviewing the overall performance of the Fund and of the undernoted Fund Managers:-

- Aberdeen Asset Management;
- Baillie Gifford Bonds;
- Baillie Gifford Diversified Growth;
- Legal and General;
- Newton Investment Management;
- Schroder Investment Management UK Equities; and
- Schroder Investment Management Property.

Decision

The Panel noted the Fund Managers' performance and the action taken by them during the quarter to 31 March 2014, in accordance with their investment policies.

9. PRIVATE EQUITY AND ALTERNATIVES UPDATE

The Panel considered a report by the Chief Finance Officer on the progress of the Pension Fund's private equity and alternatives programme arising from the Investments Programme of SL Capital (Standard Life), Wilshire Associates, Grosvenor Capital and M&G for the quarter ending 31 March 2014.

Decision

The Panel:-

(1) noted the progress of the Pension Fund's private equity, infrastructure and credit markets programme for the quarter ending 31 March 2014; and

(2) agreed that consideration on whether a commitment should be made to the new Fund being launched by Grosvenor CM would take place following consideration of agenda item 12 (minute item 13).

10. FUND MANAGER REVIEW - PRESENTATION BY NEWTON INVESTMENT MANAGEMENT

The Panel received a presentation by David Moylett and Rob Hay of Newton Investment Management.

The areas covered by the presentation included:-

- Fund Valuation and Distribution;
- Investment Views, Corporate Bonds, Rates and Currency Positions;
- Diversified Growth; and

- Portfolio Review.

The Convener thanked Mr Moylett and Mr Hay for their comprehensive presentation.

Decision

The Panel noted the presentation.

11. FUND MANAGER REVIEW - PRESENTATION BY SL CAPITAL

The Panel received a presentation by Cameron Graham and Mark Nicolson of SL Capital.

The areas covered by the presentation included:-

- SL Capital Overview;
- Overview of the Council's Commitments to products including European Strategic partners 204, 2006 and 2008 and European Small Funds;
- Current Product Offerings; and
- Differentiating Features.

The Convener thanked Mr Graham and Mr Nicolson for their comprehensive presentation.

Decision

The Panel noted the presentation.

12. EXCLUSION OF PUBLIC

RESOLVED in terms of Section 50A(4) of the Local Government (Scotland) Act 1973, to exclude from the meeting the press and public for the following item of business on the ground that it would involve the likely disclosure of exempt information as defined in Paragraph 9 of Part 1 of Schedule 7A to the said Act.

13. INVESTMENT IN UK/SCOTTISH INFRASTRUCTURE

The Committee considered a report by the Chief Finance Officer providing updated information in relation to the possible investment in UK and Scottish infrastructure projects.

At the meetings of the Panel on 28 November 2013 and the Committee on 12 December 2013 it was agreed, in furtherance of the decisions taken at the September 2013 Panel and Committee meetings, that investment in local infrastructure (to include Central Scotland, Scotland and the UK as a whole) should be further progressed, that a more structured dialogue take place with Lothian Pension Fund as the preferred option.

The updated report detailed various matters in relation to the operation of the Lothian Fund.

Decision

The Panel agreed:-

(1) **to support the proposal to collaborate with Lothian Pension Fund in making infrastructure investments within the UK and Europe; and**

(2) **agreed that in relation to consideration on whether a commitment should be made to the new Fund being launched by Grosvenor CM (agenda item 8) (minute item 9), this to take place as part of discussions surrounding the potential collaboration with Lothian Pension Fund.**

AGENDA ITEM 4

FALKIRK COUNCIL

Subject: **LOCAL GOVERNMENT PENSION SCHEME - 2015 UPDATE**
Meeting: **PENSIONS COMMITTEE**
Date: **5 JUNE 2014**
Author: **CHIEF FINANCE OFFICER**

1. INTRODUCTION

1.1 This report updates the Pensions Committee on recent developments regarding the on-going reform of the Local Government Pension Scheme (LGPS).

2. BACKGROUND

2.1 The LGPS is being updated in April, 2015 to satisfy the requirements of the Public Sector Pensions Act 2013 ("the 2013 Act"). A Heads of Agreement on scheme design between COSLA, Unions and the Scottish Government was reached in December, 2013. A Heads of Agreement on governance requirements is still the subject of ongoing discussion.

3. REGULATORY DELAY

3.1 In order that LGPS (Scotland) 2015 can be implemented in full, several pieces of legislation need to be made by the Scottish Parliament. These will expand on the high level principles set out in the Heads of Agreement. Unfortunately, there has been some slippage on the part of the Scottish Public Pensions Agency in drafting the provisions. The delay is not yet material, however any further slippage may have consequences such as software houses having a shortened timeframe in which to develop their systems and passing resulting costs onto authorities. COSLA is aware of this issue and is pursuing it through appropriate channels.

4. GOVERNANCE

4.1 Committee members will recall that at a national level the 2013 Act requires that there must be a **Scheme Advisory Board** to provide advice and guidance regarding the effective administration and management of the scheme. Equally, at a local level, the Act requires that there must be a **Scheme Manager** (aka the Pensions Committee) to make scheme decisions and a **Pensions Board** to support the Scheme Manager. The Pensions Board must contain an equal number of Union and Member representatives.

4.2 At the national level, it is likely that the existing Scottish Local Government Pensions Advisory Group (SLOGPAG) will mutate into the **Scheme Advisory Board** for Scotland, the main difference being that the Scottish Government will become observers rather than voting members.

4.3 At the local level, Unions are understood to favour Pension Committees and Pensions Boards being combined. Other stakeholders are wary of this since it would mean Unions having an equal voice in setting investment strategy. This seems unlikely to be agreed as the cost of any failed investment strategy would continue to fall on employers, rather than Scheme members. A counter argument to this is that employees could face additional costs due to the fact that LGPS 2015 will contain a mechanism to limit employers costs.

4.4 It is understood that a compromise solution is being considered whereby Committee and Board will exist as separate entities, but will meet together to consider a joint agenda.

5. LGPS DEVELOPMENTS IN ENGLAND AND WALES

5.1 One of the recommendations of the Hutton report in 2011 was for the UK Government to investigate the options for greater collaborative working amongst LGPS Funds. By summer, 2013, this broadened out into a consultation on the future structure of the LGPS issued by the Department of Communities and Local Government (DCLG) – the so called "Call for Evidence".

5.2 To assist the call for evidence, DCLG commissioned a research paper from Hymans Robertson looking at the costs and benefits of various options, including a single fund or several large funds. The report concluded that significant savings could be made if Funds:

- invested collectively;
- made greater use of passive management; and
- moved away from all "fund of fund" structures.

5.3 The total investment cost for the 89 England and Wales Funds amounts to approximately £790m per year. If all these Funds moved to passive investment of equities and bonds and accessed these through a common investment vehicle, the savings are estimated to be £420m, being a combination of a £230m saving from fees and a £190m saving from transactions costs. It is suggested that these savings could be realised within 2 years.

5.4 It is also estimated that a further £240m savings could be achieved by ceasing to use "fund of fund" arrangements for alternative assets in favour of a common investment vehicle. These savings would take longer to manifest as Funds could potentially have to wait up to 10 years for existing arrangements, such as private equity investments, to unwind.

5.5 The Call for Evidence and Hymans Robertson research has prompted DCLG to issue a further consultation paper - "Opportunities for collaboration, cost savings and efficiencies." Respondents are asked to consider the extent to which compulsion should be used to force Funds to adopt a passive/collective investment strategy.

5.6 The consultation also seeks views on the following:

- whether asset allocation decision making should be left locally with Funds
- how many collective investment vehicles should be established
- what asset classes should be covered by the collective investment vehicles
- the governance arrangements for collective investment vehicles

5.7 In relation to pensions administration, the Government recognises that efficiency savings could be achieved through improved fund collaboration and greater use of automation. However, the savings are miniscule in comparison with those that could be realised from a change in investment practice. As such, DCLG has decided to allow LGPS 2014 to bed in before considering any change of pension administration arrangements.

6. CONCLUSION

6.1 The LGPS reform agenda continues to roll on apace and shows little sign of abating.

6.2 The delay on the part of the Scottish Public Pensions Agency in bringing forward scheme rules is regrettable. Implementation of the scheme must happen on 1st April, 2015, so any further slippage will simply reduce preparation time for Funds and their software providers.

6.3 Discussions surrounding the shape of new LGPS governance arrangements appear to be moving forward, with a proposal for joint Committee and Board meetings being considered as a compromise solution between Unions and Employers.

6.4 The recently launched LGPS consultation in England and Wales with its proposed change in investment practice could be "the next big thing" for local authority pension funds. The statutory underpinning of the LGPS and its long term time horizons mean that a strategy of passive investment can be contemplated. There could however be circumstances in which active management is still preferable (e.g. where a Fund requires income rather than capital growth or where there is a prolonged bear market). The consultation should be the opportunity for these types of issue to be debated.

6.5 Whilst there is no guarantee that the line of thinking being pursued in England and Wales will be repeated in Scotland, it is inevitable that any cost cutting measures implemented south of the border will be of interest in Scotland.

7. RECOMMENDATION

7.1 The Committee is asked to note the developments taking place towards the implementation of the LGPS (Scotland) 2015.

Chief Finance Officer

Date: 23 May 2014

Contact Officer: Alastair McGirr

<u>LIST OF BACKGROUND PAPERS</u>

NIL

AGENDA ITEM 5

FALKIRK COUNCIL

Subject:	**PENSION FUND – GENERAL GOVERNANCE MATTERS**
Meeting:	**PENSIONS COMMITTEE**
Date:	**5 JUNE 2014**
Author:	**CHIEF FINANCE OFFICER**

1. INTRODUCTION

1.1 This report updates the Pensions Committee on various matters associated with the business of Falkirk Council Pension Fund.

2. PENSIONS AND THE BUDGET

2.1 The Chancellor of the Exchequer presented his Budget to Parliament on 19 March 2014. This contained the proposal for members of defined contribution pension schemes to be able to take the whole of their pension pot as a lump sum, 25% of which would be tax free and the remaining 75% taxable. The position prior to the Chancellor's proposal is that individuals are only allowed 25% of their pot as a lump sum with the remainder of the benefit having to be taken in pension form – usually as an annuity. The new facility does not extend to members of defined benefit schemes such as the Local Government Pension Scheme.

2.2 The Budget announcements also included a package of measures intended to strengthen the battle against pension liberation fraud. These will now include powers for HM Revenue to investigate where they believe the scheme administrator is not a fit and proper person or where they believe the scheme has not been established to provide pension benefits.

3. PENSIONS ACT 2014

3.1 The Pensions Bill 2014 received Royal Assent on 14 May 2014, becoming the Pensions Act 2014. The Act introduces a variety of important changes:

- contracting out to be abolished from 6 April 2016;
- single-tier State pension for those reaching State pension age (SPA) on or after 6 April 2016;
- increase in SPA to age 67 is accelerated - it will now be phased in between 2026 and 2028 rather than 2034 and 2036
- Future changes to SPA will be based upon a five-yearly review (with the first scheduled for the next Parliament)
- For money purchase schemes only, there will be an automatic transfer of small pension pots (those less than £10,000) when workers change jobs
- The relevant Government Minister will be given the power to make exceptions to the general requirement on employers to automatically enrol all eligible persons.

4. RISK REGISTER

4.1 The Pensions Committee has asked officers to provide a regular update on any significant changes in risk. The following items are considered worthy of reporting:

Identified Risk per Risk Register	Reason for Change in Risk Rating
Employer taking action with potential impact on Fund	It is understood that a formal agreement has been reached whereby Clackmannanshire Council employees will be suffering an across the board cut in pay in the near future. This is likely to result in a further 2,000 scheme members being awarded Pension Protection Certificates. This will be in addition to around 2,000 certificates recently awarded to Stirling Council employees who suffered a pay cut. Certificates of protection carry a significant administration overhead for the Pensions Section in terms of ensuring that pensionable pay for these members is correctly calculated. The bulk issuing of certificates also has implications for employers' contribution rates as members benefits are effectively being protected at a level that is higher than is being paid for by their contributions.
Falling asset values putting an upward pressure on Employer Contributions	The reduction in quantitative easing by the US Federal Reserve and various other economic indicators makes it expected that interest rates will rise in 2015. Whilst this may be priced in by the market to some extent, increased interest rates could result in reduced company earnings and thus reduced dividends and falling equity prices.

5. COUNCILLORS PENSIONS

5.1 Regulations have been made in England and Wales which abolish the right of Councillors and other elected office holders to be members of the Local Government Pension Scheme from 1 April 2014. Councillors who are already members of the Scheme will be able to retain their membership until the end of their current fixed term of office.

5.2 There is no similar policy intention in Scotland to restrict Councillors from being members of the Scheme.

6. LOCAL AUTHORITY PENSION FUND FORUM (LAPFF)

6.1 The LAPFF represents the interests of 58 local authority pension funds with combined assets of around £120 billion. Its mission is to promote the highest standards of corporate responsibility amongst the companies in which member funds invest.

6.2 The LAPFF is supported by PIRC Ltd, who are the Forum's company research and engagement partner. PIRC are also the Falkirk Fund's proxy voting agents and advisers on ESG matters.

6.3 Recent LAPFF engagement has included meetings with:

- Barclays over improved governance and financial sector pay;
- Nestlé SA, Easyjet, BT and Roche Holding on executive pay; and
- Lonmin as part of ongoing engagement around labour relations

LAPFF have also provided a response to the Law Commission's fiduciary duty consultation as well as being vocal in recommending a vote against the Board of Trinity Mirror due to their perceived failure to properly 'bottom out' potential exposure to phone hacking claims.

6.4 Many of the Fund's investee companies have been reporting recently. The main areas which have resulted in PIRC voting against motions at AGMs are as follows:

- Excessive remuneration packages including an unacceptable ratio of Chief Executive pay to other employees pay
- Excessive Long Term Incentive Plans
- Directors serving for more than 9 years and therefore not considered independent
- Chief Executive role and role of Chair combined
- Lack of target for female members on Boards
- High fees paid to auditors but not for audit work – calling into question auditor independence

7. RECOMMENDATION

7.1 The Committee is asked to note the contents of this report and invited to comment as appropriate.

Chief Finance Officer

Date: 23 May 2014

Contact Officer: Alastair McGirr

<u>LIST OF BACKGROUND PAPERS</u>

NIL

AGENDA ITEM 6

FALKIRK COUNCIL

Subject: **INVESTMENT IN SOCIAL/AFFORDABLE HOUSING**
Meeting: **PENSIONS COMMITTEE**
Date: **5 JUNE 2014**
Author: **CHIEF FINANCE OFFICER**

1. INTRODUCTION

1.1 This report updates the Pensions Committee with further information following its decision to invest in Social and Affordable Housing.

2. INVESTMENT DECISION

2.1 At the Special Meeting of the Pensions Committee on 17 March 2014, it was agreed that:

- Hearthstone plc be appointed to manage a £30m investment in Social and Affordable Housing; and that
- £15m of the £30m would be invested in Social Housing with the remaining £15m to be invested in Affordable Housing.

2.2 The £30m investment is estimated in broad terms to deliver around 300 property units on the basis that each housing unit will cost around £100,000.

2.3 The target return from the investment is RPI plus 2% net of fees and costs. The manager fee is 0.5% of the Fund per annum.

2.4 Formal announcement of the investment has given rise to a modest amount of press coverage – mainly from specialist pension journals. Two other Scottish LGPS Funds as well as the Scottish Government Innovative Financing Unit have asked for details of the investment model. A copy of the Hearthstone press release is attached as an appendix to this report.

3. INVESTMENT PROCESS

3.1 The process involves the £30m being invested in Hearthstone's soon to be launched "Housing Fund for Scotland" and made available to Castle Rock Edinvar (CRE). CRE are an Edinburgh based Housing Association and are Hearthstone's strategic partner in this enterprise.

3.2 The legal structure of the Hearthstone Fund will be an EPUT (an Exempt Property Unit Trust). This is an onshore tax efficient vehicle which will allow the Fund to avoid stamp duties. Falkirk already has exposure to EPUTs through the existing property mandate with Schroders.

3.3 The investment in **Social Housing** is to be delivered through Hearthstone making a 10 year loan to CRE at a fixed interest rate of 4.5% p.a. It is envisaged that this loan will be made (and Falkirk start to earn its 4.5% return) immediately after the legal formalities between Hearthstone and Falkirk have been completed. CRE intend to use the loan primarily to develop Social Housing within the Falkirk Fund area. The speed of deployment of capital will depend on suitable sites being identified and agreed with underlying Councils.

3.4 The investment in **Affordable Housing** will be delivered through Hearthstone/CRE purchasing newly built properties and renting these out under mid-market rental projects. This may be in areas such as Edinburgh and Aberdeen where rents are highest. To avoid an over concentration of risk in one location, Hearthstone envisage the affordable investment being spread across 4 to 5 different sites. Depending on the growth in the capital value of these properties, some units may be eventually sold to maintain an appropriate level of return for the Hearthstone Fund and its investors.

4. LATEST DEVELOPMENTS

4.1 The Chief Finance Officer has written to the Chief Executives of both Clackmannanshire and Stirling Councils to make them aware of the Fund's property investment. A first meeting has recently taken place between CRE and the housing leads of the three Councils.

4.2 Lawyers for Hearthstone are in the process of drafting the legal documentation for the establishment of the Hearthstone Fund.

4.3 Representatives from Hearthstone and CRE have been asked to attend the Pensions Committee in September to provide an update.

5. CONCLUSION

5.1 Following the decision to invest in Social and Affordable Housing, discussions are ongoing between the various parties to finalise the investment agreement and to consider the options for the Social Housing development.

5.2 Subject to legal formalities being completed, it is expected that the Hearthstone Fund will be launched towards the beginning of July, 2014.

6. RECOMMENDATION

6.1 The Committee is asked to note the actions that have been taken in relation to the agreed investment in Social and Affordable Housing.

Chief Finance Officer

Date: 23 May 2014

Contact Officer: Alastair McGirr

LIST OF BACKGROUND PAPERS

NIL

HEARTHSTONE ANNOUNCES HOUSING FUND FOR SCOTLAND WITH FALKIRK COUNCIL PENSION FUND AS CORNERSTONE £30M INVESTOR

LONDON 14th April 2014

Hearthstone Investments, the specialist residential property fund manager, has won a £30m investment mandate from Falkirk Council Pension Fund to invest into social and affordable housing within Scotland. The investment will form the first stage of a new Housing Fund for Scotland, managed by Hearthstone.

The fund is the first of its kind and allows pension funds to invest in local housing infrastructure, adding to the supply of new homes and supporting local economies. Investors in the fund will benefit from stable, long-term returns associated with residential property, matching the typical investment objectives of many pension funds.

The Housing Fund for Scotland will invest into social housing via fixed rate corporate bonds issued to registered social landlords of appropriate credit standing. Affordable housing will be delivered via the purchase of properties from major developers seeking to meet section 75 planning obligations. These properties will then be let to a Housing Association on an operating lease for an initial period of ten years. The mixture of investment between social and affordable housing will flex to ensure that overall returns from the fund stay within a pre-defined range.

Christopher Down, founder and Chief Executive of Hearthstone, commented:

"We are extremely pleased to have been awarded this mandate, which clearly illustrates the advantage of our specialist team and investor-led approach. With over £180billion of capital in Local Government Pension Funds, there is now an opportunity to expand the supply of UK housing while providing a genuine alternative to commercial property holdings."

Places for People, a UK-wide property management, development and regeneration company which owns or manages over 143,000 homes, will be delivering the first stage of the fund's investments via a Scottish subsidiary, Castle Rock Edinvar. The fund is anticipated to launch in the second half of 2014 and the first phase of investment from Falkirk will provide funding for around 300 new social and affordable homes.

David Cowans, Chief Executive of Places for People, commented:

"We are delighted to be involved in delivering the first stage of the Housing Fund for Scotland. Places for People have a long history in developing and managing cost-effective homes across all tenure types, and it is encouraging to see the growing trend toward institutional investment in the sector continue."

Hearthstone was selected by Falkirk following a competitive tender process run by Hymans Robertson LLP, who are advisors to the Falkirk Pension Fund. A large number of UK real-estate managers were involved, highlighting the current interest in the sector. The win means that Falkirk is the second Local Government Pension Fund to invest with Hearthstone, following a £20m investment by Islington Borough Council's pension fund in January 2013.

John Patrick, the convenor of the Council's Pensions Committee, commented:

"We were very pleased at the volume of responses to our mandate for social and affordable housing, and look forward to working with Hearthstone as the winning bidder. This is an investment that will deliver solid returns for our Fund and social good for communities. Social benefit and financial returns are both important to funds like Falkirk and we feel confident this residential property solution will meet our objectives."

-Ends-

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About Hearthstone Investments

Hearthstone Investments plc is a specialist residential property fund manager which was founded in 2010. The Hearthstone team is behind the UK's first residential PAIF*, which gained FSA approval in May 2012 and opened for investment in late July 2012.

The TM Hearthstone UK Residential Property Fund aims to give retail and institutional investors exposure to residential bricks and mortar without the risks and hassle of direct ownership. It targets UK house price inflation (HPI) plus a net rental return of around three to four per cent from lettings. It has proved popular for investors wishing to diversify existing investment portfolios and individuals considering buy-to-let or who want to invest in residential property via a SIPP. Families have also used the fund to make regular long term investments into property on behalf of their children or grandchildren using tax efficient wrappers such as Junior ISAs.

The TM Hearthstone UK Residential Property Fund is operated by Thesis Unit Trust Management Limited (Tutman), with Eversheds acting as legal advisors. Northern Trust supply administration and custody services with NatWest Trustee and Depositary Services acting as depositary.

The fund is authorised and regulated by the UK Financial Conduct Authority, and can be held as a direct investment, online fund platforms and via ISA, Junior ISA, Pension/SIPP, Trusts and Offshore Investment Bonds.

*PAIF: Property Authorised Investment Fund.

www.hearthstone.co.uk

About Places for People

Places for People is one of the largest residential property development, management and regeneration companies operating across the UK in areas from strategic land, master planning, development and property management. The Group owns and manages 143,000 homes and provides housing including homes for sale, market and affordable rent. Uniquely the Group manages residential properties in all tenures and is one of the UK's largest managers of private rented homes and leasehold properties.

As one of the leading registered provider groups in the UK, Places for People works in 205 Local Authority areas and is a not-for-dividend organisation, which means that the profits it makes are reinvested back into its core business of creating and maintaining sustainable places.

Castle Rock Edinvar is one of Scotland's leading housing associations and a Scottish Charity. Part of Places for People, Castle Rock Edinvar owns or manages over 6,000 homes and works with over 8,000 customers across 8 local authority areas in Scotland.

AGENDA ITEM 7

FALKIRK COUNCIL

Subject: FUND MANAGER PERFORMANCE REVIEW
Meeting: PENSIONS COMMITTEE
Date: 5 JUNE 2014
Author: CHIEF FINANCE OFFICER

1. INTRODUCTION

1.1 The Local Government Pension Scheme Regulations require that Falkirk Council, as administering authority for the Pension Fund, review the investments of its managers at least once every three months, which includes an analysis of returns and risk. This paper reports on performance for the overall Fund and reviews individual manager performance and developments.

1.2 The rates of return achieved by our fund managers are measured against pre-determined benchmarks. This service is provided by the Fund's custodian, Northern Trust.

1.3 The undernoted benchmarks are in place to measure the performance of each Manager.

Fund Manager	Benchmark
Aberdeen Asset Management (AAM)	MSCI All Countries World Index
Baillie Gifford Bonds (BGB)	Customised benchmark comprising UK Fixed Interest and UK Index Linked Bonds
Baillie Gifford Diversified Growth (BGDG)	UK Bank of England Base Rate
Legal & General (L&G)	Customised benchmark comprising UK and Overseas Equities
Newton Investment Management (NIM)	FTSE All World Index
Schroder Investment Management (SIM) UK Equities	FTSE All Share Index
Schroder Investment Management (SIM) Property	AREF/IPD UK Quarterly Property Fund Indices

1.4 Full details of each Manager's portfolio activity and any engagement with companies on corporate governance issues are recorded in their individual quarterly investment reports, which are enclosed.

2. MARKET REVIEW AND OUTLOOK

2.1 Global financial markets had to face a combination of geo-political tensions stemming from Russia's intervention in Crimea, prospects of monetary policy tightening in the US and a loss of economic momentum, particularly in China where policymakers are grappling with high levels of credit. The backdrop favoured bonds over equities, but only at the margin. Developed market equities managed to eke out a small gain with Europe ex UK leading. Index-linked gilts, however, produced better returns but still in the low-mid single digits.

2.2 The CPI headline rate of inflation fell throughout the quarter ending at 1.6% in March. The expectation is that it will remain subdued in the short to medium term aided by a modestly stronger sterling. During the quarter the Bank of England's Monetary Policy Committee (MPC) made no change to quantitative easing (QE) or the UK Bank Rate at £375bn and 0.50% respectively. Notable UK economic statistics this quarter included the year-on-year increase in average weekly earnings which has caught up with the inflation rate for the first time in six years (apart from two months in 2010). Stronger-than-expected retail sales in February and house prices rising 8.7% year over year in March direct attention to the prospects for higher interest rates. Consensus expectations are for interest rates to start rising during 2015.

2.3 Expectations across the Channel are quite different. The European Central Bank (ECB) maintained its benchmark interest rate at 0.25% but members of the ECB were unanimous in their willingness to begin QE if inflation, currently sitting at 0.5%, stayed well below the 2% target. Policymakers also raised the idea of further cuts in the ECB's benchmark interest rate, taking it to below zero. Mario Draghi said such measures could be needed because of the strength of the Euro. The current strength of the Euro is estimated to account for a half percentage point of the decline in the annual inflation rate.

2.4 Further afield, the new Fed Chair Janet Yellen suggested a six month gap between QE ending and interest rates rising. Given the excellent stock market returns since 2009, investors are obviously nervous about the reversal of policies that have supported financial asset prices. In Japan, a weak equity market in the quarter reflected some concerns about a sales tax increase, which might offset some of the economic and inflation momentum that recent policies have achieved. The increasingly important Chinese economy remains highly controversial and some weakening in the currency may signal a change of policy or simply an attempt to dissuade financial speculation. Given the rapid credit expansion following the global financial crisis, this bears watching as China is large enough to affect asset prices across the globe.

2.5 As always, investment markets are fraught with uncertainty. What can be observed with some certainty, however, are the real returns available from index-linked gilts, probably the best match for the liabilities of the Fund. These are decidedly and uncomfortably negative. The policies that have engineered such a situation are equally responsible for declining yields in other assets from bonds to equities to property. Nobody knows when these falling yields/rising prices might reverse direction, but some of the Fund's managers fear that valuations are high enough and prospective returns low enough that a turnaround is inevitable.

3. ANALYSIS OF PERFORMANCE RESULTS

3.1 The total fund and individual external manager returns are shown in the table in Appendix 1. The returns for the quarter ending 31 March 2014 are shown, but this is a very short period to measure performance. It simply reflects the regular reporting cycle. Each manager has been set its own individual investment objective, which depends on the type of mandate awarded. Each active manager is tasked with outperforming their benchmark over either three or five year periods. The table in Appendix 1 incorporates the relevant return and benchmark data and the excess return relative to the manager's benchmark and outperformance objective. More detail on individual manager mandates and objectives can be found in Appendix 2.

3.2 Developed equity markets were little changed over the first quarter of 2014 (+0.6%) while emerging markets declined modestly (-0.8%). Index-linked gilts (+3.6%) was the best major asset class in the UK closely followed by commercial property (+3.3%), corporate bonds (+2.5%) and conventional gilts (+2.1%).

3.3 The overall Fund's return of +0.9% over the quarter was ahead of the benchmark return of 0.7%. Over the 3 year period the Fund benefited from equity market strength and SIM's outperformance in UK equities, rising +8.8% per annum compared with the benchmark return of +6.6% per annum, an excess return of +2.2% per annum. Long term return data shows Fund appreciation of +13.5% per annum over 5 years and +7.2% per annum since September 2001. These long term returns are above the benchmark returns.

3.4 Over the first quarter of 2014, the Fund's three active equity managers posted returns from -2.2% to +2.4%. AAM and NIM beat their benchmark of global equities while SIM lagged its UK benchmark. The Fund's passive equity manager, L&G, produced a return of +0.2%, in line with its benchmark return, and so consistent with its mandate.

The return from BG's bond mandate was +2.9%, ahead of its benchmark by 0.3%. BG's other mandate, the Diversified Growth portfolio, rose 0.7%, ahead of its benchmark by 0.6%.

The property portfolio managed by SIM lagged its benchmark by 0.2%, but rose 3.1% in absolute terms.

3.5 Longer term return data shows that SIM's UK equity portfolio is comfortably ahead of its objective of +1.25% per annum above the benchmark over the 3 year period and since inception.

NIM's global equity mandate stipulates an objective of +3% per annum above the benchmark over 5 year rolling periods. Returns over the past 3 years and since inception have beaten the benchmark, but have lagged over 5 years. Since inception in June 2006, returns are ahead of benchmark by 1% per annum, so NIM has added value, but it has not achieved its objective of +3% per annum above the benchmark.

The AAM mandate's objective is +3% per annum outperformance over 3 year rolling periods. After a very poor 2013, performance is now lagging the objective, but is ahead of the benchmark over 3 years. After an excellent start to the mandate, the last 12 months performance has detracted from relative returns. Returns are now ahead of benchmark by 0.7% per annum since inception in May 2010, but lag the objective by 2.4% per annum.

The performance of BG's bond mandate is lagging its benchmark by 0.2% per annum since inception in 2007, but the 3 and 5 year performance have been very strong. The excess return over the benchmark of +1.4% per annum comfortably exceeds the objective of +0.9% per annum over rolling 3 year periods.

SIM's property performance has been disappointing in recent years, and this has reversed positive results in the early years of the mandate. Since inception in 2005, a period of low returns for commercial property owners, the portfolio has performed in line with its benchmark, but has fallen short of the objective by 0.7% per annum.

4. CONCLUSION

4.1 Following the market gains of 2013, the FTSE All-Share Index retreated by 0.6% on the back of disappointing US earnings returns. However this only told part of the story as political tensions between Russia and Ukraine, US tapering pronouncements, subdued inflation figures and interest rate predictions all played a part in influencing market sentiment.

4.2 All managers managed to beat their benchmarks during the quarter, except for Schroders – the UK Equity mandate pausing for breath after strong returns in 2013 and the Property mandate still suffering from the exposure to Continental Europe. Despite failing to meet the benchmark, the property mandate has nonetheless appreciated by over 10% (around £11m) during 2013/14. It was also both pleasing and reassuring to note that Aberdeen Asset Management were once more ahead of benchmark after a period of underperformance.

5. RECOMMENDATIONS

5.1 **The Committee is asked to note:-**

(i) the Manager's performance for the period ending 31 March 2014; and

(ii) the action taken by Managers during the quarter to 31 March 2014 in accordance with their investment policies.

Chief Finance Officer

Date: 23 May 2014

Contact Officer: Alastair McGirr

LIST OF BACKGROUND PAPERS

1. The Northern Trust Company – Fund Analytics 31 March 2014

Any person wishing to inspect the background papers listed above should telephone Falkirk 01324 506304 and ask for Alastair McGirr.

APPENDIX 1 – PERFORMANCE MEASUREMENT (RATES OF RETURN)

Rates of Return by Manager with Excess Returns - 31 March 2014							
			Returns				
Manager	Market Value £	Weight	3 months	3 year	5 year	Since inception	Inception Date
Aberdeen Portfolio	212,088,663	13.7%	2.4%	8.4%	-	9.3%	May-10
Benchmark			0.6%	7.7%	-	8.7%	
Excess Versus Benchmark			**1.8%**	**0.6%**	**-**	**0.7%**	
Excess Versus Objective			**-**	-2.4%	**-**	-2.4%	
Baillie Gifford Bond Portfolio	135,255,136	8.7%	2.9%	8.7%	11.1%	6.2%	Mar-07
Benchmark			2.6%	7.2%	7.7%	6.4%	
Excess Versus Benchmark			**0.3%**	**1.4%**	**3.4%**	**-0.2%**	
Excess Versus Objective				**0.5%**	**2.5%**	**-1.1%**	
Baillie Gifford Diversified Growth	189,496,135	12.2%	0.7%	-	-	6.9%	Feb-12
Benchmark			0.1%	-	-	0.5%	
Excess Versus Benchmark			**0.6%**	**-**	**-**	**6.4%**	
Excess Versus Objective *			**-**	**-**	**-**	2.9%	
Legal & General	328,238,499	21.1%	0.2%	8.5%	15.7%	14.7%	Jan-09
Benchmark			0.2%	8.4%	15.5%	14.6%	
Excess Versus Benchmark			**0.0%**	**0.1%**	**0.2%**	**0.1%**	
Excess Versus Objective			**-**	**0.1%**	**0.2%**	**0.1%**	
Newton	227,508,643	14.6%	1.2%	8.3%	14.7%	8.5%	Jun-06
Benchmark			0.5%	7.7%	15.0%	7.4%	
Excess Versus Benchmark			**0.6%**	**0.7%**	**-0.3%**	**1.0%**	
Excess Versus Objective			**-**	**-**	**-3.3%**	**-2.0%**	
Schroders UK Equity	223,860,100	14.4%	-2.2%	15.7%	20.4%	9.7%	Sep-01
Benchmark			-0.6%	8.8%	16.4%	7.1%	
Excess Versus Benchmark			**-1.6%**	**6.9%**	**4.1%**	**2.6%**	
Excess Versus Objective			**-**	**5.6%**	**2.8%**	**1.3%**	
Schroders Property	112,076,532	7.2%	3.1%	4.8%	5.3%	1.7%	Nov-05
Benchmark			3.3%	5.8%	7.6%	1.7%	
Excess Versus Benchmark			**-0.2%**	**-1.0%**	**-2.3%**	**0.1%**	
Excess Versus Objective			**-**	**-1.7%**	**-3.0%**	**-0.7%**	
Total Fund	1,553,394,729	100.0%	0.9%	8.8%	13.5%	7.2%	Sep-01
Benchmark			0.7%	6.6%	12.3%	6.9%	
Excess Return			**0.2%**	**2.2%**	**1.2%**	**0.3%**	

*** Note that objectives are set over 3 or 5 year periods and Baillie Gifford's Diversified Growth mandate has not been in place for the requisite periods.**

There are small rounding effects in the table above.

APPENDIX 2 - INVESTMENT MANAGER COMMENTS

Aberdeen Global Equity

(13.7% of Total Fund)

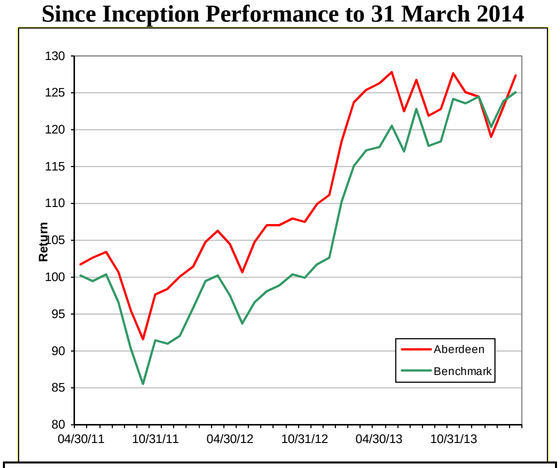
Investment Approach:

High conviction, research-driven house. Only invest in companies they have met. Regional teams produce Global buy list of 330 stocks. Global team carries out comparative analysis and produces model portfolio of 50 stocks from which team must build portfolio. Long-term horizon, trading highly price-sensitive.

Investment Objective:

To outperform the MSCI AC World Index in sterling by 3% per annum, gross of fees, over rolling 3 year periods (inception date 16 May 2010)

Since Inception Performance to 31 March 2014



Q1 2014	: +1.8% excess return
3 Years	: +0.6% excess return
Since inception	: +0.7% p.a. excess return

Summary

Better performance this quarter after a terrible 2013. Careful examination and justification of holdings is comforting from a long term perspective.

Portfolio

The portfolio is genuinely unconstrained, which indicates that it should be able to achieve its objectives. No single investment more than 5% of the portfolio is allowed, but sector and country limits are wide (+/-15% for sectors and +/-35% for countries allowed). Cash currently at 2.7%.

The portfolio is more geographically diverse than the benchmark. North America represents >50% of the benchmark, but the portfolio is u/w by > 20%. The fund is o/w the UK (+9%), Europe ex-UK (+4%), and LatAm (+6%). By sector, the portfolio remains heavily o/w defensive sectors, such as consumer staples (+6%), energy (+7%), materials (+3%) and healthcare (+3%), and has low exposure to cyclical earnings, such as consumer discretionary shares (-10%), I.T. (-4%) and industrials (-2%). Financials are also underrepresented (-5%). Consequently, the portfolio is likely to perform relatively poorly in strong equity markets, but its defensive tilt should help protect it in the event of equity markets falling. Aberdeen's rhetoric and its portfolio positioning remain very cautious.

Performance was comfortably ahead of the benchmark because of the overweight allocation to Europe ex-UK and underweight in Japan, but also because of good stock selection in the US and Asia Pacific ex-Japan. The o/wt in healthcare and u/wt in consumer discretionary and good stock selection in energy, healthcare, financials and I.T. were significant contributors to this quarter's good performance – EOG Resources, QBE Insurance, Banco Bradesco and Potash all rose more than 10%, while Vodafone and Vale fell by 10% or more.

Aberdeen continue to follow their process investing in quality companies with lower than average levels of debt and relatively stable earnings and cashflows. In the absence of major price volatility, portfolio activity has been, and can be expected, to be low. Over the past year, there have been two new stock positions, MTN Group and BHP Billiton and two outright divestments, China Mobile and Canon. Otherwise, transactions have involved topping up and top-slicing existing shareholdings largely to reflect shifts in valuations.

Key considerations/developments

Ownership has not changed, but the acquisition of SWIP is very large – it adds £138bn of assets under management taking the Group's assets to £325bn - there will be integration distractions, but there is a potential short term positive - some of SWIP's global portfolios will be retained and invested in the existing holdings of Aberdeen's portfolio; the **client base** is quite stable (-£593m in Q1 (3%), but 3 net clients won) and the **investment process** has not changed/is standardised across equity products. This facilitates cross-fertilisation of ideas and a team-led approach. Stable, well-resourced and experienced **investment team** (6 most senior team members average >19 years in industry and >12 years at Aberdeen), backed up by extensive and experienced regional teams.

Baillie Gifford Bonds

(8.7% of Total Fund)

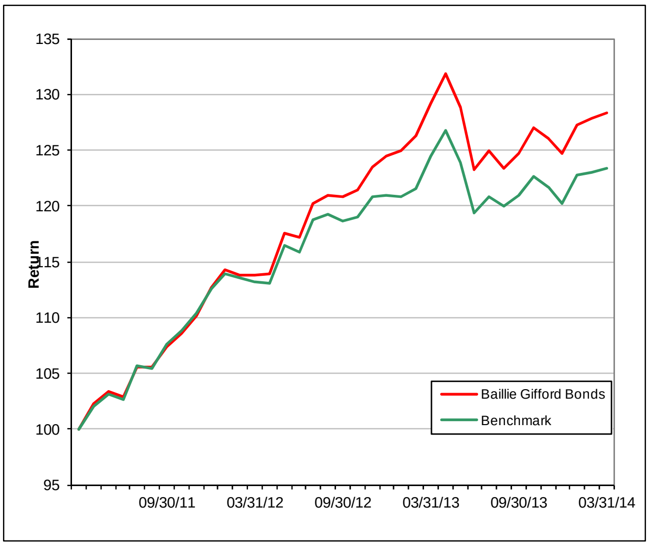
Investment Approach:

Baillie Gifford employs fundamental analysis to identify sustainable trends. It believes that there are inefficiencies that can be exploited in the areas of stock selection and interest rate and currency strategies.

Investment Objective:

To outperform a customised benchmark comprising index-linked gilts, conventional gilts and investment grade bonds by 0.9% per annum net of fees over rolling 3 year periods (inception date 30 March 2007).

3 Year Performance to 31 March 2014



Q1 2014	: + 0.3% excess return
3 Year	: + 1.4% p.a. excess return
Since inception	: - 0.2% p.a. excess return

Summary

3 year performance is well ahead of the objective.

Portfolio

The portfolio has a customised benchmark (20% FT-Actuaries Over 5 Years Index Linked Gilt Index, 30% FT-Actuaries All Gilts, 50% Merrill Lynch Sterling Non-Gilt Index). Baillie Gifford (BG) invests in three BG Funds on a no-fees basis to achieve the appropriate exposure.

Geo-political issues came to the fore over the quarter and there was a significant ‘flight to safety’ effect from the political uncertainties generated by the position in Ukraine. As a result of this and the market perception that US interest rates would be held low for longer, bonds generally had a very good quarter, with Index-Linked gaining 3.6%, Corporate Bonds 2.5% and UK Gilts 2.1%.

The portfolio had a further quarter of positive relative performance, returning 2.9% over the quarter against a benchmark return of 2.6%. Over both the quarter and the one year periods, stock selection has been the dominant factor in the positive relative return generating a +1.2% contribution over the year. Their positioning in securitised, insurance companies’, and lower credit rated bonds have all proved positive for the portfolio. The portfolio’s position in high yield reduced during the quarter, although mainly due to the ratings upgrade of their Daily Mail position to investment grade. Asset allocation also added to the performance over the quarter, due to the portfolio’s modest overweight in corporate bonds relative to sovereigns. As a post quarter event, they noted that they had liquidated their small Russian sovereign bond position, and replaced it with a US swap, maintaining a synthetic rather than physical exposure.

However, currency detracted from the relative performance over both the quarter and the one year period. Their Emerging Market currency strategy is to seek relative value rather than taking directional positions. They are therefore overweight Mexico / underweight Chile, and similarly overweight Columbia / underweight Peru. However their biggest position relative to the benchmark is +2.4% overweight US Dollar (which they had increased during the quarter). They are also 1% underweight GBP. They are hardly the only frustrated US Dollar bulls and sterling bears in the market, but the position is a slight negative early in the second quarter.

Key considerations/developments

Baillie Gifford is a long established, reputable partnership; the client base is stable and the investment process has not changed.

Assets under management in the sterling aggregate product increased slightly from £570m to £581 over the quarter. There were no changes to clients in the fund or to the investment staff.

Baillie Gifford Diversified Growth

(12.2% of Total Fund)

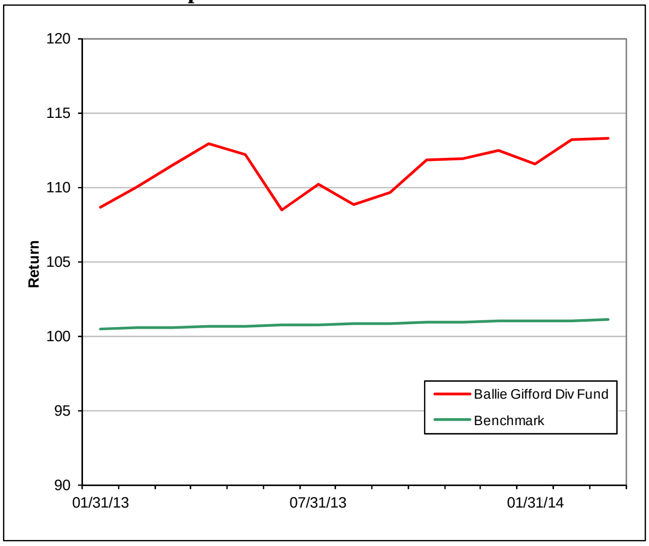
Investment Approach:

Baillie Gifford invests in a broad range of traditional and alternative asset classes, such as equities, bonds, property, private equity, infrastructure, commodities and currencies, adjusting portfolio weightings to reflect the relative attractiveness of the individual assets.

Investment Objective:

Objective: to outperform the UK base rate by at least 3.5% per annum (after fees) over rolling five year periods with an annual volatility of less than 10%. (Inception date 2 February 2012)

Since Inception Performance to 31 March 2014



Q1 2014	: +0.6% relative to base rate
1 Year	: +1.1% relative to base rate
Since inception	: +6.4% relative to base rate

Summary

Since Falkirk invested in Feb 2012, the risk/return is beating the modest fund objectives of (0.5% + 3.5% =) 4% pa net return with less than 10% volatility, by realising 6.4% pa net return with 6.5% volatility.

Portfolio

While net performance beats the modest 4% pa target since inception, it is broadly flat year on year (chart above). BG now sees “risk less well rewarded” and expect lower return from here. They have reduced High Yield by 2% to 5% and with just 1% yield premium for corporate bonds ask “when do we step away?” Cash is now 9.5% of the fund (up from 6% last year) and Govt/Investment grade bonds are up to 14.5% - having just bought ECB 5 year bonds returning 1.5% pa. Neither of these will hit the 4% pa return target.

Around 1/3rd of the fund is invested in other Baillie Gifford funds. These are “benchmark constrained” by their own benchmarks and objectives, which may differ from that of Diversified Growth, causing contradictions and adding to risk. For example, they have 8.6% of the fund invested in their Emerging Markets Bond fund, which has c10% of its benchmark in Russia. Hence, they have c1% of the fund in Russian bonds.

“Active Currency” is reported at “0.0% of assets”, and “5% of volatility”. But in Q1, currency was the major negative impact to performance at -0.7% derived from a c8% fund short position in Australian Dollars. (Half of this was reported as the contribution from “Absolute Return” assets.) The short positions in Australian Dollar, Yen, Sterling, Euro and Swiss Francs are >30%. This implies FX risk may be understated.

The predicted volatility is now 6.6% - with around half of this from (listed and private) equities. Targeted maximum volatility is 10%. (cf global equities are 16.9%).

Key considerations/developments

Baillie Gifford is a long established, reputable partnership. Despite determining £5bn “capacity” end 2012 and “closure to all new clients” in June 2013, **assets** increased in Q1 to £5.36bn on £105m net inflows (after £0.75bn net inflows 2H 2013). There have been no changes to the organisation, the **investment process** or **the team**.

Newton Global Thematic Equity
(14.6% of Total Fund)

Investment Approach:

Newton identifies structural trends to gain perspective on the important risks and opportunities in investment markets. This thematic framework drives stock selection, which results in a concentrated portfolio.

Investment Objective:

To outperform FTSE All World Index by 3% per annum (net of fees) over rolling 5 year periods (inception date 30 June 2006)

3 Year Performance to 31 March 2014

Q1 2014	: + 0.6% excess return
5 Years	: - 0.3% p.a. excess return
Since inception	: + 1.0% p.a. excess return

Summary

Portfolio not achieving objective, but is ahead of benchmark since inception. It has been constructed to take advantage of weak equity markets.

Portfolio

The portfolio is genuinely unconstrained (48 stocks), indicating that it should be able to achieve its objectives. This is an equity portfolio, but the manager is able to hold up to 10% in cash. The manager continues to take a very defensive stance and cash (mostly short term US Treasuries) was 9% at quarter end.

Stock ideas flow from Newton's themes, which include deleveraging, financial concentration and growing Chinese influence. The portfolio is characterised by companies with stable earnings, strong cash flows, competitive advantages, inflation linkage, innovation, exposure to growth economies, good management & governance and attractive valuation.

The portfolio is overweight Europe (+7%) and UK (+5%) equities, and underweight North America (-6%), Japan (-5%), Pacific (-5%) and other/emerging markets (-6%). It has high exposure to companies in the healthcare and consumer goods sectors, while financials, industrials and oil and gas companies with cyclical earnings are under-represented (though is o/w materials). The portfolio is likely to perform relatively poorly during strong equity markets, but its defensive tilt and high cash position should protect it if equity markets fall.

The portfolio outperformed in Q1 benefiting from good selection in other/emerging markets and Japan. The overweight allocation to a strong healthcare sector was a major positive contributor. The top contributors within healthcare were Teva Pharmaceuticals, Roche, Express Scripts and Novartis and, within I.T., Microsoft and EMC. Detracting from performance within the telecommunications sector were Vodafone and Sprint and within financials Citigroup and AIA Group.

During the quarter, four new stocks were introduced: Apple, Kraft Foods, Wolters Kluwer (publisher) and TJX Companies (retailer); three stocks were sold outright (Lab Corp, Fresenius, Principal Financial) and one reduced (Associated British Foods).

Key considerations/developments

Newton remains one of Bank of New York Mellon's asset management subsidiaries based in London; in the face of weak relative returns, management reassessed the **investment process** in 2011/12 and made some personnel changes to improve rigour, but did so without changing the key elements of the global thematic strategy; the **client base** is stable (no flows in or out).

Schroders UK Equity

(14.4% of Total Fund)

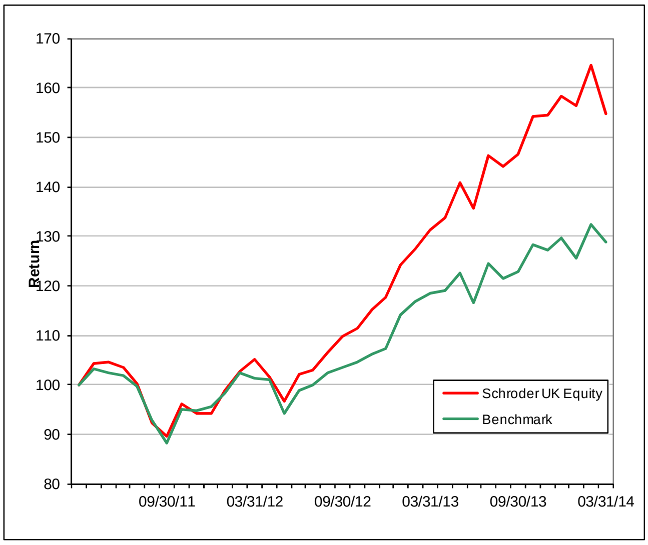
Investment Approach:

Schroder seek to identify stocks which trade at a substantial discount to their intrinsic value and where they believe that profits will surpass expectations. The investment style can be categorised as "value".

Investment Objective:

To outperform FTSE All Share Index by 1.25% per annum (net of fees) over 3 year rolling periods (inception date 31 March 2007)

3 Year Performance to 31 March 2014



Q1 2014	: -1.6% excess return
3 Year	: +6.9% p.a. excess return
Since inception	: +2.6% p.a. excess return

Summary

Underperformance in Q1 perhaps unsurprising given recent strength. Manager comfortably ahead of the objective on all long term timeframes. Clearly articulated strategy with stable ownership, client base and investment team.

Portfolio

The portfolio of 39 stocks deviates from the benchmark meaningfully, which means that the objective should be achievable, but the return profile is likely to be highly variable. Active sector positions are very similar to last quarter. The portfolio retains an overweight position in the general retailers and life insurance sectors. Mining is the biggest underweight.

Relative returns in the first quarter were negative (-1.6%), yet the portfolio is still +9.1% over the most recent 12 months. Life insurance stocks suffered in Q1 as a result of UK Budget proposals to change the structure of the annuity market while gaming stocks were negatively impacted by the unexpected hike in the rate of duty on fixed-odds betting machines. Food retailers were again under pressure with a profit warning from Morrisons serving to highlight the ongoing competitive threat from the "hard discounters", such as Lidl and Aldi. More positively, Astrazeneca shares were buoyed by a better outlook for long term drug sales. The team are closely following the situation regarding the Pfizer bid for Astrazeneca.

The team has continued to trim the winners in the portfolio where the gap between fundamental value and share price has narrowed. These names include Close Brothers, Daily Mail, Trinity Mirror, Home Retail, Dixons and Rentokil. RSA Insurance was also trimmed following a succession of value destructive acquisitions, which caused the balance sheet to deteriorate. Proceeds have been used to add to cash and top up positions in Tesco, Vodafone and Pearson.

The resurgence in equity market confidence is highlighted following marked increases in the volumes of acquisition activity and equity issuance. The team have regularly cautioned that equity market returns from here are not going to match those of the recent past. They take this one step further with the following comment in the report: "...when market conditions mean significant prospective gains are not possible, the best way to guard against long-term capital losses is to favour the least expensive companies available that also have strong finances".

Key considerations/developments

Schroders is a publicly listed asset management company, which is still controlled by the family; the **client base** is fairly stable and the **investment process** has not changed. The UK Value product, in which Falkirk is invested, runs approximately £5.3bn in assets split roughly 1/3rd institutional and 2/3rd retail. The **investment team** appears to be stable and demonstrates high conviction in its investment approach.

Schroders Property Multi-Manager

(7.2% of Total Fund)

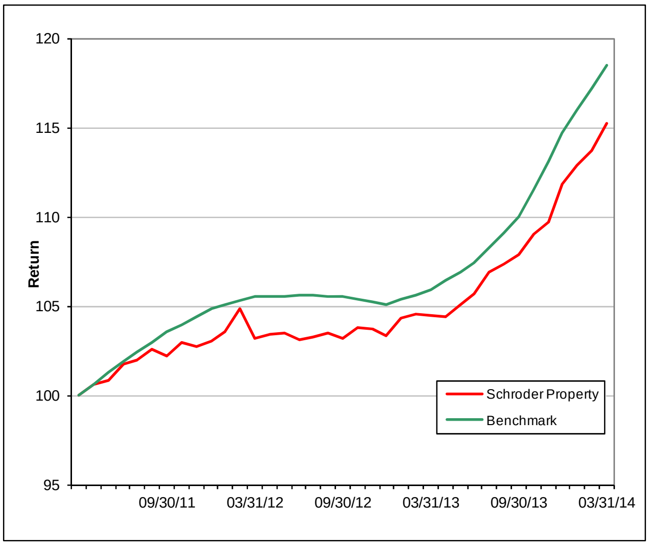
Investment Approach:

Schroders runs a segregated mandate providing a multi-manager portfolio of property funds. The manager seeks to identify attractive property markets and property funds with skilled managers, some of which are sector specialists.

Investment Objective:

To outperform AREF/IPD UK Pooled / Quarterly Property All Balanced Funds Weighted Average Index by 0.75% per annum (net of fees) over 3 year rolling periods (inception date April 2006)

3 Year Performance to 31 March 2014



Q1 2014	: -0.2% excess return
3 Year	: -1.0% p.a. excess return
Since inception	: +0.1% p.a. excess return

Summary

Latest 3 year performance remains weak (-1.1%pa relative). Since inception the performance is broadly in line with the benchmark, but less than the objective. Significant restructuring undergone to position the portfolio for the future.

Portfolio

The portfolio is comprised of a diverse group of 15 funds investing in property assets largely in the UK. The portfolio is valued at £113m. Activity was fairly significant from 2009-2013, with over £80m of property transactions taking place, replacing 6 holdings with 6 new funds. There is now expected to be low levels of future transaction activity.

Continental European exposure amounts to approximately 6% of the portfolio. The poor three year relative performance has been dominated by exposure to Continental Europe, which is not in the benchmark. (Recap in '06-07, 10% of the portfolio was committed to Europe. In addition, transaction costs and cash drag in a rising market affected performance.

The portfolio's risk profile has been rebalanced through greater investment in low geared, core balanced property funds and those funds targeting an income focussed approach. As a result, the manager believes the portfolio is well positioned for the current investment environment, in which the income yield on property is very competitive with government bonds.

The portfolio now targets to hold minimal amounts of cash - which now represents 0.7%, and is expected to reduce further as capital is drawn from the Local Retail Fund.

Key considerations/developments

Schroders is a publicly listed asset management company, which is still controlled by the family; the **client base** is fairly stable and the **investment process** has not changed. The **investment team** appears to be stable, but the poor performance puts it on the defensive.

APPENDIX 3 – GLOSSARY

Benchmark - The yardstick used to measure the success and structure of a portfolio. All managers are measured against benchmarks. Passive managers are tasked with producing returns that are the same as the benchmark. Active managers are tasked with producing returns that are higher than the benchmark.

Benchmark return - Identifies the total return of the benchmark for the identified period. Return numbers for periods of one year or less show the actual return over the period. Returns for periods of greater than one year are annualised returns - they show the return per annum (%pa).

Dividend Yield - The dividend a company pays divided by its current price.

Duration - A measure of the sensitivity to interest rates of bonds. It identifies the approximate percentage change in a bond's price for a 100 basis point change in yield

Excess Return - Is the out / underperformance of the portfolio relative to the benchmark for the identified period. Return numbers for periods of one year or less show the actual return over the period. Returns for periods of greater than one year are annualised returns - they show the return per annum (%pa).

Investment Objective – All managers (and the Fund) are set investment objectives, which are related to a specific benchmark. The investment objective for a passive manager is to match the returns of the benchmark. The investment objective for an active manager is to exceed the returns of the benchmark by a pre-determined percentage per annum over a pre-determined period.

Market value (£) - Identifies the total market value of the portfolio / Fund

Portfolio return - Identifies the total time weighted rate of return of the assets of the portfolio for the identified period. Returns for periods up to 12 months are the return over that period. Returns for periods longer than 12 months are annualised returns – they show the return per annum (%pa).

Turnover - Is the level of purchases and sales for the period. High turnover is generally regarded as bad because trading costs are incurred.

AGENDA ITEM 8

FALKIRK COUNCIL

Subject:	**PRIVATE EQUITY AND ALTERNATIVES UPDATE**
Meeting:	**PENSIONS COMMITTEE**
Date:	**5 JUNE 2014**
Author:	**CHIEF FINANCE OFFICER**

1. INTRODUCTION

1.1 This report updates the Committee on the progress and key events arising from each Manager's investment programme for the three months to 31 March 2014.

1.2 The Fund's private equity and alternatives programme is managed as follows:

SL Capital (Standard Life)	-	European Private Equity
Wilshire Associates	-	Global Private Equity
Grosvenor	-	Global Infrastructure
M&G	-	Credit Markets

1.3 The Fund's strategic allocation to private equity and alternatives (excluding the allocation to the Baillie Gifford Diversified Growth Fund) is set at 10% of total fund assets. This is split 5% to private equity and 5% to infrastructure.

1.4 The attached schedule gives details of the current valuations and commitment levels.

2. SL CAPITAL PARTNERS

2.1 SL Capital is a subsidiary of Standard Life Investments, who in turn own 60% of the business. The remaining 40% is owned by 8 partners.

2.2 The Fund's overall commitment to SL Capital is €102m (£84m), spread across four European Investment Funds – ESP 2004, ESP 2006, ESP 2008 and ESF 1 – all being fund of fund structures.

2.3 The first quarter of 2014 has seen the manager reasonably active with the Fund benefitting from distributions of €1.8m from the maturing 2004 and 2006 ESP Funds. With regard to drawdowns, €2m was called in for ESP 2008 and ESF I.

2.4 In terms of market outlook, the manager observes a gradual acceleration in economic growth in northern Europe. However, Italy and France remain areas of concern due to a lack of financial reform, whilst with Spain - where cost cutting measures have been implemented - the challenge is in finding underlying managers of proven quality.

2.5 Recent strategic developments include a final close for ESF 1 at the end of 2013 and the taking over of the private equity investments of Ignis Asset Management to the value of €800m. In respect of this latter development, SL Capital have indicated they will be increasing their staffing complement accordingly.

2.6 SL Capital have a pipeline of products available for investment, however as the Fund's actual allocation to private equity is in line with its strategic allocation, there is no pressing need to make a further commitment at this stage.

3. WILSHIRE ASSOCIATES

3.1 The Fund has made various commitments to Wilshire Associates covering several geographical areas. €10.9m has been committed to European focused funds, $53.2m to US and $3.8m to Asia, On top of this there is the recent $15m commitment to Fund IX which has a global scope. In total, this equates to £52m.

3.2 In their quarterly update, Wilshire reaffirm their view that 2013 was a turning point for global economic recovery and the longer term stabilisation of private capital markets. This is based on global GDP growth in 2013 being 3% and Wilshire's observation that private fund-raising and deployment of capital are all continuing to improve.

3.3 During the quarter, there was a slight decrease in deal flows across Wilshire's Euro Funds with €36k called in and €393k distributed. The US Dollar funds continued to show greater activity with $546k called in and $1.5m being distributed.

4. GROSVENOR CAPITAL

4.1 The Fund's global infrastructure investments are made through an $80m commitment to the Customised Infrastructure Strategies Fund managed by the GCM Customised Fund Investment Group (CFIG).

4.2 Although no distributions were made during the quarter, healthy investment activity was demonstrated by CFIG calling in €4.6m and advising that they expected to make the final investments to the Customised Fund in Q2 2014 which will make the Fund fully subscribed.

4.3 Grosvenor have recently announced that they are seeking to raise capital of $750m for a second infrastructure fund (CIS II). As with CIS I, the team are targeting a mix of primary funds, secondary fund purchases, direct/co-investments and, opportunistically, infrastructure debt. The Fund will be looking to have 45% of investments in North America, 45% in Western Europe and 10% in the rest of the world.

4.4 CIS II has a target return of 10% plus and a cash yield of between 3%-5% p.a. The managers advise that they are seeking broad diversity by investing across different sectors and geographies, by investing in a mix of green and brownfield investments (although tilted heavily towards brownfield) and by investing in a range of structures over a three year period – broadly speaking, a similar strategy to CIS I.

4.5 The CFIG team of 6 senior professionals have an average of 18 years' experience in infrastructure and with bases in New York and London appear well placed to have oversight of global opportunities. Net returns from CIS I have been just above 10% (for 1st close investors) and the team continues to have the endorsement of the Fund's investment adviser, Hymans Robertson.

4.6 Setting aside the potential investment of £30m that may be made to UK/Scottish Infrastructure, the Falkirk Fund's allocation to global infrastructure is 5% of the Fund value. As the current commitment equates to around 3%, a further commitment could be made to the CFIG to increase investment levels towards the 5%.

5. CREDIT MARKETS

5.1 The M&G UK Companies Financing Funds provide the pension fund with exposure to UK credit markets. The Funds play a valuable economic role in providing debt financing to UK companies that face refinancing challenges. The aim of the M&G Funds is to create attractive levels of income for investors - LIBOR plus 3%-6% - with low levels of risk.

5.2 Falkirk's commitment to the M&G Fund I is £11.8m and this has now been fully invested. The more recently agreed commitment of £10m to Fund II is in the process of being drawn down.

5.3 The most significant event recently affecting Fund I has been the sale by the Stobart Group of 51% of their transport and logistics business. This resulted in them having to repay their Fund I loan together with an early repayment fee of £750k. Fund I also includes loans of between £30m and £100m made to companies such as Hogg Robinson, Taylor Wimpey and Provident Financial. The return from the Fund is currently 5% and all loans are being repaid in accordance with their covenants.

5.4 In relation to Fund II, five loans equalling £135m have now been made to companies including Workspace Group plc, Caffe Nero and Hall & Woodhouse Ltd. The average loan period in this Fund is 6.4 years. Since the launch in November, 2012, the Fund has achieved a net return of 5.25%.

6. CONCLUSION

6.1 The investment experience of our private equity managers is that conditions are becoming more receptive to fund-raising and deal making. This gradual thawing of the financial climate is welcome as several of our funds are reaching their divestment or harvesting stage with managers of the underlying funds actively seeking opportunities to realise their assets through public offerings, trade sales or secondary sales.

6.2 Grosvenor Capital Management are raising capital for a second Customised Infrastructure Strategies Fund. As the Falkirk Fund is underweight in its allocation to global infrastructure, consideration should be given to making a commitment to the new fund.

7. RECOMMENDATIONS

7.1 The Committee is asked:

(i) to note the progress of the Private Equity, Infrastructure and Credit Markets Programmes as at 31st March 2014;

(ii) to agree whether or not a commitment should be made to the new infrastructure Fund being launched by Grosvenor CM; and

(iii) subject to the decision in (ii) above, the amount of any commitment.

Chief Finance Officer

Date: 23 May 2014

Contact Officer: Alastair McGirr

LIST OF BACKGROUND PAPERS

NIL

Appendix A

Falkirk Council Pension Fund
Alternative Markets Update - 31/03/2014

Exchange Rates	
$	1.6574
€	1.2031

Alternative Assets Summary - Approx Sterling Value

Manager	Fund	Commitment £,000	Unfunded £,000	(a) Cost £,000	(b) Return of Cost £,000	(c) Distrbtn Gains £,000	(d) Market Value £,000	(b + c + d) Total Value £,000	Total Value to Paid in Cap.	Inception Rate of Return
Private Equity										
SL Capital Partners	European Strategic Partners 2004	24,936	2,876	22,060	7,354	5,637	13,474	26,465	1.20	5.5%
SL Capital Partners	European Strategic Partners 2006	24,936	3,418	21,518	5,175	1,433	17,846	24,454	1.14	2.4%
SL Capital Partners	European Strategic Partners 2008	22,442	10,101	12,341	1,069	-	12,381	13,450	1.09	-0.7%
SL Capital Partners	European Smaller Funds I	12,468	10,224	2,244	-	-	1,871	1,871	0.83	N/A
	SL Capital Partners Total	84,782	26,619	58,163	13,598	7,070	45,572	66,240		
Wilshire Associates	Fund VI - Europe	2,992	230	2,762	1,320	913	1,519	3,752	1.36	5.8%
Wilshire Associates	Fund VII - Europe	2,992	290	2,702	477	270	2,147	2,894	1.07	-0.8%
Wilshire Associates	Fund VIII - Europe	3,075	740	2,335	372	307	2,160	2,839	1.22	30.7%
Wilshire Associates	Fund VI - US	8,447	495	7,952	2,691	2,572	5,442	10,705	1.35	3.5%
Wilshire Associates	Fund VII - US	6,939	531	6,408	1,713	1,408	4,998	8,119	1.27	3.2%
Wilshire Associates	Fund VIII - US	7,663	1,133	6,530	1,723	786	5,697	8,206	1.26	5.2%
Wilshire Associates	Fund VII - Asia	1,086	114	972	402	237	599	1,238	1.27	3.1%
Wilshire Associates	Fund VIII - Asia	1,207	720	487	104	34	480	618	1.27	-15.5%
Wilshire Associates	Opportunities Fund II-B	9,050	2,319	6,731	3,547	1,221	3,840	8,608	1.28	9.5%
Wilshire Associates	Fund IX	9,050	9,050	0	0	0	0	0		
	Wilshire Associates Total	52,501	15,622	36,879	12,349	7,748	26,882	46,979		
	Private Equity Total	**137,283**	**42,241**	**95,042**	**25,947**	**14,818**	**72,454**	**113,219**		
Infrastructure										
Credit Suisse/Grosvenor	Customised Infrastructure Strategies	48,268	13,568	34,700	3,519	1,933	34,006	39,458	1.14	7.0%
	Infrastructure Total	**48,268**	**13,568**	**34,700**	**3,519**	**1,933**	**34,006**	**39,458**		
Credit Markets										
Prudential/M&G	UK Companies Financing Fund	11,835	0	11,835	2,593	103	10,752	13,448	1.14	4.7%
Prudential/M&G	UK Companies Financing Fund II	10,000	7,371	2,629	0	21	2,681	2,702	1.03	2.5%
	Credit Market Total	**21,835**	**7,371**	**14,464**	**2,593**	**124**	**13,433**	**16,150**		
	Total Alternative Fund Value	**207,386**	**63,180**	**144,206**	**32,059**	**16,875**	**119,893**	**168,827**		