LGPS Survey 2023

Room151 in association with Schroders

Room151 | Schroders

Contents

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Introduction

Firstly a big thank you to everyone who participated in the Room 151 and Schroders, Local Government Pension Scheme questionnaire. The survey was completed by 47 organisations including the representatives of five pools and 42 local authority funds.

The questionnaire was timed to coincide with the government's response to the LGPS investments consultation and aims to feed into the ongoing debate about the future of the LGPS.

There was a focus on five key themes, generating a snapshot of where the LGPS community stands today on.

1. The future of the LGPS.
2. The trends within asset allocation and cashflow management.
3. Levelling up and local investment.
4. Private market strategies.
5. How to tackle climate change.

So how would I summarise the responses and did anything surprise me?

Structure of regional pools: Less than half of you believe that the current structure of eight regional pools is the most appropriate. However, two thirds think cross-pool investment opportunities would be desirable. In addition a significant majority (77%) feel that pooling has been beneficial for performance and fee saving benefits have justified the initial setup costs. Two-thirds of the respondents believe that asset allocation should remain the responsibility of the administering authorities.

Local investing and levelling up: I was surprised that the appetite for local investment was not as strong as I thought it would be. Two-thirds of the respondents believe that levelling up should be a consequence of investment strategy rather than a requirement imposed by central government. Whilst a significant majority (75%) of respondents suggested there was better infrastructure and venture opportunities outside of the UK. A lack of scalable local opportunities that can meet the funds' return targets was a major concern for 61% of respondents.

Within **private markets** there was a very clear direction of travel that the LGPS has. This will result in significant increases in exposure across the asset classes, with 70% responding that private asset allocations would increase. This was at the expense of listed equities and government bonds. Sustainability strategies, private debt and renewable energy were the big winners in terms of new allocations. Even higher gilt yields are not impacting strategic asset allocations to private markets as 93% say you invest for the long term.

Barriers to sustainable investing: The lack of clear definitions and transparency of reported data related to net zero investments were identified as the biggest barriers to sustainable investing. Approximately one-third of respondents still have performance concerns; is there a trade-off between sustainability and return? The most attractive net zero asset classes did not surprise, with renewable infrastructure emerging as the clear favoured strategy with 79% of respondents expressing interest. Natural capital ranked second, with 36% of respondents finding it appealing to contribute to net zero targets.

I hope you find the survey results of interest and the many discussions on the achievements and challenges of the great LGPS sector continue for years to come.

Please do get in touch with me or Peter, Jockum or Mona at Room 151 if you're keen to discuss the findings in more detail.

Paul Myles
Head of LGPS, Schroders

The LGPS are facing many new headwinds and hurdles, from the government's levelling up agenda and investment consultation, to the aftermath of the gilt crisis and the desire to implement carbon reduction strategies. This survey creates a snapshot of the industry's views and response to these numerous challenges.

About the survey

The UK pensions industry has witnessed drastic changes over the past decade - none more so than the Local Government Pension Scheme (LGPS) sector.

When then chancellor, George Osborne, first announced his intention to pool local government pension assets into 'sovereign wealth funds', it caused much scepticism. Fast forward eight years and the pooling of LGPS assets is a fait accompli, and the eight pools managing c. £370bn in pension assets are influential players in the UK's £2.5 trillion pension market. However, there may be further transformational changes to come, as indicated by the chancellor in his Manson House speech in July 2023. The government is keen to accelerate the pace of pooling and aims for a full consolidation of all LGPS assets by March 2025. In addition, it has ambitions for LGPS capital to help fund its ' levelling up' agenda as well as facilitating national 'net zero' goals.

With the LGPS on the brink of some potentially far-reaching changes, Room151 and Schroders have teamed up to gauge the temperature among practitioners, representing local authorities, the pools as well as independent investment advisers.

Leveraging our broad network of contacts , we have gained comprehensive insights on key asset allocation decisions, the mood on the future of pooling, appetite for private markets and how the LGPS sees levelling up and net zero targets.

The responses sketch an interesting picture: LGPS practitioners have largely adopted pooling and are keen to align investments with net zero and levelling up goals. Nonetheless, financial objectives remain primary to investment decision-making, regardless of political priorities. We are extremely grateful to the 61 respondents from 47 organisations who have completed the survey and we hope our research will feed into the lively debate on the future of the LGPS.

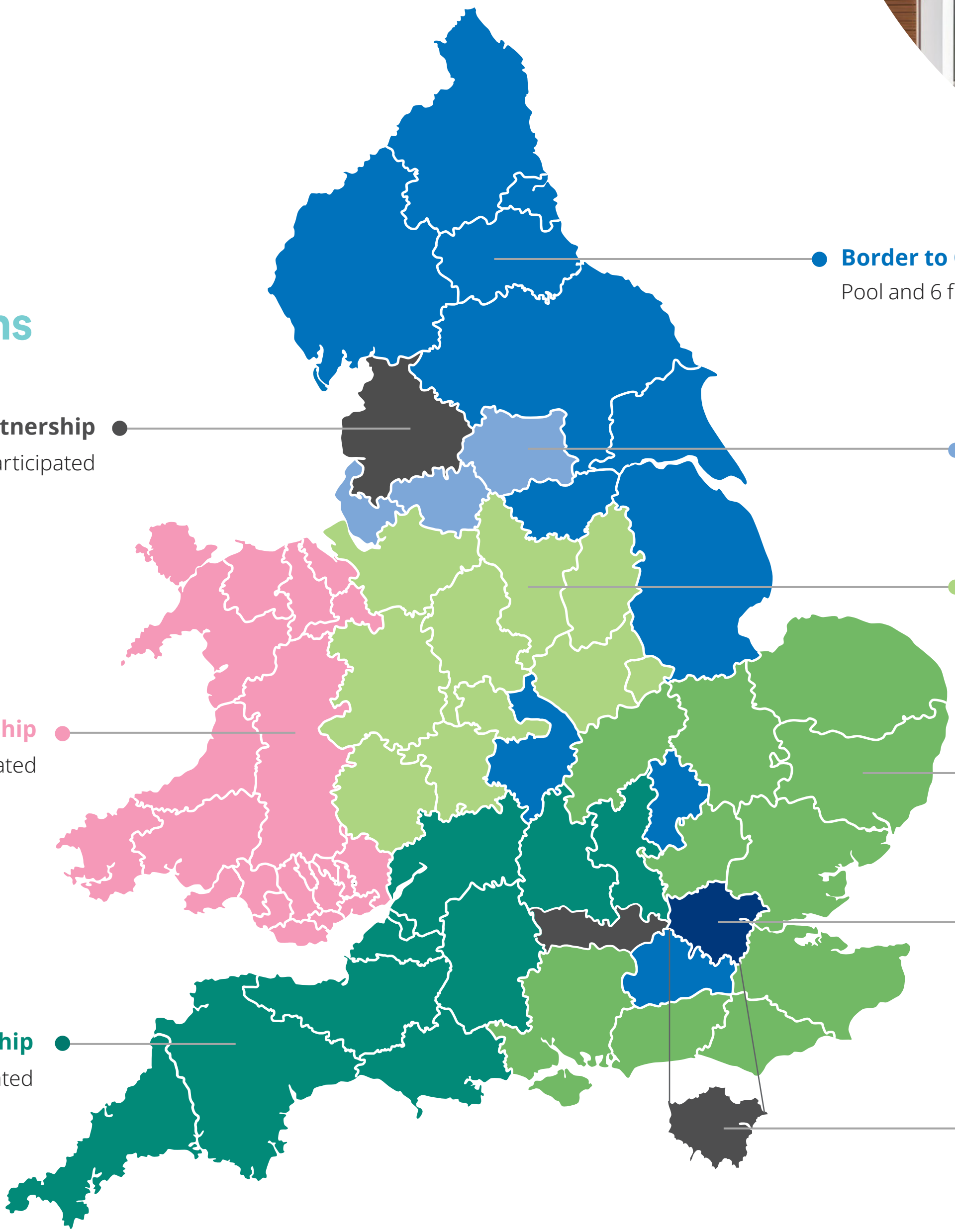
Mona Dohle
LGPS editor, Room151

Leveraging our broad network of contacts, we have gained comprehensive insights on key asset allocation decisions, the mood on the future of pooling, appetite for private markets and how the LGPS sees levelling up and net zero targets.

The LGPS pools in England and Wales

61
Separate responses

47
Different organisations



The future of the LGPS

Backing for pooling

The future of the LGPS has become a source of much speculation and discussion ever since George Osborne, as Chancellor of the Exchequer in 2015, set out plans for the consolidation of the scheme's assets.

Eight years and six chancellors later, Jeremy Hunt has reignited the debate around pooling. In his Mansion House speech in July 2023, he outlined the scope of potentially significant changes, not just on the speed of pooling but also around possible changes to asset allocation, reflecting a desire to attract more investment to UK venture capital.

Underpinning the questions in this section of the survey was a desire to understand how practitioners see the scheme developing, and to what extent they think the asset pooling process has been successful thus far.

The section is perhaps best digested in conjunction with the numerous written submissions by respondents to question 19, The Voice of the LGPS, where officers from administering authorities and pools have described the key priority for the LGPS to deliver stability in the coming years. Many of the responses invoke the Chancellor's Mansion House speech and a strong sense emerges of a sector at pains to stave off further "interference", while seeking clarity of guidance.

With any survey canvassing the LGPS, there are clearly more administering authorities to survey (86) than there are pools (eight). Of the eight pools, five (London CIV, LPPI, Brunel Pension Partnership, LGPS Central, Border to Coast Pensions Partnership) have an investment executive employed by the pool entity itself, while three (Northern Pool, Wales Pension Partnership, Access) are managed by collectives of LGPS officers directly employed by the constituent administering authorities. You might expect, therefore, the results to display a significant bias towards the agenda/s of the administering authorities, insofar as they might diverge from those of the pools.

Regardless of the profile of survey constituents, respondents have come out strongly in favour of pooling. Less than 15% of respondents believe the scheme should be taken back to its pre-pooling status quo; whereas close to a half think the current eight pool structure isn't broken and so doesn't need fixing.

More than a third of respondents backed the consolidation of LGPS assets but thought the magic number of pools lies somewhere between two and seven.

Almost eight out of ten of those surveyed believed the benefits of pooling have already outweighed the costs or will do in the future. The section paints a picture of a scheme that is positive about the progress it has made since the 2015 pooling mandate but is sceptical about the potential for the Mansion House reforms to deliver value for money.

77%

of respondents believe performance and financial benefits of pooling outweigh the set up costs

The future of the LGPS

LGPS practitioners seem to have widely adopted pooling as a fait accompli, with only 15% of respondents expressing a desire to hand back investments to the 86 administering authorities. There appears to be some appetite for greater consolidation, as expressed by 36% of respondents. But a clear majority of 48% also state that pools should maintain their regional structure.

Q1: What is the optimal number of LGPS pools in England and Wales?

0%
0 – Government take the LGPS on an unfunded basis

15%
0 – Go back to 86 Administering Authorities in England and Wales

2%
1

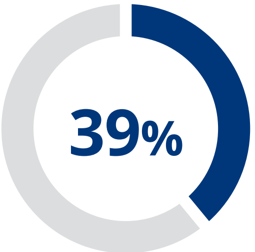
16%
2–4 if Pools need to be in excess of £100bn

20%
5–7 if Pools need to be in excess of £50bn

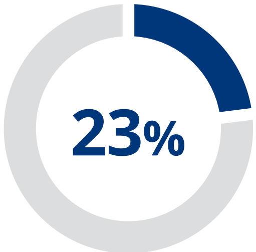
48%
8 – As the current mainly regional structure

The future of the LGPS

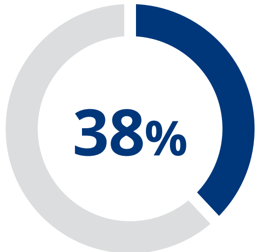
Q2: Have performance and financial benefits of pooling outweighed the set-up costs?



Not yet,
but I think they will



Not yet,
and I don't think they ever will



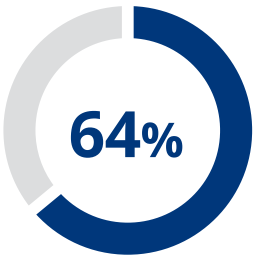
Yes,
the benefits of pooling have already outweighed costs

Q3: Would consolidating all LGPS assets by March 2025, as proposed in the Mansion House speech, be beneficial or counterproductive to scheme members and their financial outcomes?

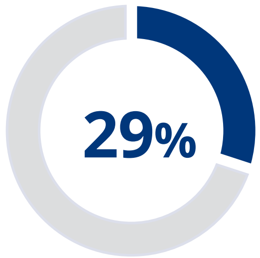
- Beneficial
- Neutral impact
- Counterproductive

The future of the LGPS

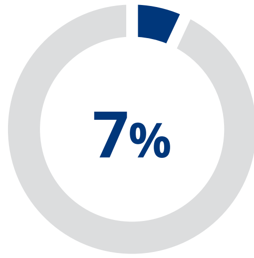
Q4: To what extent do you think pools should play a role in asset allocation going forward?



Leave it to the administering authorities

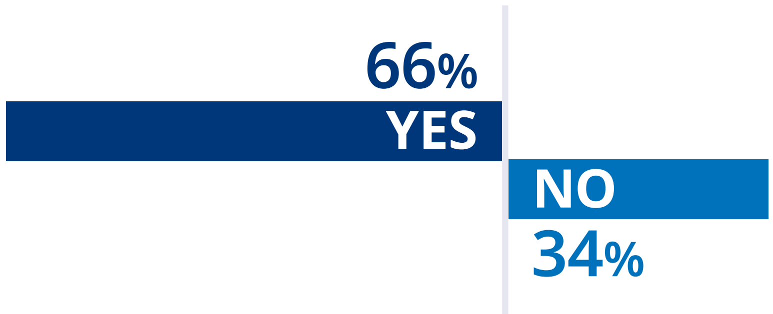


Some input could be useful



Asset allocation should also be pooled

Q5: Would a scenario where administering authorities could invest across pools for specific assets classes/ investment opportunities be more desirable than the current system?



Asset allocation and cashflow

Branching out into alternatives

Amid a breakdown of the negative correlation between bonds and equities, LGPS investors appear keen to branch out to other sources of portfolio diversification.

Despite improved funding ratios and higher returns on cash, an overwhelming 71% of investors plan to increase allocations to private markets. Less than a quarter said that they intend to keep their private and public market allocations stable. Only 5% of survey respondents plan to reduce their private market investments.

Equities have historically been a cornerstone of LGPS portfolios, but this could now change. Indeed, 56%, more than half of survey respondents said that they intend to reduce their exposure to equities and only 8% plan to increase allocations.

With central bank rates at the highest levels in more than a decade and the LGPS enjoying an aggregate funding position of 103%, fixed income assets may seem appealing, but appetite for sovereign debt appears muted.

Only about a quarter of respondents expect to increase their allocation to government bonds, mirrored by 23% who plan to reduce their allocation. There appears to be little interest in emerging market debt, with almost half of all respondents stating that they are not currently invested.

In contrast, 46% of respondents are considering increasing their allocations to corporate debt, in search of higher yields.

Meanwhile, investor demand for private markets appears to be greater, albeit with a moderate risk appetite. Within private markets, the most popular asset classes are private debt / direct lending solutions with 54% of survey respondents stating that they intend to increase their allocations.

Of this, 36% are looking to invest in private debt vehicles investing in real assets such as infrastructure and real estate debt. Despite the government's Mansion House ambitions, only 34% of investors plan to increase their allocations to private equity. This may be because 89% of respondents are already invested in the asset class.

Amid rising rates, investors are cautious on real estate with only 20% of respondents planning to increase their global property allocations; demand is similarly muted for the UK market. At the same time, 82% plan to cut their exposure with 38% intending to keep their global property allocations in this illiquid asset class constant.

The growing investor demand for private markets coincides with continued interest in sustainable investment and climate solutions. Indeed, a majority of 59% are on the lookout for new climate and natural capital solutions and over half are planning to invest more into renewable infrastructure such as solar, windfarms and other emerging technologies.

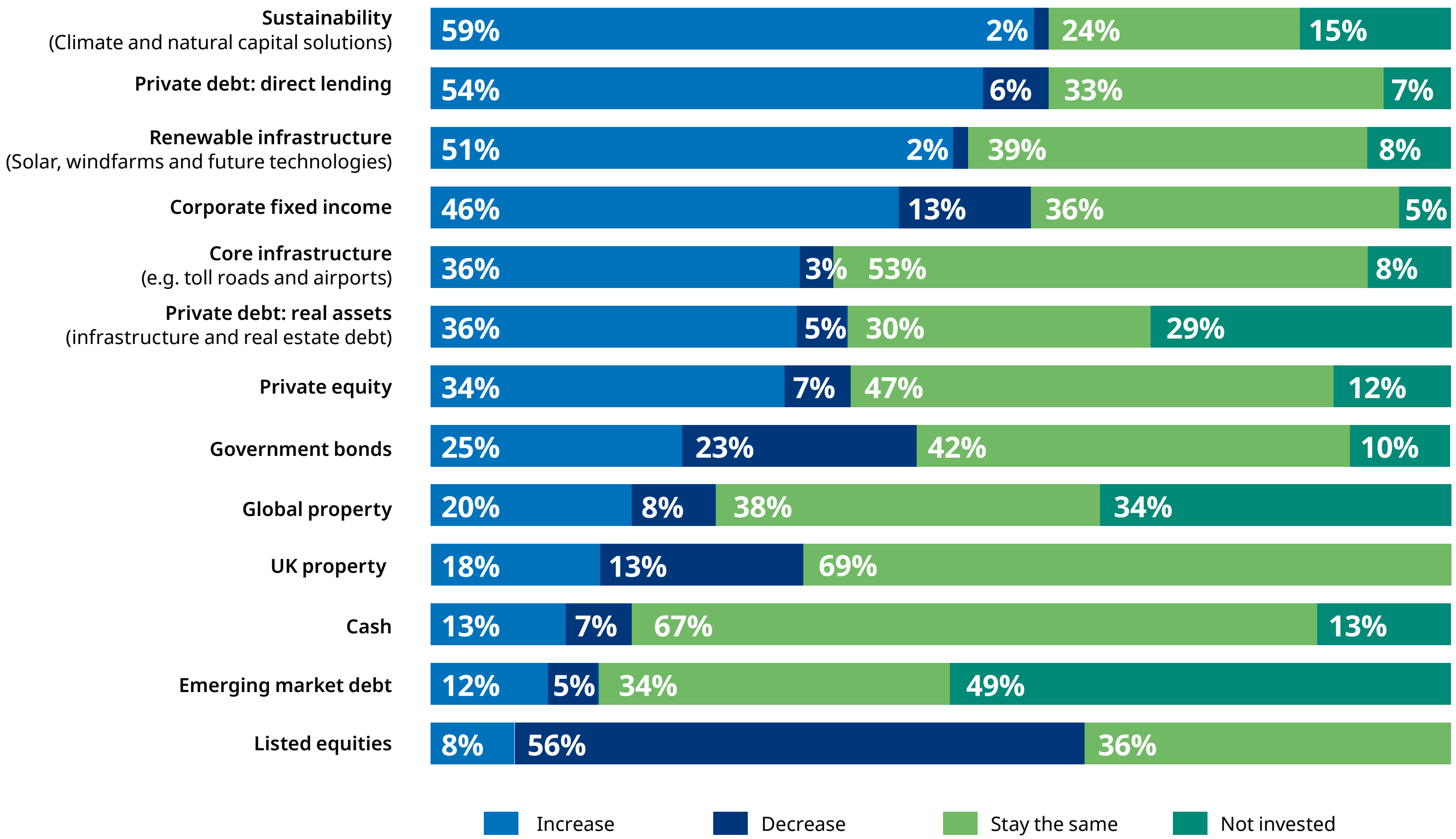
The survey also revealed that the overwhelming majority of LGPS investors already have some form of exposure to climate solutions, only 8% of survey respondents said they are not currently invested in renewable infrastructure.

64%

of respondents said listed equities was the asset allocation they most considered changing

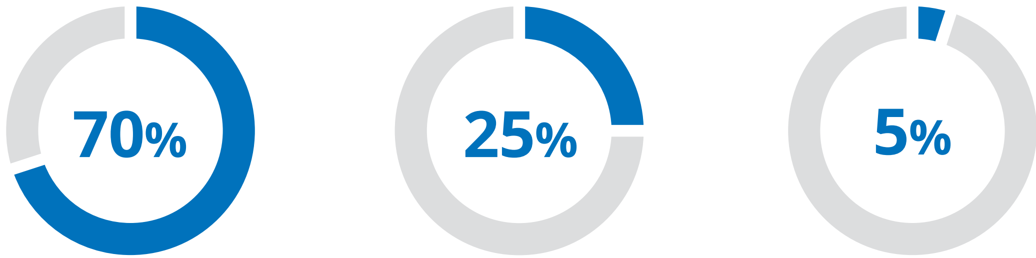
Asset allocation and cashflow

Q6: At your most recent review, what asset allocation did you make or consider changing? (Pools can also respond to this question looking at the totality of their AUM). Independent investment advisers should speak to the broad picture where they advise more than one authority.



Asset allocation and cashflow

Q7: Given the responses to question 6, in aggregate what will this mean for your asset allocation?



An increase in private asset allocations

No change in allocations between private and public assets

A decrease in private asset allocations

Local investing and levelling up

Appetite for collaboration

The UK government has set an ambition that LGPS funds should invest up to 5% of their assets in so-called 'local investments'. This aligns with former prime minister, Boris Johnson's levelling up agenda, a would-be rebalancing of economic fortunes across the UK.

The idea that local authority pension fund assets should in some way "buy British" and support the government of the day in its economic programme is one that has drawn its fair share of criticism. The LGPS, as many practitioners have pointed out, is not a sovereign wealth fund and its raison d'etre is to meet its liabilities as and when they fall due.

The UK, and the local / levelling up agendas may well offer up investment opportunities which meet the strategic investment objectives of asset allocators. In this section we sought to understand more about LGPS attitudes towards the different asset classes that could align with these investment themes as well as the role of the LGPS in delivering on government ambitions.

Survey results show that there continues to be a strong sentiment against putting the onus for local development on the LGPS. Only 13% of respondents said that it was the LGPS' responsibility to support the levelling up agenda. Having said that, a full 64% expressed openness to investing in local projects, if it suited their investment strategy. Moreover, 64% of respondents also said that investing in local projects was likely to have a beneficial impact on communities.

In terms of execution, it is worth noting that only 15% of survey respondents think local investment is best delivered by administering authorities, compared to 28% who believe pools are best placed to deliver local solutions. A majority of 57% believe that there is scope for collaboration.

This is significant, bearing in mind that local authorities represent a majority of survey respondents.

More broadly, there is scepticism on whether the UK offers the most attractive investment opportunities. A full 75% of survey respondents said that better opportunities could be found abroad, only a quarter believed the LGPS should focus on investment in the UK.

In terms of asset classes, residential housing appears to be the most popular vehicle for levelling up investments, with 74% of survey respondents expressing interest, followed by renewable infrastructure.

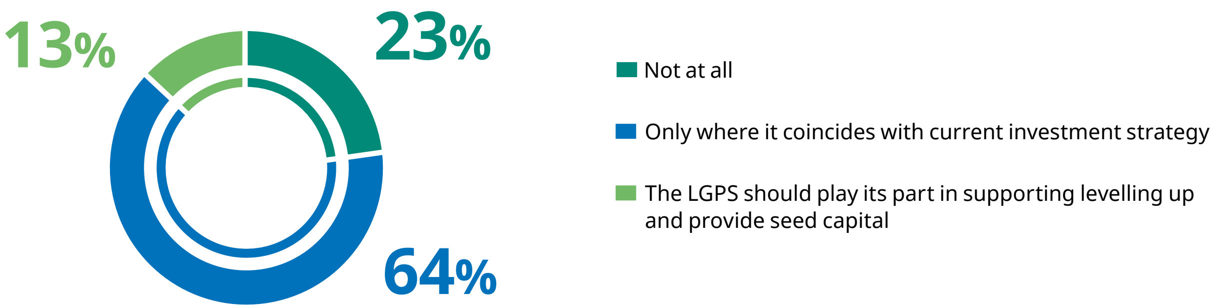
Nearly half of survey respondents said that there was a case for investments in social infrastructure including investments in education and healthcare. A third expressed interest in private equity, venture capital and real asset debt.

74%

of those surveyed believe residential housing is the asset class best suited to the 'local investment' agenda

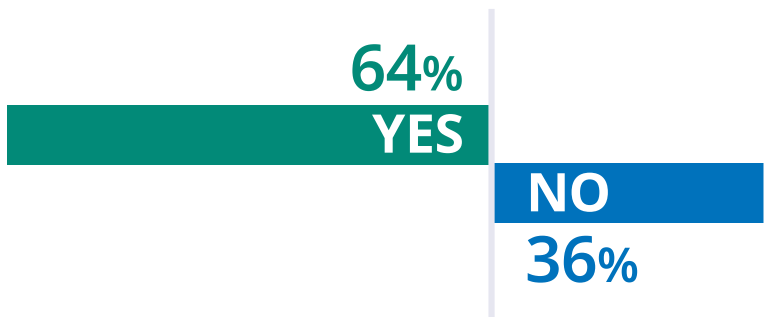
Local investing and levelling up

Q8: To what extent is it the LGPS's responsibility to support the levelling up agenda?



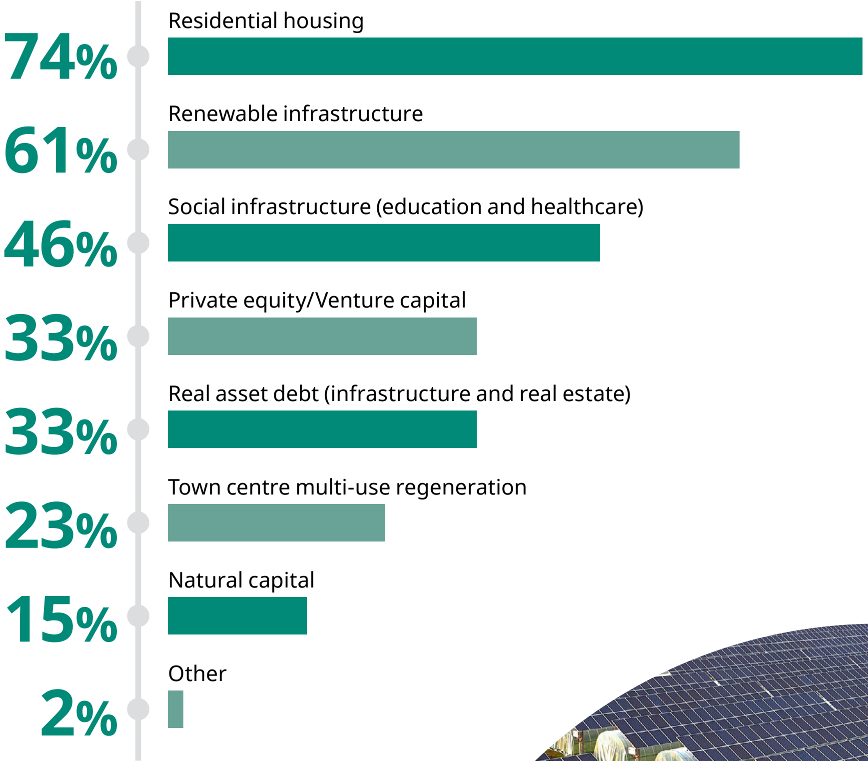
Q9: Should local investment solutions be delivered by pools or administering authorities?

Q10: Do you expect to increase investment in local opportunities that support levelling up or create a local beneficial impact?



Local investing and levelling up

Q11: Which asset classes do you think best suit the 'local investment' agenda for LGPS investors?



Q12: Does the UK offer attractive investment opportunities in infrastructure and venture capital?

The LGPS should focus primarily on UK opportunities

There are better international opportunities

Private markets

Taking a long-term view

There is strong interest in private market investments, as the earlier section on asset allocation revealed. More than 70% of investors plan to increase their allocations to unlisted assets, funding this from listed assets such as equities.

The macro backdrop does pose investment challenges for private markets allocations. Long-dated government debt now offers yields of more than 5% but rising rates have also added refinancing risk to leveraged strategies, causing LGPS investors to reconsider the attractiveness of some private market risks and returns. The outlook is potentially less gloomy for private debt solutions, where the market liquidity and yields might be shifting in investors' favour, a trend which is reflected in the growing demand for private debt strategies as outlined earlier, but many LGPS investors are also acutely aware of growing risks.

Overall LGPS investors appear to be taking a long-term approach to private markets. An overwhelming 93% of respondents say they will continue to invest in private markets, despite rising rates.

Local / levelling up investments are most frequently considered as private market opportunities. However there seem to be key practical challenges, particularly considering the scalability of these. More than 60% of survey respondents said that they struggle to source suitable investment opportunities

93%

of respondents said that private assets have a long-term horizon, and they will keep investing

Private markets

Q13: Are higher gilt yields impacting your strategic asset allocation to private markets?

7% YES

as we are now overweight private assets within the strategic asset allocation

93% NO

private assets have a long-term horizon, and we will keep investing

Q14: Are there enough scalable local investment opportunities available to you, that you would be interested investing into, that meet both your return target as well as creating a local measurable positive impact?

26% – **Yes,** but typically administering authorities lack the resource to manage these investments

13% – **Yes,** and we have the resources to source/manage these in house

61% – **No**

Net zero and sustainability

Interest in renewables, but barriers remain

The UK has made an ambitious climate pledge, embedding its 2050 net zero target into law. Local government funds could potentially play a key role in helping the government meet this target and important steps have been taken already.

Many local authorities now have net zero targets in place, a trend which has been mirrored by their pools. In addition, responding to a growing appetite among partner funds for climate solutions, pools are increasingly offering their own climate investment opportunities.

While climate divestments and tilts in listed markets will help reduce a pool's carbon footprint, investment in private markets and climate solutions will play an important role in transitioning to a new green economy. Renewable infrastructure and private equity are seen as offering the most attractive net zero opportunities.

Our survey revealed that while local authorities and pools are willing to make significant commitments to tackling climate change, there remains a degree of scepticism. 54% of survey respondents believe that emission reductions in their portfolios do not necessarily lead to real world emissions reductions.

At the same time, a third of respondents believe that there are no barriers to increasing net zero allocations. Moreover, only 8% of LGPS respondents fear the risk of political backlash such as an anti-ESG movement in the UK.

Concerns aside, LGPS investors express a continued commitment to invest in climate solutions with renewable infrastructure being seen as by far the most popular asset class for 79% of respondents. It is followed by natural capital, where more than a third of investors are seeing opportunities, and climate focused private equity funds, with 18% of respondents expressing an interest.

Meanwhile, emerging markets, green bonds and listed renewable energy assets appear to be of less interest to investors, and only 5% consider private credit and real estate as attractive net zero investments.

A lack of transparency from data providers on the impact of sustainable investments is seen as the key barrier to increased allocations for 39% of survey respondents. Investors are also concerned about the lack of clarity on what constitutes a sustainable investment and potential trade-offs with performance. Some 30% of investors also report that they struggle to identify suitable investment options.

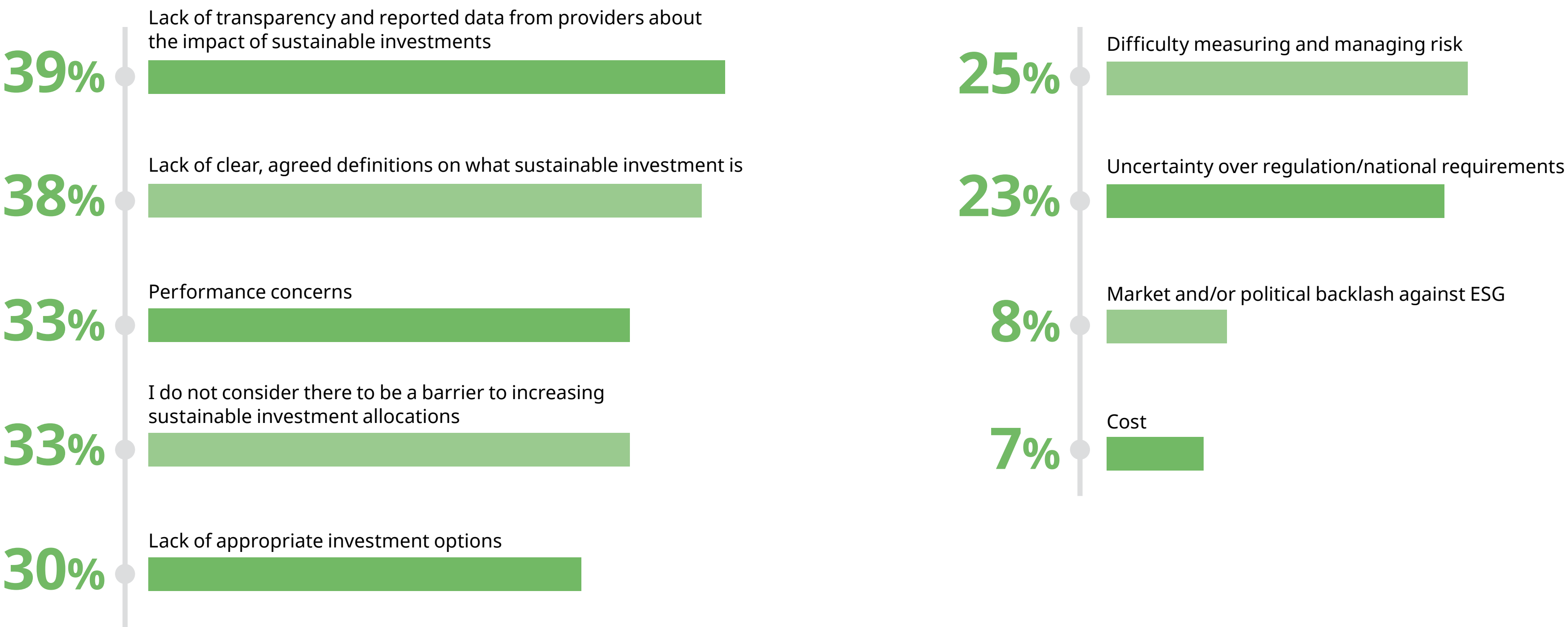
79%

of respondents believe renewable infrastructure is the most attractive net-zero related investment opportunity

Net zero and sustainability

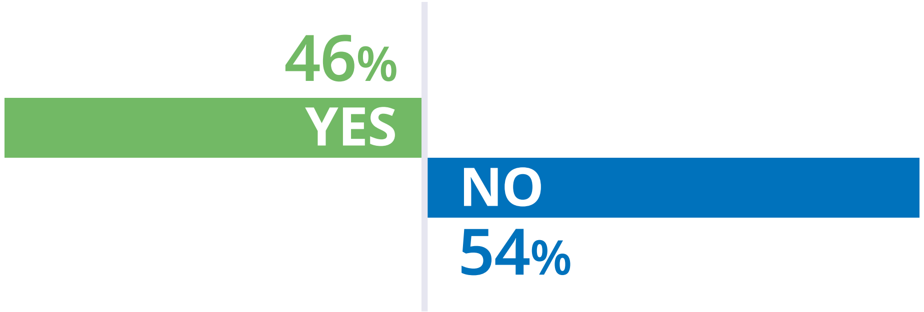
Despite significant allocations to climate solutions, LGPS investors share significant concerns about some obstacles to increasing their net zero allocation, with lack of clarity, transparency and performance trade-offs being seen as key challenges. At the same time, costs and anti-ESG backlash appear to be a marginal concern for the LGPS.

Q15: What factors do you consider to be a barrier to the LGPS increasing sustainable investment allocations?



Net zero and sustainability

Q16: Do you believe that LGPS portfolio level emissions reduction will inevitably lead to some real-world emissions reduction?



If no, why not?

Not sufficient scale to make a measurable difference.

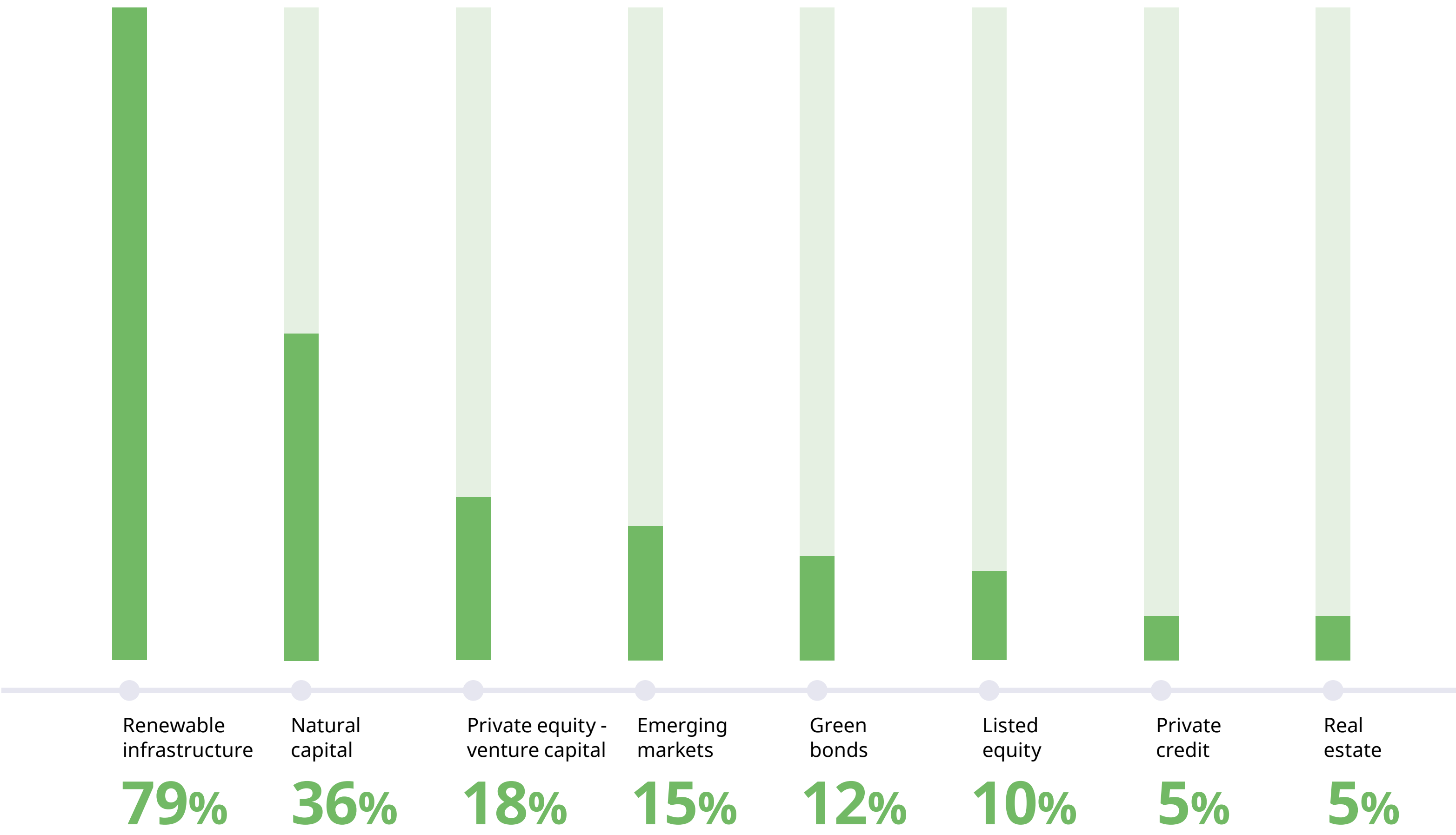
This requires collective action driven by government policy and regulation.

If reductions are a result of divestment or exclusion then the assets will continue to operate but with different shareholders/owners.

There are always concerns about greenwashing and also simply passing along carbon credits to others. We need more mechanisms to invest in truly carbon-negative investments (e.g. green tech).

Net zero and sustainability

Q17: Where, in your opinion, are the most attractive net-zero related investment opportunities?



The voice of the LGPS

Q18: In one sentence, what in your opinion is the key priority over the next few years to ensure the stability of the LGPS?

Government Interference and Regulation

Less interference by government for political purposes in the LGPS, whatever party might be in government.

Leave us alone to get on with our job; we are not a political football to be kicked from pillar to post.

Withdrawal of government intervention.

Ensuring a supportive, clear government policy environment to aid in the growth and evolution of the LGPS.

Investment Pooling and Strategy

Above benchmark returns combined with official clarity as to the medium-term direction of pooling.

Clear direction from government on regulatory changes around investment pooling and mandatory asset allocations to enable administering authorities to have clarity when making long-term investment strategy decisions.

Governance and Fiduciary Standards

Maintain high governance and fiduciary standards.

Effective partnership between pools and partner funds to deliver long term investment performance, cost efficiency and a strong collective voice on responsible investment.

Sustainability and Responsible Investment

Putting sustainability at the heart of investing so that we ensure a stable financial market for the future.

Navigating competing demands of climate change and improving funding levels and keeping both employers and employees happy with how the scheme develops.

Funding and Financial Performance

Achieving decent real investment returns to support relatively stable employer contribution rates.

Continue to generate strong investment returns.

Maintenance of funding levels at current fully funded basis.

Focus on net performance over pool cost savings/management fee savings.

Thank you to those that participated in this survey

Barking & Dagenham Pension Fund
Barnet Pension Fund
Bedfordshire Pension Fund
Berkshire Pension Fund
Border to Coast Pensions Partnership
Brunel Pension Partnership
Buckinghamshire Pension Fund
City & County of Swansea Pension Fund
Clwyd Pension Fund
Derbyshire Pension Fund
Devon Pension Fund
Dorset Pension Fund
East Riding Pension Fund
East Sussex Pension Fund
Environment Agency Pension Fund
Gloucestershire Pension Fund
Greater Gwent (Torfaen) Pension Fund
Greater Manchester Pension Fund
Hampshire County Council Pension Fund
Haringey Pension Fund
Harrow Pension Fund
Isle of Wight Council Pension Fund
Lambeth Pension Fund
LGPS Central
Local Pensions Partnership Investments
London Borough of Bromley Pension Fund
London Borough of Southwark Pension Fund
London Borough of Sutton Pension Fund
London Borough of Waltham Forest Pension Fund
London CIV
London Pensions Fund Authority
Merseyside Pension Fund
Merton Pension Fund
Nottinghamshire Pension Fund
Oxfordshire Pension Fund
Shropshire County Pension Fund
Somerset County Council Pension Fund
South Yorkshire Pensions Authority
Staffordshire Pension Fund
Suffolk Pension Fund
Surrey Pension Fund
Teesside Pension Fund
Tower Hamlets Pension Fund
Tyne and Wear Pension Fund
Wandsworth Pension Fund
West Yorkshire Pension Fund
Worcestershire Pension Fund

This LGPS Survey 2023 was originated and conducted by Room151 and is sponsored by Schroders.
The results constitute the anonymised responses of 61 separate LGPS professionals working in senior capacities for LGPS pools and administering authorities.
The survey and the material herein does not constitute investment advice. 609707

If you'd like to hear more about the insights generated by this survey, please do get in touch.

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