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London Pensions Fund Authority

LONDON PENSIONS FUND AUTHORITY CALL FOR EVIDENCE TO THE NATIONAL INFRASTRUCTURE COMMISSION OPEN CONSULTATION

7 JANUARY 2016

Introduction

London Pensions Fund Authority (LPFA) welcomes the National Infrastructure Commission's Open Consultation into the development and funding of the UK's long-term infrastructure needs.

In submitting our response to the consultation, we do so as a fund within the Local Government Pension Scheme (LGPS) which:

- Has already in its own right made direct investment into a number of smaller-scale infrastructure and construction projects; and,
- Will, as part of a larger funding pool (explained below), also be a prospective direct funder of larger-scale infrastructure projects in general, whether nationally or regionally-focused, or within a specific sector, such as transport or utilities.

As such, our response to this consultation outlines:

- Why we consider direct investment in infrastructure to be a highly desirable strategic asset allocation option for LGPS funds;
- How the wider LGPS is evolving in the shorter term to pool funds so that the sector can participate in larger-scale infrastructure funding opportunities;
- Our own experience to demonstrate how LGPS funds can successfully collaborate for pooling purposes and to fund larger-scale infrastructure development;
- Proposals for a mechanism whereby infrastructure opportunities could be more effectively and speedily matched with prospective LGPS investors.

Why we consider direct investment in infrastructure to be a highly desirable strategic asset allocation option for LGPS funds

Infrastructure is a very attractive investment for pension funds. It provides inflation protection, since assets often include an inflation linkage. Moreover, it produces a long-term income with consistent stable cash flows over a long term time horizon. The scarcity of good quality assets and active management also leads to capital appreciation. And, there is the opportunity to benefit from supernormal returns, since there is often an element of development risk.

However, as the LGPS is currently structured, with multiple smaller funds, it is not easy for these smaller funds to invest in this asset class. Currently, infrastructure makes up a very small amount of LGPS assets under management (AUM). Scale and expertise is required to be successful. LPFA has actively been calling for collective investment between LGPS Funds as a positive step forward, both in enabling LGPS funds to address their deficits and to facilitate much-need investment in UK infrastructure.

How the wider LGPS is evolving in the shorter term to pool funds so that the sector can participate in larger-scale infrastructure funding opportunities

The LGPS is currently undergoing a period of radical reform, which will see the 89 individually-small pension funds that currently make up the scheme, potentially join forces and pool their c. £200bn AUM to create a number of £25bn+ wealth funds from 2018.

Through collaboration, these pooled funds will have the capacity to scale up their direct investment in large-scale infrastructure projects in the same way that, for example, overseas-based Sovereign Wealth Funds and pension funds (e.g. Ontario Municipal or Australian Super) have been able to invest. To-date as individual small funds, LGPS funds have typically lacked the scale to invest directly in infrastructure and have, in the main, been restricted to investing in funds or funds of funds. These options are often expensive and do not necessarily offer the long-term return that funds seek.

As the National Infrastructure Commission may be aware, a two-stage submission process is already underway, run the DCLG. Briefly, the first stage completes on 19th February 2016, by when individual LGPS funds are required to submit their initial pooling proposals to government. Thereafter, refined and completed submissions will be required from funds by 15 July 2016.

Funds' proposals are to include, amongst other things, how infrastructure will feature in a fund's investment strategy and how the pooling arrangements will improve the capacity and capability to invest in infrastructure. Government expects that pooling proposals which meet its criteria will be in place within 18 months. This is a relatively short timescale for a new and very significant pool of funding to be available for UK infrastructure.

Pooling will undoubtedly make the LGPS funds a valuable long-term funding source for those UK infrastructure projects that offer the appropriate level of risk versus reward over the long term in relation to the liabilities to be matched. And, importantly, LGPS funds are directly connected to their regions and are potentially ideal 'local partners with local knowledge' for regionally important infrastructure projects.

We are thus making this submission to ensure that this potential source of long-term funding is considered by the National Infrastructure Commission in its Call for Evidence.

Although LPFA cannot 'speak' for other funds within the LGPS, we can show by our own experience that there is already a strong appetite for pooling to create scale for direct investment in infrastructure.

<u>Our own experience to demonstrate how LGPS funds can successfully collaborate for pooling purposes and to fund larger-scale infrastructure development</u>

The LPFA is one of the 89 authorities that make up the LGPS in England and Wales. On our own, we have some £4.6bn assets under management (AUM) and we look after the long-term pension provision for around 80,000 active, retired or deferred members.

We have already been an active participant in pooling arrangements, specifically to enable us to increase our direct investment in infrastructure and, more generally, to expand our fund, so we have the capacity to invest directly in a number of asset classes. At present, we invest 5.5% (£270m) of our fund in infrastructure, with an ambition to grow this to 10%.

Our current projects include:

- To provide 85% of the funding for the fast-track creation of new high-quality homes in East London. The development will include 150+ private-rented-sector homes, 40+ for affordable rent and 30+ for shared ownership, whilst the project will also improve access to the popular Thames Barrier Park.

- In 2014/2015, we collaborated with a like-minded fund, the Greater Manchester Pension Fund (GMPF), to create a £500m joint infrastructure investment fund. The first long-term investment – a renewable asset – was announced in October 2015, with more to follow. Previously, both LPFA and GMPF had individually made direct investment in smaller-scale infrastructure projects in their respective region. This collaboration is a natural next step for two funds that have experience of direct investment in infrastructure and have now gained valuable in-house expertise in this type of investment.

  We are also actively pursuing new partners to build this partnership for the express purpose of what the National Infrastructure Commission is aiming to meet – to further invest in projects from house and road building, to commercial and mixed use developments, or large scale regeneration projects. Our aim is to provide a vehicle for other LGPS funds to invest in infrastructure and thus grow the pot substantially.

We are currently in discussions with the DWP and Treasury about this option and would welcome the opportunity to provide the Commission with further information.

- LPFA and Lancashire County Pension Fund have created a £10bn pool. This is the first partnership of its kind within LGPS and once it is FCA approved (expected within Q1 2016), the fund will be open to multiple LGPS funds to collaborate and pool resources. This pooled fund will invest across a broad range of asset classes and again bringing to bear their individual past experience, infrastructure will feature highly in strategic asset allocation.

<u>Proposals for a mechanism whereby infrastructure opportunities could be more effectively and speedily matched with prospective LGPS investors</u>

Pooling will allow funds to harness resources, use economies of scale and share talent in order to make a difference in investing in infrastructure. However, pooling only solves part of the problem. Whilst it may allow us to access sufficient funds needed to invest in larger-scale projects, it does not help us to source and access infrastructure deals.

Along with the Local Government Association, we are advocating an LGPS body which could match infrastructure opportunities with prospective investors.

We believe local government is the ideal partner for these private infrastructure deals. Innovative councils can identify projects suitable for direct investment and are in a key position to collaborate with investors to develop these ideas. It also goes without saying that they negate a certain level of political risk by acting as a local partner in a multinational consortium.

Arguably nationally important projects should be funded by public borrowing as the cost of capital will most likely be lower than the equity returns institutional investors require. However, with the Government's stated objective of reducing public sector borrowing it creates a scarcity of available 'balance sheet'. Nevertheless, we believe Government should be creative in leveraging the balance sheet available and seek ways in which it can share/offset the low probability, but large impact, risks that would put off private investment (e.g. Construction risk in large Greenfield projects).

The LGPS body, which we firmly believe needs to be created, would play a pivotal role in matching investors to investees and assist in attracting private investment.

It would be responsible for gathering information about potential infrastructure and housing investments, and subsequently matching councils and private investors together, presenting the right opportunities to these interested parties, so they could put their own money forward through co-investment. We believe this body will be most successful if it were also deploying capital directly into many of the same projects. This will ensure efficient deployment of resources toward projects that are more likely to be investable and engender confidence amongst the end co-investors.

In order to fulfill its role, the body would also need to have a properly staffed investment function with an agreed set of criteria, potentially working in parallel to the Commission. A strong symbiotic relationship would clearly exist between the NIC and this proposed body; we would welcome the opportunity to speak about this in more detail.