

Aberdeen City Council

Aberdeen 28/29 August 2008

Minute of the Meeting of the Joint Investment Advisory Committee.

Present: Councillor N Fletcher Convener, Councillor J Kiddie, Councillor A Milne, Councillor A Bews, Councillor S Coull, Councillor R Thomas, Councillor M Watt, Councillor P Paul, Councillor G McDonald, Mr G Morrice. In Attendance, Mrs J Hope, Pensions Manager, Mrs Laura Goodchild, Principal Accounting & Investment Officer, Miss C Mann, Pensions Officer – Investments, and on the 29th Nicola Fraser observing.

Apologies for Absence

1. Apologies for absence were intimated on behalf of Douglas Millican & Ms S Cooper for both days while Councillor Bews & Councillor Watt intimated their apologies for the second day .

Minute of the Previous Meeting dated 30 May 2008

2. The Committee had before them the minutes of the Joint Investment Advisory Committee of 30 May 2008.

Mr Morrice wanted it noted that the colleges view is that the employers contributions rates are heading to totally unobtainable proportions and with the next actuarial valuation due to show a greater discrepancy, they will become impossible to maintain.

Minute of the Pensions Panel dated 12 March 2008

3. The Committee noted the Minute of the Pensions Panel of 12 March 2008

Investment Report to 30 June 2008 - Report by the City Chamberlain

4. Mrs Hope highlighted the following issues from the report:
 - Very Good returns by Blackrock (return of 2.9 against a benchmark of -1.4) and Baillie Gifford (return of 1.7 against a benchmark of -1.7) brought the Fund above the benchmark for the quarter.
 - The Fund produced performance figures of -1.0 against a benchmark of -1.9 giving a relative performance over the quarter of 0.9.
 - Emerging markets continued to perform well
 - Cash has suffered a slight drop this quarter due to the credit crunch.
 - Capital International continued to perform badly giving a return of -2.9 against a benchmark of -1.9 there annual return has now fallen to -11.5 against a benchmark of -7.6. (see item 6)
 - Rogge had a very poor quarter (return of -4.2 against a benchmark of -1.9) they got it wrong they did not spot the rise in inflation.
 - Goodmans also performed poorly (return of -9.3 against a benchmark of -2.7) (see item 7)
 - Due to our Custodian ABN Amro Mellon being bought over by Bank of New York as best practice a tender exercise has begun to review the services of the new organisation versus the market.
 - The Transport Fund had a poor quarter with a relative return of -2.1

Cllr Coull asked what was going to happen to funds cash of 111million. Mrs Hope advised that it is presently held in a Standard Life Liquidity Plus Fund and will at an opportune time be placed on a short-term deposit with the fund custodian ahead of future investment in alternatives.

Mr Morrice wanted to know when the final decision about which alternatives the fund would be investing would be made as the committee has been discussing the topic it for some considerable time.

Mrs Hope advised that following Joanne Holden from Mercers presentation the committee might be in a position to make a final decision then.

A number of questions were raised by elected members specifically regarding the forthcoming actuarial valuation figures and the level of employer contributions.

Mrs Hope advised that:

- the valuation results will be available in December early indicators are that it will be around the 76% mark.
- longevity has had a big effect on the figures and that employer's rate will have to increase accordingly.
- The valuation is based on the year-end figures at Mar 08 that unfortunately for the fund coincided with the height of the credit crunch.
- Our predicated valuation is in line with other Scottish Councils.

Mr Morrice asked what our present funding level was, Mrs Hope advised that it was 84% Mr Morrice again raised his grave concerns about the employer's contribution rates going forward.

Cllr Kiddie wanted to know how other European countries were fairing. Mrs Hope advised that she would obtain this information for him.

Cllr Fletcher confirmed the fact it is the council's legal duty to provide a pension scheme, the details of which are set down by Westminster. The only time pension schemes have an opportunity to change things is when a new scheme is put out for consultation, but regrettably despite the concerns raised by the Aberdeen City Pension Fund over the severe burden to employers the fund was unsuccessful in getting any amendments to the scheme passed.

Mrs Hope advised that after the Actuarial valuation is received (Jan/Feb 08) the Committee would then set the Funds Funding Strategy Statement which in turn sets the Employers contribution rates for the next three years.

Cllr Fletcher stated that everyone could see that the pension fund would eventually become unsustainable in the future, and for that reason the next pension funding strategy statement should be put before the full council so that lobbying could be done on all levels to obtain a fairer contributions split going forward.

The Committee resolved:

To note the report.

Pension Fund Governance Documentation

5. A booklet of the Pension Funds Governance was handed out to all members of the committee.

Review of Fund Manager - Report by the City Chamberlain

6. This report was held over to be discussed before Capital International's presentation.

UK Property Mandate - Report by the City Chamberlain

7. This report was held over to be discussed before Aberdeen Property Investors presentation.

Alternative Asset Presentation - Joanne Holden Mercers

8. Joanne gave a training session on Alternatives covering
 - Alternatives background
 - Private Equity
 - Infrastructure
 - Commodities
 - Active Currency Management
 - Hedge Funds
 - Core Plus Bonds

The training session gave the committee a chance to raise lots of questions on the alternatives market and hear how some of the options might give the Fund greater diversity than others. Joanne reiterated the point that choosing the correct manager is essential in the alternatives markets.

The committee had some discussions about which alternatives asset class they liked but due to time constraints it was suggested that a special meeting of the JIAC be arranged as soon as possible to make a final decision on Alternatives.

The Committee resolved:

To hold a special meeting of the JIAC during which they will make the final decision on Alternatives.

Any Other Competent Business

9. The committee requested that a paper be produced showing what the effect would be in changing the regional split for StateStreet from 50/50 to 60% (Global) 40% UK.

Mr Peter Dick was going to attend as an observer on the 29th but unfortunately could not attend, he may be taking over from Mr Morrice as the college's representative and the committee has extended an open invitation to him to attend any future JIAC meetings

Investment Manager Presentation's

10. Capital International

Review of Fund Manager - Report by the City Chamberlain

The reports recommends that Capital are continued to be monitored on a quarterly basis, and that a tender exercise for a Global Equity (Ex UK) fund manager be started in preparation for reviewing the current Capital International mandate in Spring 2009.

Capital - Started by confirming that they are bottom up stock pickers that they don't follow trends and look for business's with cash on their balance sheets, with good products and little debt. A lot of money has been invested by Capital in increasing their research and analysis sections, and they have brought in 4 people to improve the financial section. They have reposition our portfolio over the last 6 months as they have been looking for good stocks in financial services and have invested in more companies in this sector. They continue to hold Freddie Mac & Fannie Mae even though it is a highly contentious view even at Capital, they believe that the US regulator will never nationalise them as the cost would be far to high.

Cllr Coull wanted to know why they had bought more Lehman Brothers during the quarter They answered that the company was fully capitalised and did not need to go to the market to raise more money, the share price was low and it was a good purchase and should add value going forward.

Cllr Fletcher wanted to know when they though a turnaround was due to be seen in their performance. Their reply was that they believed that the portfolio is now invested in the best possible stocks and they are confident that they can reach targets but can't say if that will happen in 3,6 or 12 months.

Cllr Coull stated that their stock picking seemed inflexible how do they decide which stock to pick. They stated that book value, price earning ratio and cashflow are some of the things they take into consideration, and they by no means have one narrow view.

Mr Morrice wanted to know why their Emerging Market Fund was underweight to benchmark. They advised that they feel that the prices in emerging markets are too high at the moment, but would be moving back into this market once prices had fallen.

Cllr Kiddie very disappointed by their performance relative to benchmark and wanted to know why we should stick with them. They confirmed that they were even more concerned with the poor performance record over recent years than us, but with their company having a long respected record they know that they can come out of it.

Capital relative quarterly return -1.0% and an annual relative return of -3.9%

The Committee resolved:

To accept the proposal to go out to tender for a new Global Equity (Ex UK) fund manager be started in preparation for reviewing the current Capital International mandate in Spring 2009.

Blackrock – Quarterly relative return +4.3% Annual relative return of +7.7%

Blackrock gave a very good upbeat presentation, explained that they made good calls during the quarter and that the UK market is in fact an international one. They think that growth will be sluggish in the UK, there will be immediate relief in inflation and that base rates should start to fall slowly in early 2009. They were also honest enough to admit that they had been achieving outstanding performance recently but that this probably would not continue going forward.

Mr Morrice asked if the take over of Merrill by Blackrock had been a good thing. The answer was absolutely, the communication at Merrill was awful in comparison with Blackrock. Access to information sharing has impacted positively on the portfolio performance.

Cllr Kiddie intimated his apologies as he had to leave at this point.

Aberdeen Asset Managers (Transport Fund) Quarterly relative return -2.1% Annual relative return of -2.3%

AAM (Transport Fund) started by informing the committee that they had recently lost 5 members of staff from their bond team to a hedge fund, but that it would have no diverse effect on out portfolio. They then acknowledged that recent performances had been poor but are confident of their strategy in looking at fundamentals that in the long term produce results.

Cllr Fletcher asked why they did not follow the Index.

They again went back to there ethos of bottom up stock pickers picking in sectors and on the house style, they look at fundamentals which can result in under performance in the short term but not in the long term.

Cllr wanted to know why they did not invest in China.

They think that prices there are very high at the moment but in the longer term would be keeping an eye on that area for when prices become more realistic.

The Committee resolved:

To monitor the performance especially there style of investment in volatile markets.
A report on this manager was requested for the next JIAC meeting.

29 August 2008

Before the presentations of the day started Joanne Hope gave a reply to the Statestreet benchmark query noted under AOCB.

If Statestreet had a slightly different benchmark the difference over the last 5 years would have been.

1 year (present benchmark)	-6.6%	against a FTSE Allworld	-1.4%
3 year	"	+8.0%	" " +10.2%
5 year	"	+11.6%	" " +12.8%

Cllr Thomas also asked for Statestreet to produce a paper giving their thoughts on this proposed change to the benchmark.

The Committee resolved:

To look at the paper from Statestreet giving their view's on a change in the benchmark at the special meeting of the JIAC at which time they will take the decision about altering the benchmark.

Private Equity

Laura Goodchild Principle Officer Accounting & Investments gave an overview on all the Funds private equity managers.

The Fund has invested in three funds with Standard Life; currently £29.6m is invested with total commitments of £55.3m. Standard Life focuses on medium and large buy-outs in Western Europe.

The Fund also invests in four funds with HarbourVest; currently £25.07m is invested with total commitments of £47.6m. HarbourVest seeks to invest in premier partnerships, secondary interest and operating companies; they only invest in the USA market for our fund.

Aberdeen Asset Managers held a segregated and invested portfolio, in 2005 it was decided to terminate the mandates. The segregated portfolio is being run down by the manager and is currently valued at £5.1m. The invested portfolio was bought in-house to avoid paying high managers fees, and is being run down and is currently valued at £9.9m.

Both Harbourvest and Standard Life have new funds that we could invest in, both companies are premium managers and the returns both have been returning are excellent.

Mr Morrice asked why we did not invest in Private Equity in emerging markets

Mrs Hope advised in 2004 the committee decided to invest in overseas Private Equity for the first time, at that time it was decided that Europe and USA would be the best places to invest as the funds first foray in that area.

The Committee resolved:

To look at increasing the funds investment in Private Equity at the 21 Nov meeting of the JIAC.

Barings - Quarterly relative return -0.4% Annual relative return of +1.8%

Barings began by saying that the portfolio had suffered a temporary blip in Q2 that resulted in a slight under performance but they are now back to achieving better results, they are confident that the trend will continue. In the future they believe that there will be different monetary trends around the world and that market selection will be crucial going forward.

The fund has a small overweight position in Mortgage Backed Securities but these are only in Prime mortgages backed by FNMA or FHLMC.

Cllr Coull asked what effect Inflation in China would have.

They believe that due to low base growth the days of getting double-digit returns from China are now over more realistic figure would be around 8% going forward.

Rogge - Quarterly relative return -2.3% Annual relative return of -3.6%

Are fully aware that the performance figures they have recently been achieving are poor. To turn things around, they have been reshaping our portfolio going overweight in financials which will store up value for the future, will continue to be underweight in USA and UK, and will be long on the front end of the yield curve.

Cllr Fletcher asked why our fund had done so badly when they as a firm rate very highly within the bond market.

They replied that our fund was not run any differently from any other funds they operate. The fund was launched in low volatile conditions and they have been adjusting volatility ever since. Also it was because of 40% of the benchmark was UK gilts and they have been performing badly. They are expecting significantly higher returns going forward.

Cllr Macdonald asked if the change of administration in the USA would have any impact. If the republicans win everything will remain the same if the democrats do it probably won't make much of a difference and any change's they make to the economy will take some time to take effect.

Cllr Thomas wondered why some of the bonds are in such small amounts. They stated that they had inherited these holdings on taking on the mandate.

After the meeting Joanne Hope contacted Rogge about their comments regarding the 40% UK benchmark and the inherited holdings. The benchmark - they have in fact total discretion as to whether they hold 0% or 100% in UK Gilts therefore the benchmark should not effect performance at all. The inherited - A list of the holdings was made available to them on appointment and they had the choice of which stock to choose, or to take 100% cash.

Rogge came back saying that they meant that when a large portion of the benchmark performs well it is sometimes hard to push an even bigger portion of the portfolio into that market. The second point they confirm is that it was their choice to accept the stock, but as a matter of policy and to save clients the bid offer spread when changing managers they kept some stock, the choice however was theirs as to what to keep. They apologise for not being clear and assure us that they were not trying to misinform the committee in any way.

Baillie Gifford - Quarterly relative return +3.4% Annual relative return of +9.2%

Baillie Gifford gave a good presentation; they performed exceptionally well over the period. Their best areas were in commodities with strong price rises in oil, food, iron ore etc which reflects their good stock selection and their overweight position in emerging markets. They have little exposure to western banks, retailers and property so have been able to avoid the worst of the credit crunch. Looking ahead they believe that there are tough times ahead, with the fall in consumer spending and housing markets, and it will become more difficult to borrow money from banks. There is still the potential for growth in the agriculture sector and in commodities, as the demand remains high.

Cllr Coull suggested that with fuel prices and other costs rising agriculture was a surprising area for growth.

They believe that with the continual rise in the price of grain and soft commodities the prices the farmers receive will be far higher than the costs involved.

Cllr Paul & Cllr Macdonald intimated they apologies but had to leave at this point.

Aberdeen Property Investors Quarterly relative return -6.6% Annual relative return of -5.3%

Review of UK Property Mandate - Report by the City Chamberlain

The report recommends that JIAC seek reassurances from Aberdeen Property Investors as to the future level of service to be provided to the Pension Fund.

Joanne Hope discussed the main areas of concern, which are performance and more worryingly service delivery; the fund manager breached their covenant, and the nature of the underlying investments.

Cllr Kiddie had asked the fund manager back in Feb 08 about continuing to buy property in London and was assured that this was best place to buy, this was obviously wrong giving the huge loss on the sale of Wood Street.

Cllr Thomas stated that it was totally unacceptable that they had not contacted the pension fund to advise of the breach of covenant.

Cllr Fletcher advised that this manager had come to the fund with a property proposal (A Retail Property Fund) the pension panel was not convinced of the merits of the property and stated that if the manager paid for the due diligence they would look at it again. No more contact was received regarding this purchase.

The committee decided to make a recommendation to the report after the fund manager's presentation.

Presentation

The presentation began by the fund manager explaining the reasons behind the buy out by of Goodmans by Aberdeen Property Investors. They are now one of the top ten property managers globally, which means that they are now big enough to work on many new projects in the UK and their European experience is there as an option for us. They have a lot of experience to draw on and now can attract new people; they will have a new manager to replace Chris Darroch in place in November. The property market has fallen but our portfolio suffered more of a loss due to the sale of Wood Street, which at the time of purchase was a good investment. Income stream on the portfolio is very strong with a potential income yield of 7.4% against an IPD of 6.7%.

Cllr Thomas wanted more information about the huge Wood Street loss.

The reply was that borrowing had counted against them that magnified the losses. Their logic of going into it at the time was sound, revenues were as predicted, but the credit crunch caused the problem.

Cllr Coull wanted to know why they did not hold on to the property and wait for the market to improve.

The property would have needed more equity to keep the property going, and the value was the best they could get if they had kept it longer the losses may very well have worse.

Cllr Kiddie asked about the breach of covenant.

They have been working since Dec to close the deal and had a plan to work with the bank to sort the situation. In June there was a technical breach of covenant. They did try to work

things out with the bank but their terms were outrageous. The loss is limited to the amount we invested; there was never any possibility of us being held liable for any additional losses. They are sorry that they had not kept Joanne Hope up to date of the situation but they were focusing on the situation with the bank. Processes have been put in place to stop this ever happening again.

Cllr Fletcher wanted to know what plans they had for the approx. £20m they had available to be invested.

They have been looking at 16 properties over the last 9 months 3 are currently under consideration. They have not made any new investments over the last year but have been working on improving revenues and continually reviewing the existing assets.

Cllr Fletcher asked about the underlying investments and what had happen about the project proposal they had advised the fund of earlier.

The underlying investments are secondary but they are in prime locations, the project proposal had fallen through because of a loss of a manager.

Cllr Kiddie asked their thoughts on amending their mandate to include overseas property. The mandate they operate to for UK property is fine may want to tweak it about the edges in the future, with regards to overseas investment there would be merit in going globally and they would recommend that we invested in pooled vehicles.

They were asked to make a presentation to the committee on overseas investment at the Feb 09 JIAC meeting.

The committees discussed the presentation and were as a whole very dismayed by the manager's reaction about the breach of covenant. They also did not like the fact that they claimed the proposed project was ended by them through a departure of a manager instead of the truth which was that they would not pay for the due diligence.

Cllr Fletcher stated that he was very unhappy that the council's reputation had been put at risk over the breach in covenant.

Cllr Coull felt that their trust in the fund manager had been dented.

The Committee resolved:

To place Aberdeen Property Investors on a formal notice of review.

Councillor Fletcher closed the meeting by stating that the two days of meetings with managers had been very informative and thanked everyone for their attendance.