WILTSHIRE COUNTY COUNCIL **AGENDA ITEM NO. 12**

WILTSHIRE PENSION FUND COMMITTEE
27 February 2008

PROPOSED CHANGES TO CURRENCY AND PROPERTY MANDATES

Purpose of Report

1. The purpose of this report is to seek Members' approval for minor operational changes in relation to two of the Fund's investment mandates.

Background

2. Members will remember that when Mr Mark Bunny from ING Real Estate (ING) presented to this Committee in November 2007, he suggested that, given current and expected property market conditions, it would be beneficial if ING could be given increased flexibility to invest in Europe, up to a maximum of 20% / 25% of total investment.

3. Members will also remember that when the Passive Currency Hedge was put in place in July 2007 through Record Currency Management (Record), it was on the basis of a 50% hedge of overseas equity holdings, with a view to moving to 75% at the appropriate time.

Key Considerations for the Committee / Reasons for Proposal

ING Real Estate – Proposal for increased flexibility to invest in Europe

4. The UK property market had a difficult time over recent months (although ING's performance has been excellent) and opinion is divided on what 2008 holds. However, the arguments behind ING's original request for a variation to their mandate still hold true, namely that the European property market is on a different cycle to the UK one and returns could be enhanced by further investment in Europe.

5. It would therefore be beneficial if ING could be given flexibility to place up to 25% of the amount they invest (13% of the Fund) in Europe. Currently the maximum percentage to be invested in Europe is 10% and this limit has recently been reached. The benchmark (wholly UK) would remain unchanged.

Record Passive Currency – Proposal for delegated authority to vary percentage hedged

6. Sterling has suffered a significant devaluation over recent months, relative to other currencies. This has clearly justified the decision not to go straight to a 75% hedge when the new arrangements were put in place, because the "losses" from the hedge (circa £12m) would then have been greater than they have been.

7. Of course, this is not really a loss but rather a net currency gain, because the underlying equities that have been hedged produced higher returns because of the currency effect. Therefore, because the hedge was only 50%, the "gains" on the equity returns were twice as large as the "losses" on the passive hedge. The hedge merely provides a smoother return over time while currency markets go up and down.

8. However, it is possible that the situation will arise where it would be beneficial to increase the hedge to 75% in order to provide greater protection for the Fund should Sterling recover. This is because when Sterling does rise, the Fund's overseas assets are negatively impacted by the currency move. The point to move the hedge to 75% has not

yet been reached, but it is quite likely that it will not happen conveniently around the time of a meeting of this Committee.

9. Therefore, delegated authority is sought from the Committee for the Chief Financial Officer, after consultation with the Chairman / Vice-Chairman of this Committee and advice from Hymans Robertson, to be able to vary the size of the hedge within the range 50% to 75% of overseas equities. It may be that in the future that this delegation would also be used to reverse the position back down from 75% to 50%, depending on market conditions.

Financial Implications / Risk Assessment

10. There are no financial implications of the proposed change to the ING mandate. An increase in the currency hedge to 75% would cost less than an additional £35k per annum, but this is minimal in relation to the currency "gains" that could be achieved as a result.

11. In terms of risk, the purpose of both of these changes is to give increased flexibility to help maximise the Fund's returns at the appropriate time. If used inappropriately, they do have the potential to reduce returns (like any investment opportunity), but the Fund will rely on the sound judgements of ING in respect of the first proposal, and Hymans Robertson and Record in respect of the second, to ensure that they are used at the appropriate time in the most beneficial way.

Environmental Impacts of the Proposals

12. There are no known environmental impacts arising from these proposals.

Proposals

13. The Committee is asked to:

    a) Approve a change to ING Real Estate's mandate to allow up to 25% investment in European property funds, with no change to the benchmark; and

    b) Delegate authority to the Chief Financial Officer to vary the percentage of overseas equities to which the passive currency hedge operated by Record Currency Management is applied, after consultation with the Chairman / Vice-Chairman of this Committee and advice from Hymans Robertson.

SANDRA SCHFIELD
Chief Financial Officer

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Unpublished documents relied upon in the production of this report: NONE

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