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19 February 2016

By email: LGPSReform@communities.gsi.gov.uk

Dear Sirs,

DCLA consultation: Local Government Pension Scheme: Investment Reform Criteria and Guidance

We, The Association of Real Estate Funds[1], wish to comment on the current stage in this consultation; whilst we appreciate that it is primarily targeted at the administering authorities themselves we hope that our comments will be helpful in ensuring that the authorities remain able to access an important asset class and in supporting the Government's overall objectives of the reform. Many authorities are already significant investors in our member funds, either directly or through indirect strategies.

Property is an asset class to which investors are attracted for a number of reasons and is particularly important to long-term investors such as pension schemes. Firstly, it has a relatively low correlation with other asset classes and therefore provides attractive risk diversification characteristics. Secondly, its price is not overly sensitive to the volatility inherent in stock market valuations. Thirdly it provides a relatively high and stable income stream. Finally, as a real asset, it carries a very low risk of default; where a tenant default does occur there will be a break to the income stream but the asset remains available for re-letting.

Property assets offer an attractive combination of relatively long-term and measurable income streams (similar to those derived from fixed-income investments) with longer-term inflation hedging (through rent-reviews or index linked rents) and defensive/accretive capital strategies (protecting or enhancing investment value). This makes the sector attractive to longer-term asset/liability matching investors such as pension funds.

As a real asset, property is not homogenous and skilled managers, multi-managers and fund of funds managers are able to create value through active management. To achieve the best results from each approach it is essential to focus on net-of-fee returns and the value created and not on the costs in isolation. Fund deficits can be reduced only by reducing liabilities or by growing assets. As property investment managers our members can contribute to reducing fund deficits by maintaining a focus on creating value. It is therefore important that pooling arrangements are not unduly constrained in the choice of strategies.

We note the analysis prepared by PwC setting out a number of options for possible pooling vehicles but also note that this makes relatively little reference to property as an asset class. However PwC

[1] The Association of Real Estate Funds represents the UK real estate funds industry and has around 65 member funds with a collective net asset value of more than £50 billion under management on behalf of their investors. The Association is committed to promoting transparency in performance measurement and fund reporting through the AREF Code of Practice, the AREF/IPD UK Quarterly Property Funds Index and the AREF/IPD Property Fund Vision Handbook.

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does specifically refer to the current proposed SDLT seeding legislation. It will be important to ensure that legislation encourages authorities to pool existing, directly or indirectly held, property assets should they wish to do so and the Government might need to consider special reliefs for LGPS pools to facilitate a shorter transition time.

Commenting specifically on points 3.17 – 3.19 authorities should be able to clearly articulate why the benefits of retaining directly held properties outweigh the pooling benefits, including the use of third-party funds, in terms of expected risk-adjusted returns per unit cost.

Turning to infrastructure, we note, and fully understand, the Government's desire to facilitate greater investment in infrastructure by the authorities. Many infrastructure investments share many of the characteristics of property outlined above and it is a very noticeable recent trend in the investment industry for investors and investment managers to amalgamate the two activities together under a real assets banner. Indeed the boundaries between the two are increasingly blurred; many of our member funds are already investing in property assets which are part of the wider social infrastructure, for example healthcare, retirement homes, GP surgeries, student accommodation and, increasingly, PRS housing.

What is often overlooked however is the extent to which large scale property re-generation investment can itself unlock infrastructure benefits such as transport improvements or community facilities. Authorities may not have the risk appetite or appropriate skills to undertake such projects directly so, by ensuring that they can deploy capital through funds, infrastructure benefits can be achieved with costs and risks mitigated.

Lastly, we note that the consultation still places a strong emphasis on cost reduction which is understandable. In general, and in accordance with the nature of the businesses we represent, we have refrained from commenting above on matters in the consultation that do not relate directly to the LGPS' property investments. However we would like to repeat the comment we made in our response to the previous consultation on 11 July 2014 namely that we agree with the Government's comments in the response to the call for evidence that *"Higher returns and better value for money are more likely to be realised if funds have strong governance and decision making arrangements in place."* Proper governance will ensure that the secondary objective *"to reduce investment fees"* is not pursued to the detriment of investment returns and value for money.

We remain of the view that Government should consider further the case for more actively restructuring the property component of the LGPS and we would be happy to contribute to this consideration. Please contact me if we can provide further assistance.

Yours faithfully,

John Cartwright
Chief Executive
The Association of Real Estate Funds