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The Renewable Energy Infrastructure Opportunity for Local Government Pension Schemes (LGPS)

A Review of Approaches Across England and Wales

Executive Summary

In this briefing, we review approaches by local government pension schemes (LGPS) in England and Wales towards investing in unlisted infrastructure, focusing on renewable energy. Infrastructure assets are "real assets" that generate predictable cash flows, for economic services such as transport, energy generation and water provision. Government interest in private investment in infrastructure has grown, leading to measures which provide investors with quasi-government-backed, long-term cash flows, well suited to the long-dated liabilities of maturing defined benefit pension schemes.

There are 89 underlying LGPS in England and Wales. These were recently aggregated into eight collective investment vehicles, or pools. The goals of this new UK government initiative included allowing the underlying schemes to benefit from economies of scale, for example to negotiate lower management fees, and acquire the skills to execute complex deals, especially in infrastructure. The underlying schemes had assets under management totalling £270 billion as of March 2018 (see Table 1 below).

The goal of this briefing is to explore whether pools are offering their LGPS members choice in unlisted renewable energy infrastructure. Under the government's pooling guidelines, the LGPS are meant to invest via their respective pool going forward. However, the LGPS also retain responsibility for strategic asset allocation. The pools should therefore offer enough choice to respect those strategic preferences, while there is inevitably some need for compromise, given that pools have up to 32 members, as in the case of London. Our particular focus in this briefing is the London pool, called the London Collective Investment Vehicle (CIV).

Now is a good time to discuss allocations under pooled investments going forward. LGPS typically review strategic asset allocations after each triennial valuation, whose latest cycle started in March 2019. This process could lead to new and revised investment strategies in place from 2020, or in some cases sooner. By offering more choice, pools could appeal to a greater number of schemes, and achieve greater overall allocation for renewable infrastructure, while respecting the preferences of their members.

This briefing is a result of discussions with a group of London schemes interested in greater allocations to renewable energy infrastructure via the London CIV, and a review of approaches taken by other pools towards renewable energy infrastructure, sourced from published material and direct correspondence with those pools. We conclude that there are multiple options for pools, including the London CIV, to offer their underlying schemes choice in investing in renewable energy infrastructure, according to their investment strategy, philosophy, and appetite for risk. As a result of our review, we note four broad approaches or options towards pooled investment in unlisted renewable energy infrastructure.

These options include:

1. Appoint a fund manager to develop an infrastructure solution with two or more investment “sleeves,” each sleeve offering nuanced choices for participating LGPS. These choices could be between more or less renewable energy, for example, or between investing in infrastructure assets directly or via a fund or funds of funds. The Central Pool is expected to adopt such a sleeves approach.

2. Invest in GLIL (Greater Manchester and London Pension Fund Authority Infrastructure Limited), an existing LGPS joint venture, whose partners include the underlying schemes in the Northern Pool and LPP Pool. GLIL makes direct investments in various infrastructure assets, including a significant exposure to renewable energy.

3. Develop in-house infrastructure expertise, to invest in funds, funds-of-funds and underlying assets, according to their level of expertise, and the agreed preference of the underlying LGPS members. This is the approach taken by the Brunel Pool, which describes its approach as skewed towards renewable technologies and sustainable infrastructure.

4. Develop a new renewable energy mandate. Instead of tilting a more general infrastructure approach towards renewable energy, a pool might create a separate, all-renewable energy mandate, for example appointing a specialist to manage investments for interested LGPS schemes. No pool has adopted this approach to date.

Table 1: Infrastructure Allocations by LGPS Pool, as of March 2018

LGPS Pool	Number of schemes	Total AuM, £mln, March 2018	Number of LGPS investing in infrastructure	Average infrastructure % of AuM (of those investing)	Average infrastructure % of AuM (including those not investing)	LGPS member with largest infrastructure allocation	Infrastructure allocation of leading member, % of AuM
Access	11	40,844	6	2.15%	0.98%	Essex	4.57%
BCPP	13	45,716	7	2.20%	1.19%	Tyne and Wear	4.06%
Brunel	11	28,920	7	3.82%	2.43%	Environment Agency	7.49%
Central	8	43,987	5	3.67%	2.29%	West Midlands	3.96%
London	32	33,541	10	5.43%	1.65%	Waltham Forest	10.05%
LPP	3	15,287	3	8.20%	8.20%	Lancashire	13.00%
Northern	3	44,627	3	3.33%	3.33%	Merseyside	5.00%
Wales	8	16,763	1	1.46%	0.18%	Gwynedd	1.46%
ALL	89	269,685	42	3.94%	1.80%		

Source: IEEFA interpretation of LGPS 2017/18 annual reports.

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Introduction

Some 89 local government pension schemes (LGPS) in England and Wales have recently created investment pools to bring together the management of their assets into eight collective investment vehicles, or pools. The government's goals for LGPS pooling included to allow pension schemes to benefit from economies of scale, for example to negotiate lower management fees, and acquire the skills to execute complex deals, especially in infrastructure.

LGPS have pooled on the basis of shared characteristics, such as size, geographical location, or investment philosophy. The resulting pools of these like-minded schemes have in the main created Financial Conduct Authority (FCA)-regulated vehicles, or appointed FCA regulated operators, a number of which fall under the Alternative Investment Fund Manager (AIFM) directive. The pools have been created to manage the investments of the participating funds. In the case of London, the pension schemes of the 32 London boroughs created an AIFM called the London CIV.

In this briefing, we review the approaches taken by seven of the eight new pools to date, in offering schemes flexibility to achieve their asset allocation choices in infrastructure, in particular, in renewable energy. The springboard for the briefing was the emergence of several London-based LGPS whose pension fund committees had expressed interest in allocating more funds specifically to renewable energy infrastructure. On February 8, 2019, the Institute for Energy Economics and Financial Analysis (IEEFA) and climate campaign group Platform coordinated a workshop and roundtable discussion of chairs, deputy chairs and members of investment committees at some of these London LGPS.[1] The main topic of the workshop was to discuss how they could achieve their preferred allocations to renewable energy, under the pooling initiative. Regarding infrastructure investments, London CIV is planning to offer London schemes a single infrastructure unit trust. The London CIV has three times more pension scheme members than any other pool, at 32, complicating the task of achieving consensus on investment strategy and approach.

Infrastructure assets are "real assets" that generate predictable cash flows for economic services such as transport, energy generation and water provision. As with any other asset class, infrastructure carries risks. However, investor interest continues to be fuelled by commitments from governments for increased infrastructure spending, and the involvement of generally established companies or projects that will mature over a long time. This tends to translate into stable, long-term cash flows.

[1] Representatives from Enfield, Hackney, Haringey and Lewisham LGPS were present. These four funds expressed interest in a greater allocation towards renewables, within a pooled infrastructure mandate, than presently envisaged by the London CIV. The CIV has informally indicated a floor of 20% or 33% renewables within an infrastructure mandate.

LGPS Pooling and Implications for Asset Management

Historically, key investment decisions facing LPGS included the allocation of funds between different asset classes (such as equities, bonds, property), and the selection of asset managers to make and manage those investments. Some schemes also made investments internally, rather than via asset managers. Historically, LGPS members and trustees have assumed a fiduciary duty to manage assets in a cost-effective way, and regularly review asset management with this in mind, both regarding the types of assets held, and management arrangements including fees. The Local Authorities, as administering authorities, typically delegated functions in relation to the Pension Fund, including investment decisions to a pensions committee composed of elected councillors, who in turn would take advice from both external advisers and local authority officers.

The UK government published pooling criteria guidance in November 2015, which stated that almost all new investments going forward should be made on a pooled basis, once pooling became effective after April 1, 2018. The pool would select asset managers, with a strong preference that elected officials would not be involved. Responsibility for strategic asset allocation would remain with the local authority pension committees.

Historically, LGPS have made investments either through external managers including pooled investment vehicles such as life funds, or directly, for example acquiring shares in listed companies. The latter would include unitised funds invested in public equities, and limited liability partnerships invested in private markets such as debt, property, private equity and infrastructure.

Going forward, most pools have chosen to manage liquid assets such as bonds and shares through sub-funds of an Authorised Contractual Scheme (ACS), using a mix of external managers or internal management. An ACS structure facilitates pooling by allowing participating schemes to pool assets into unitised structures with Funds being allocated into sub-funds, with the opportunity to receive or re-invest income.[2] Regarding illiquid assets, most pools have preferred to use alternative structures, such as Scottish Limited Liability Partnerships (SLLP), where such structures are available.

How Do Pools Plan to Manage Unlisted Infrastructure Investments?

The following summarises approaches for pooling investments in unlisted infrastructure. We review seven of the eight pools. We omit the eighth, Border to Coast Pensions Partnership, because of a lack of published information.

[2] Link Asset Services, Undated. Authorised Contractual Schemes.

Access Pool

Access Pool has 11 participating funds, and has appointed Link Fund Solutions as operator to provide a range of ACS and non-ACS solutions.[3] Under the pool's transition plan, passive listed assets are already under pool governance, having carried out a procurement exercise to appoint a single life fund provider. A longer timetable is envisaged for the launch of in-pool investments in alternatives such as infrastructure, from 2021. Closing existing illiquid investments would be costly, and Access therefore, plans to exit these only as they mature or are at the end of their fixed term lives. Access states that it cannot yet provide a timescale for new, pooled infrastructure investments, because this will depend on the strategic allocation decisions of participating funds, and the availability of suitable pooled vehicles.

Brunel Pool

The Brunel Pool has created an in-house team for managing pooled infrastructure investment, to execute a solution developed with the 10 participating funds.[4,5] From 2018, funds wishing to allocate to infrastructure will only do so via this pool solution. Brunel states that "The portfolio will invest in a range of assets with a skew towards renewable technologies and sustainable infrastructure." The approach will comprise commitments to infrastructure funds investing in a mix of overseas and domestic assets, with co-investment opportunities. Brunel aims to use co-investment to develop in-house expertise, ultimately towards conducting its own direct investments.

Central Pool

The Central Pool comprises nine participating funds.[6] At present, the pool is focusing on three investment offerings: services to manage legacy assets; operation of an ACS; and operation of "Other Collective Investment Vehicles." The latter will be used to manage more illiquid assets, including infrastructure. Regarding illiquid assets going forward, the pool states that its "aspiration is for all alternative assets to be managed by the pool, subject to the development of appropriate product offerings". Regarding infrastructure specifically, the pool has appointed a dedicated investment director to develop a Limited Liability Partnership. Although the details are still in the process of being finalised, the pool might be expected to offer two infrastructure "sleeves", within this LLP, in a similar way to its 2018 private equity fund, for direct/co-invest versus externally managed investments, for participating funds to choose between or invest in both, according to their strategic preference.

London CIV

The London CIV has appointed several external firms to manage fixed income and equities assets, all via ACS sub-funds, for example in global and emerging market

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[3] Access, 2018. Local Government Pension Scheme Pooling: Progress Report October 2018.
[4] Brunel, 2018. Portfolio Specifications.
[5] Brunel Pension Partnership, 2018. Autumn 2018 Report to MHCLG.
[6] LGPS Central, 2018. Local Government Pension Scheme Pooling: Autumn Progress Report.

equities.[7] The CIV is in discussions with investment firm StepStone on infrastructure allocations. The proposed London CIV infrastructure offering will aim for a minimum of 25% exposure to renewables. The London CIV has indicated its view that targeting higher levels of renewables may sacrifice returns, compared with infrastructure in general. Its view reflects the stiff competition for brownfield renewable energy assets in Britain. UK renewables assets have traditionally received quasi-government-backed revenues over a period of 15 years, making them low-risk.

Northern and LPP Pools

Pension schemes participating in both the Northern Pool and the Local Pensions Partnership (LPP) Pool are already full members of the existing, specialist infrastructure investment joint venture, GLIL.[8,9] Investing in a joint venture such as GLIL suited these LGPS, because of their large size and infrastructure investment experience. GLIL has already made multiple, direct investments in infrastructure including renewable energy. While entering a joint venture exposes the participating funds to certain liabilities, it also involves them directly in the investment process, giving them greater choice and participation. GLIL recently secured AIFM regulated status, operated by the LPP Pool, as a way that allows more LGPS funds and Pools to access the vehicle, whether passively, if they lacked internal expertise, or as active members, where they have such resources. Northern Pool states: "This is an interim solution aiming to deliver an infrastructure platform for as many participants as possible whilst implementation of pooling takes its course. Other regulatory solutions will be examined."

Wales Pool

Wales Pension Partnership has appointed Link Fund Solutions as pool operator, with responsibility for selecting external asset managers.[10] The pool expects to offer ACS sub-funds solutions for new liquid investments going forward, and "pooled vehicles" for illiquid asset classes, such as infrastructure. The pool states that it intends to make one or more pooled vehicles available for infrastructure. It notes that it may be more efficient to invest in a national vehicle, such as GLIL.

Conclusion: Giving LGPS Flexibility to Invest in Renewable Energy Infrastructure

The emergence of a group of London schemes interested in higher allocations to renewable energy infrastructure than envisaged by the London CIV raises the question whether it may be possible to offer more choice. We note four broad

[7] London CIV, 2017. Stewardship Code Statement of Compliance.
[8] Greater Manchester Pension Fund, 2018. Northern Pension Pool Constitutional Arrangements.
[9] Northern Pool, 2018. Local Government Pension Scheme Pooling: Autumn Progress Report.
[10] Wales Pension Partnership, 2018. Local Government Pension Scheme Pooling: Autumn Progress Report.

options going forward, largely based on approaches already used by other pools, as discussed above.

The Central Pool approach. The Central Pool is developing an infrastructure fund which could include two sleeves, offering greater choice and focus for participating funds. The London CIV might adopt a similar approach, where one choice could include a bigger tilt to renewables, according to the strategic preference of participating schemes. By offering choice in this way, the London CIV could appeal to a greater number of schemes, and so achieve greater overall allocation to pooled infrastructure, while respecting the strategic asset allocation preferences of participating funds. Having investment sleeves may be preferable to offering two separate infrastructure funds, by avoiding two sets of fees, but may still be more costly than a single unit trust, as presently proposed by the London CIV.

The Northern Pool & LPP Pool approach. London schemes could select GLIL as an infrastructure solution, either as London CIV, or as individual London LGPS. GLIL could become the infrastructure choice for London LGPS that wished to have greater influence over sector allocation. Investing in another pool/pooled vehicle in this way appears valid under the latest draft Ministry of Housing, Communities & Local Government (MHCLG) pooling guidance, which states: "Pool members may invest through pool vehicles in a pool other than their own where collaboration across pools or specialisation by pools can deliver improved net returns."[11]

The Brunel Pool approach. The Brunel Pool has created an in-house infrastructure solution which is tilted towards renewable technologies and sustainable infrastructure. The London CIV could tilt its planned UUT in a similar way, if it emerged most London schemes favoured a higher allocation to renewables within infrastructure investments.

A Separate Renewable Energy Mandate. Instead of adapting its present infrastructure approach, the London CIV might create a separate, all-renewables mandate. In this case, the CIV could appoint a specialist renewables fund manager to oversee the investments of interested LGPS schemes. There are multiple specialist funds that invest specifically in renewable energy infrastructure, including in Britain, Europe and globally. These funds range from less liquid, limited liability partnerships which offer long-term opportunities, to listed "yieldcos," where the investor can buy and sell shares in a fund on the open market.

[11] MHCLG, 2019. Draft – LGPS Statutory Guidance on Asset Pooling.

About IEEFA

The Institute for Energy Economics and Financial Analysis conducts research and analyses on financial and economic issues related to energy and the environment. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. www.ieefa.org

About Platform

Platform has worked with industries based in London for many years to address Climate Risk. From the cultural institutions to the finance industry, we have opened dialogue about the need to act and offered solutions; combining arts, activism, education and research in our approach. Platform campaigns to achieve energy democracy and Climate Justice by working in solidarity with communities most affected by the Climate Crisis in the UK and around the world. www.platformlondon.org

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Gerard Wynn is an energy finance consultant at IEEFA, specialising in the economics and finance of renewables and fossil fuel generation. He has previously worked as an analyst, editor and writer, in the energy and environment sectors. He worked as a decade for a reporter and columnist at Reuters News Agency, covering energy and climate change. He started his career with a PhD in agricultural economics.