Keeping it local: How the LGPS is preparing to support the UK

The government wants local authority pension funds to support local social and infrastructure investments through a significant uptick in allocations. Across much of the LGPS, this is far from a new concept

Summary
- As ESG strategies mature within the LGPS, funds are turning their attention to social factors.
- The government wants the LGPS to commit 5 per cent of total assets to UK infrastructure, supporting social causes.
- Many local authority funds have already allocated to regional and national projects.
- Diversification and inflation protection are two significant benefits of this asset class.

As environmental, social and governance (ESG) themed investing has grown in popularity, opportunities have proliferated and become more nuanced.

For the Local Government Pension Scheme (LGPS), a key area of interest is the 'S' of ESG – social investment. Some have backed social housing projects, while others have allocated to UK-based infrastructure with a view to having a positive social impact on top of a potential financial return.

This year, the LGPS's tentative exploration of this sector may get a significant boost through legislation.

In February's government white paper, *Levelling Up the United Kingdom,* officials set out a clear statement of intent for the £342 billion public sector system. Funds within the LGPS should, in collaboration with the government, increase local investment and set "an ambition of up to 5 per cent of assets invested in projects which support local areas".

Based on the system's total assets as of 31 March 2021, this would amount to more than £17 billion – and more than £20 billion if LGPS funds in Scotland and Northern Ireland are included.

At the Pension and Lifetime Savings Association's annual Local Authority Conference in June, the Department for Levelling Up, Housing and Communities (DLUHC) indicated that this 5 per cent ambition would form part of its forthcoming consultation on the LGPS.

DLUHC's head of local government pensions, Teresa Clay, told delegates that the LGPS's existing framework was "no longer fit for purpose". A revised framework, to be delivered by this year's consultation, would "aim to deliver much more substantial investment in levelling up", she stated.

LGPS Scheme Advisory Board chair, Roger Phillips, explained that funds were not "grant givers" and required a potential financial return in order to commit money to infrastructure and social investments. He also called for more accurate and detailed reporting by LGPS funds to illustrate clearly the kinds of UK investments funds are already supporting.

"We need to make very clear the definition of *[infrastructure]* and whether we are properly capturing it, and, indeed, how much UK infrastructure we are already delivering," he said. "That would be a very powerful piece of information."

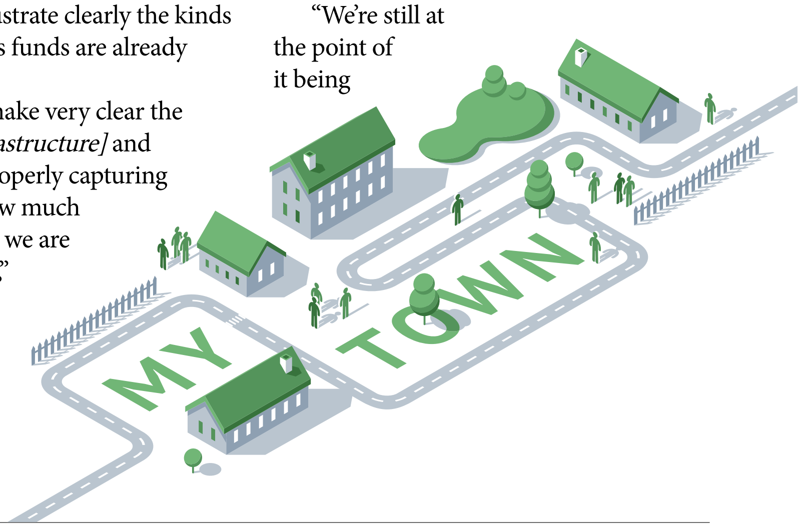
A growing appetite

A survey of LGPS staff conducted by Alpha Real Capital earlier this year finds that 89 per cent of respondents were planning to increase their allocation to local social investments over the next few years.

'Place-based investing' – allocating to local projects to achieve non-financial impacts on top a financial return – is growing in popularity, Alpha Real Capital finds, regardless of whether 'local' was seen to refer to within an authority's jurisdiction or anywhere in the UK.

Pensions for Purpose founder, Karen Shackleton, an adviser to several LGPS funds, says there has been a "noticeable uptick in interest" among LGPS funds over the past 12-18 months in social housing and regeneration, whether within their regions or across the wider UK.

"We're still at the point of it being



fact-finding at the moment," she explains. "I'm seeing pensions committees taking briefing papers about impact investing in housing and residential for example, just so that they can learn and understand. For local authority funds, many councillors *[on pension committees]* are well aware of the social need underpinning some of these investments."

Shackleton notes significant interest in strategies such as secure income, which tend to be lower risk investments with an income stream linked to local housing allowances, while others have turned to higher-risk regeneration opportunities.

"Regeneration is quite a high-risk opportunity, but the returns can be very attractive indeed," Shackleton says. Coupled with secure income investments, these kinds of allocations can "offer quite genuine diversification against traditional asset classes", she adds. "They can contribute positively at the total fund level, but they can only do that if the pension fund is going to put at least 5 per cent into these types of investments. It's got to move the needle."

As well as diversification benefits, GLIL chief operating officer, Ted Frith, says the current inflationary environment will cause many more investors to look closely at the benefits of investing in UK infrastructure.

"For the first time in a long time, we're investing in an inflationary period," he says. "I think people will be queuing up to buy infrastructure assets when they see the returns recently as a result of higher power prices or inflation more generally.

"When inflation has been zero or close to zero everywhere, it hasn't really mattered whether you're invested in a global fund or a UK-focused fund. With inflation starting to pick up globally, you are more likely to see different levels of inflation in different parts of the world."

Frith continues: "If your infrastructure assets are invested in a region that's not got the benefit of *[UK]* inflation, then you've not got the protection you hoped to have. I would argue that you want to have an overweight position to UK infrastructure as a UK pension fund."

Long-term investments

Investing in local projects such as infrastructure and social housing is not a new concept to many LGPS funds. As set out in the *Levelling Up* white paper, global infrastructure investment by LGPS funds has risen from approximately £1 billion in 2016 to £21 billion in 2021.

GLIL – set up in 2015 by the Greater Manchester Pension Fund and the London Pensions Fund Authority (LPFA) – has invested in assets such as Anglian Water, Forth Ports, and Clyde Windfarm in Scotland, and was specifically mentioned in the Levelling Up paper as an example of the kind of collaboration on UK infrastructure that the government wants to see more of. Since its launch, GLIL has expanded its reach and now caters for the LGPS funds for Lancashire, Merseyside, and West Yorkshire as well as Nest, the private sector defined contribution master trust.

Elsewhere, The London Fund is an investment partnership between three LGPS organisations to create a dedicated vehicle "to help solve some of the housing and infrastructure problems facing the capital".

The LPFA, the Local Pensions Partnership (LPP), and the London CIV pool set up the partnership in 2020 and have already raised half of its initial £300 million target from their 35 underlying LGPS funds. In April last year, it made its debut investment, an unspecified allocation to DOOR SLP, a build-to-rent housing platform that LPP said would "facilitate The London Fund's investment in housing developments in areas such as East Village, Stratford, and Elephant and Castle".

The government's 5 per cent target for UK social and infrastructure investments is designed to build on this and other examples of the LGPS's "established capacity and expertise", the white paper states.

In a briefing note published shortly after the government's *Levelling Up* report, Hymans Robertson head of LGPS investments, Philip Pearson, says local authority funds were "well placed to play a key role" in social investment due to their "long-term investment horizons and strong local knowledge and networks".

"It helps that many of the anticipated investment opportunities are in areas that have been of considerable interest to LGPS funds for many years and which fit well within their overall investment strategies," Pearson says.

The government's role

The impetus for social investment should not be wholly on LGPS funds, according to Pearson. The government has an important role to play in "increasing the pipeline of attractive, new investment opportunities" – a key challenge for the social and infrastructure investment sectors.

Potential actions that could help meet the government's 5 per cent target include streamlining the planning processes for infrastructure and housing and 'de-risking' large or complex projects, Pearson explains. Improving skills and research in the various regions of the UK is also important, as is support for asset managers that are seeking seed funding for local investments.

"Although there is a clear imperative, Levelling Up will be no quick fix," Pearson concludes. "Many of the investments needed will take time to develop and implement, and even longer to reap the benefits. Significant volumes of capital will be required, but the initiative will also require a high degree of patience and persistence from all those involved."

Written by Nick Reeve, a freelance journalist