

London Borough of Barking & Dagenham Pension Fund ("the Pension Fund")

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Hermes Infrastructure Re-advancement waiver

Introduction

This note has been prepared for the Pension Fund by Aon Hewitt and relates the Pension Fund's investment into Hermes Infrastructure Fund I LP ("the Hermes Fund").

Hermes were appointed as the Pension Fund's infrastructure manager in 2012, with an investment into the infrastructure asset class being seen as an alternative way to invest in inflation linked assets rather than through investing in Index-Linked Gilts.

As at 30 June 2017 the Pension Fund had £71.7m invested in the Hermes Fund which equated to 7.6% of the Pension Fund's total assets.

The Hermes Fund has recently realised some of its investments and has distributed the relevant share of the realisation proceeds back to investors, including the Pension Fund.

Rather than distributing some of the additional realisation proceeds back to the Pension Fund, Hermes are requesting consent to re-invest the amount into the Hermes Fund.

The current terms of the Limited Partnership Agreement ("LPA") between Hermes and the Pension Fund (and other limited partners in the Hermes Fund) states:

'limited partners may be required to re-advance an amount equal to distributions received within the Investment Period of the Fund, provided that the amount required to be re-advanced shall not exceed the amount drawn down in respect of the Acquisition Cost of such investments.'

Hermes are proposing that the restriction on the amount that can be re-advanced is revised as follows:

We are providing investors with the opportunity to waive the restriction in clause 5.1(b)(ii) of the LPA such that, if you agree, the amount that may be re-advanced in relation to the realised Seed Investments ... and redeployed shall be equal to the total realisation proceeds received by you in respect of such investments rather than being limited as set out above to the amount drawn down in respect of the Acquisition Cost.

Considerations of Hermes Request

There are two options for the Pension Panel to consider in relation to the Hermes request:

- 1) Accept the request to waive the restriction, which will mean an additional c.£5.3m will be committed to the Hermes Fund on

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behalf of the Pension Fund; or

- 2) Reject the request to waive the restriction, which will mean c.£5.3m being distributed back to the Pension Fund as Cash

There are advantages and disadvantages to each of the options outlined above, some of which we highlight below:

Option 1) – Accept the waiver

If the waiver is signed, it will result in the Pension Fund making an additional £5.3m commitment to infrastructure via the Hermes Fund.

Infrastructure as an asset class has many characteristics that are attractive to the Pension Fund, including its income distribution and inflation-linkage. These, coupled with the fact that the Pension Fund's revised investment strategy has a 9% allocation to infrastructure mean that an increase in the allocation to the asset class is something that we would be supportive of.

However, the Pension Panel would need to accept that the increase in allocation to the asset class is arrived at through an increase in allocation to the Hermes Fund without considering any other infrastructure funds which may be available to invest in at the current time.

We understand that Hermes would be able to 'get the money in the ground' relatively quickly and therefore additional exposure to the desirable characteristics of infrastructure would be achieved in a timely manner.

Option 2) – Reject the waiver

If the Pension Panel were to reject the signing of the waiver, c. £5,3m would be returned to the Pension Fund as Cash.

The Pension Panel would then need to agree how to invest this Cash.

For example, the Cash could still be used to invest in infrastructure, but through the addition of another manager (though the £5.3m in isolation would likely be an insufficient amount to commit to a fund and also consideration would need to be given to procurement requirements and also whether such an allocation could be made through the London CIV).

Alternatively the amount could be used to rebalance the Pension Fund back towards its strategic allocation, though we note that the allocation to infrastructure is already underweight relative to the benchmark so it may be that some (or all) of this amount would be re-directed to infrastructure anyway.

Recommendation & Next Steps

We believe that the Pension Fund should increase its allocation to infrastructure to bring its holding closer in line with the 9% strategic allocation. The request from Hermes presents a simple way of achieving some of this desired increase.

We understand that Hermes would be able to 'get the money in the ground' relatively quickly and also that no commitment fee would be payable on this additional amount meaning it will therefore be a more cost efficient way of increasing the allocation.

Taking all of the above into account, the recommendation from Aon Hewitt

is for the waiver to be signed and the additional c. £5.3m be committed to the Hermes Fund.

We look forward to discussing this with the Pensions Panel at the meeting on 13 December 2017.

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